Buyers' uncertainty crimps LNG supply

Market woes: Asian LNG

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ASIAN buyers' growing hesitation about committing to new long-term liquefied natural gas (LNG) export projects has heightened supply-side risks, while putting a squeeze on potential supplies post-2020.

At the recent Gastech conference in Seoul, energy research company Wood Mackenzie said that Asian government's changing energy policies are limiting the development of some new LNG supply options – indirectly favouring new supply from the US and Russia – and thereby changing the risk profile of LNG procurement.

US exports, driven by cost competitiveness, and Russian supplies, driven by the nation's desire to secure a bigger share of the Asian market ahead of the US, may well provide the bulk of incremental Asian LNG demand this decade, which presents both political and technical risks for buyers, Gavin Thompson, Wood Mackenzie's Asian gas and power specialist, told *Petroleum Economist.*

The US is projected to export some 40 million to 50 million tonnes per year (t/y) of LNG by 2020. Putting aside the large price risk exposure to Henry Hub pricing, buyers should also factor in political risk, warned Thompson.

"It's funny when you mention US political risk, [because] people wonder what you're talking about. But remember the US is not a hydrocarbon-based exporting economy – it's not Qatar or Australia – there is the contract verification, force majeure and so on".

Still it's far from certain if the US can actually realise its shale-gas potential – widely expected to underpin its wave of LNG exports.

In late February, Bloomberg addressed the most problematic issue facing shale-gas wells – their shocking decline rates and diminishing prospects for drilling in the most-profitable sweet spots of the plays.

Geologist Pete Stark, a vice president of industry relations at IHS, said "the decline rate is a potential show stopper after a while … you just can't keep up with it."

In Russia, Novatek is pushing ahead with its 16.5 million t/y Yamal LNG scheme in the Arctic. However the region's remoteness and its harsh climate make it a project fraught with technical risk and logistical complexities. Proposed projects or expansions in Russia's Far East might give buyers a little more elbow room. But there is inherent political risk tied to Russian exports, especially now, in the wake of the Crimea crisis.

Clearly, if Asian policy makers want supply diversity, minimal risk and softer prices, they need as many supply options as possible, said Thompson.

To do so they need to support projects, he added. But uncertainty over future nuclear energy policy has left the established buyers – Japan, South Korea and Taiwan – who traditionally would have underpinned new LNG trains, less confident of their future demand and unwilling to commit.

At the same time, gas and power market liberalisation policies in Asia's developing economies presents new competition for existing buyers.

As a result "both traditional, as well as new buyers, are asking for smaller incremental volumes along with greater contractual and pricing flexibility, making financing some of the proposed LNG projects more difficult" said Thompson.

Potential shortfall

Between now and the end of the decade, more than 500 million t/y of proposed new LNG supply capacity could come on line.

But projects in Canada, East Africa and a number of Australian developments, which are yet to receive approval, need long-term supply deals to move forward. These three regions, coupled with the US and Russia, account for the bulk of the proposed new capacity.

While supply will surge between 2016-19 as US and Australian projects are brought into operation, buyers could see a potential shortfall as early as 2020.

"Expectations of lower prices from US exports is not really helping and if buyers don't help make new projects happen, they won't get developed," Thompson added.

"Governments and buyers need to be acutely aware of the implications of energy policy, or sometimes a lack of energy policy, on the pace of some new LNG project development," he warned.

Leading LNG developers, including Chevron and Woodside, flagged up the indecision, saying it may stall projects that will likely be needed to meet expanding fuel demand in the region.

Expectations five years ago that four or five new projects would be approved every year have failed to materialise. In 2013, only one scheme took a final investment decision, while two might possibly get the nod this year.

Chevron's president of gas and midstream Pierre Breber told Gastech delegates that the low cost of developing brownfield LNG sites in the US is exceptional, and that future LNG supply deals must reflect the higher costs of developing greenfield plants.

And Philippe Sauquet, Total's head of gas and power, estimated that projects with breakeven costs between \$12 to \$14 per million British thermal units (Btu), would be needed to meet increased demand into the 2020s.

US LNG could be delivered to north Asia for around \$12/million Btu, based on Henry Hub prices of about \$5/million Btu, according to Cheniere Energy, one of the companies building an export plant. But if Henry Hub prices, which averaged \$6/million Btu in February, continue to rise, as most analysts predict, US exports could look significantly less competitive.

Anne-Sophie Corbeau, a senior gas analyst at the Paris-based International Energy Agency recently said that exports from the US would be competitive in north Asia with Henry Hub prices of up to \$7/million Btu.

Total estimates that around 72 million t/y of new supply is needed in Asia to balance demand by 2024, but believes that the US is unlikely to supply all of this. Asian LNG demand for 2014 has been pegged at around 200 million t/y.

Global LNG demand is expected to rise to 450 million t/y by 2025, Chevron estimates – but total supply will stand at just 350 million t/y at this date, based on today's project pipeline.

"We wait for price signals in the market, and we wait for buyers to tell us when demand is going to be there," said Peter Coleman, chief executive of Australian LNG producer Woodside.

Clearer energy policy

He added that it would help the industry if buyers were able to send clearer signals.

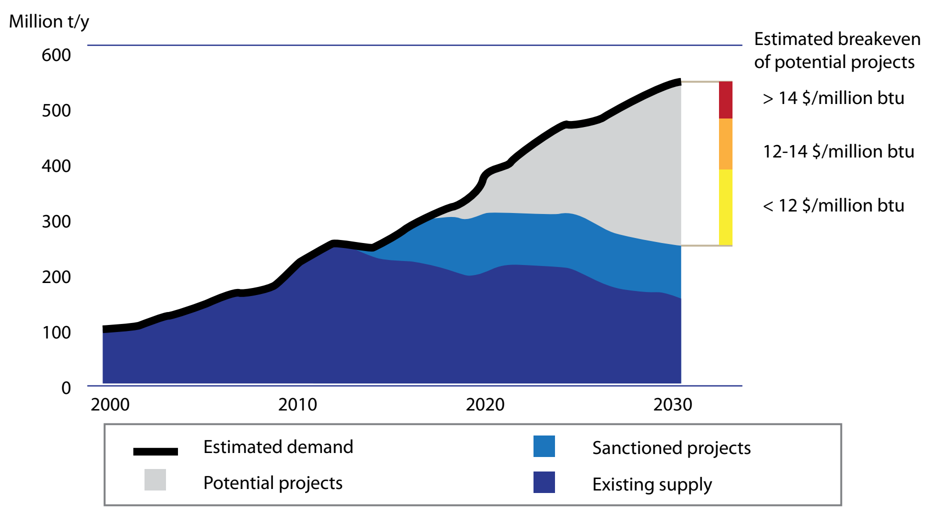
"We understand it is difficult to do, but equally, the malaise we are in at the moment is not one that is sustainable long term, and somebody is going to have to break out in the not-too-distant future and give clearer energy policy and direction."

Shell's acting upstream chief Maarten Wetselaar said innovation was a crucial part of the process to produce gas in a way that is profitable for investors and price competitive for consumers.

"We have to bargain with major resource holders and major demand holders to build a sustainable LNG supply chain," he said.

The Anglo-Dutch supermajor is pioneering floating LNG production technology, which once matured, could help cut development costs. ●

Figure 1: Total LNG supply



Source: Total