# Without further price reform, China's appetite for LNG under threat

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Lost in the fog: Can China afford to keep up with rising prices?

CHINA, the world's fastest-growing liquefied natural gas (LNG) market, is taking small steps towards allowing market-based gas pricing. But unless pricing across the entire energy system is liberalised, the move will likely accelerate fuel switching to cheaper coal.

Imports of LNG into China are forecast to hit more than 60 million tonnes per year (t/y) by 2020, up from 18 million t/y in 2013, led by new supply from Australia. Such rapid expansion would see China overtake South Korea as the world's second-biggest LNG buyer behind Japan.

As energy demand surges, China plans to more than double its natural gas supply capacity to 400 billion cubic metres per year (cm/y) by 2020. Around half of that volume would be supplied by imports, split between piped gas and LNG.

However, the biggest worry is not on the supply side, but whether consumers can afford higher domestic gas prices, Chen Wei Dong, chief energy researcher at China National Offshore Oil Corporation (Cnooc) told *Petroleum Economist*.

## Price increase

City-gate gas prices for non-residential users were pushed up 18% to $10.9 per million British thermal units (Btu) for baseline demand from 1 September, marking the second increase since the reform policy was introduced in 2013. The price of incremental demand remains unchanged at around $13/million Btu.

Baseline demand is fixed at the 2012 consumption level of 112 billion cm. In 2013, gas consumption hit 170 billion cm.

But the prospects for future demand remain uncertain as gas consumption immediately slowed down after the latest price rise, Chen said on the sidelines of Singapore International Energy Week.

With gas prices already up 15% to $9.2/million Btu in 2013, the latest jump may see non-residential consumers struggling to afford the higher prices, Facts Global Energy (FGE), a consultancy, said in a note.

The price for residential users – making up 25% of total demand – was not adjusted in the latest round of reform.

In terms of consumer affordability, the power sector, which accounts for about 23% of China's total gas demand, remains a concern, noted FGE. With electricity prices still tightly regulated by the government, many power companies are operating at a loss as fuel costs rise.

FGE warned that unless the government deregulates the electricity pricing system, continuous gas price increases will trigger demand destruction as users turn to other fuels, particularly coal, which is substantially cheaper. The industrial sector faces similar challenges.

With coal costing about 500 yuan ($81) a tonne in China – roughly $3-3.5/million Btu – the biggest challenge facing China's LNG imports under the new pricing regime is buyers' willingness to pay. LNG imports, generally costing around $18-19/million Btu from Qatar, are by far the most expensive supply option. Smaller volumes of LNG from BP's Tangguh project, in Indonesia, fetch about $8-9/million Btu.

Positively, prices of LNG imports have been fully liberalised – before gas from regasification plants shipped through the domestic network was sold at the city-gate price. But the two-tier city-gate price system limits importers' power to negotiate as buyers prefer to use those prices as a gauge.

For now higher prices will hurt demand. But the longer-term outlook for imported LNG could be brighter.

FGE is projecting a softening of regional LNG prices as weakening crude markets – the consultancy forecasts $80-85/barrel by 2018 – could lower most of the long-term LNG contract prices. As a result, by 2018 city-gate gas prices for incremental demand are likely to be on a par with the price of new LNG imports.

## Higher imports

Import capacity is expected to climb from around 31 million t/y at nine terminals to over 80 million t/y by 2018, when another 15 import plants either approved or already being built start up, boosting supply flexibility. In comparison, Japan imported 87 million t/y of LNG in 2013.

But ultimately China needs to reform its entire energy system, particularly the power sector, otherwise consumers will turn to coal-fired electricity, said Chen.

Chen noted while the Chinese government is making concerted efforts to cut coal-fired power generation (and, consequently, the pollution it causes), in an energy-hungry nation of 1.4 billion people "it's hard to strike a balance between realism and idealism".

FGE concluded that if a massive shift towards natural gas is the country's goal, it will need clear policies to deter the use of coal. Only then can the gas market be truly liberalised. ●