Eastern Mediterranean LNG: a different global gas market

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While developments relating to Eastern Mediterranean gas exports around 2020 point to a boost for the economies that will be involved, the global market into which those exports will be sold will be very different from the market existing today.

Post-Fukushima Shift Towards Asian Deliveries

After a rapid expansion of liquefaction capacity in the 2005–8 period, which saw Qatari trains coming into the market and pushing that country into the role of dominant global supplier (around 33 per cent of supply in 2012), there have been few additions to change the global supply picture. The demand for LNG, though, has seen dynamic changes with the post-Fukushima demand centres in Asia rapidly expanding, so that the region now accounts for around 75 per cent of global LNG demand (up from 60 per cent pre-Fukushima).

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The market has balanced itself by increasingly attracting volumes away from demand areas well served by pipeline gas. Europe and North America have both seen significant reductions in LNG imports, with those volumes heading instead to Asia. While the market still largely functions on long-term contracts, spot trade has increasingly developed to ensure volumes go where their value is highest. However, the spot market is still nascent and a forward curve for, say, delivery into north-east Asia, is just beginning to develop.

Potential Supply Boom

Fast forward seven to ten years and the LNG markets will be a different place. The current moratorium on investment in new capacity in Qatar means that the country's share of global LNG supply will begin to wane, and other countries will come forward.

The first of these will be Australia, which currently has some 62 mtpa of liquefaction capacity under construction and scheduled for operations in the period between 2014 and 2018. Another 36 mtpa is planned, although few of those projects are likely to go ahead before the end of this decade.

Second, the USA has issued full export licences for the export of 26 mtpa and has another 200+ mtpa of applications for shale gas exports pending. While not all of these will go ahead, the US DoE is coming under increasing pressure to make decisions on the outstanding applications. By 2020 we certainly think that exports of around 73 mtpa are likely (this only covers the top six applications out of 27 different projects).

The list of Canadian export projects is not as long (six so far, with export capacity of 62 mtpa), but Canada seems to have fewer concerns about granting export licences. If Canada adds another 20 mtpa or so, then North American exports could be as high as 95 mtpa by 2020. North American supply is particularly important for the market as a whole, as most of it is based on a model that does not involve direct indexation of gas to oil prices.

Aside from Australia and North America, there are further proposals for additional liquefaction in other countries, with construction underway to add some 27 mtpa of capacity. There are also plans for another 71 mtpa of capacity in regions including Russia, East Africa and Cyprus. Summing the likely increments from Australia and North America, together with a contribution from the rest of the world of another 55 mtpa or so, suggests that global LNG supply should be higher by some 220 mtpa. To put this in context, supply in the last two years was around the 240 mtpa level, so the global market in seven years could be almost double the size it is now.

Regasification

Alas, supply is only ever half the story, and while money is pouring into liquefaction it is also pouring into regasification. There is over 100 mtpa of regas capacity under construction, with Asia boasting almost half of this (50 mtpa), Latin America (29 mtpa), and Europe (23 mtpa). The market appears more balanced when you look at proposed regas plants, which would add another 180 mtpa of demand, although a number of those proposed look very speculative and will not proceed.

Having said that, regas plants can usually be completed faster than the more complex liquefaction projects and this is particularly the case when projects involve floating storage and regasification (FSRU), a technology which is increasing in popularity (most of the Latin American projects involve FSRU). As such, there is certainly still time for more regas projects to be announced, constructed, and brought on stream by 2020.

How tight (or loose) the LNG market gets from here will be down to project timing. However, at an overall level, the ratio of global regas to liquefaction is around a factor of 2:1. Surplus regas capacity provides the holders of liquefaction capacity with greater destination optionality. By 2020, however, the increments in capacity look to favour liquefaction additions, and these will likely outstrip increments in regas. This state of affairs should help loosen the overall physical market – making more LNG volumes available for the residual LNG market that is Europe.

This has implications both for the commercial terms of the global LNG market and for the direction of regional flows. In commercial terms, a looser global LNG market will create greater competition between sellers to place volumes, and this should begin to reduce prices and stimulate demand, particularly in the power sector, as LNG-fired plants tend to operate at the high-cost end of the mid-merit power order.

Gas Trading Mechanisms

The greater levels of spot trade will help establish more transparent pricing and the old certainty of selling gas linked to

oil will begin to come under pressure. Key in this move will be the US exports that are all largely being sold into the market under contracts with direct exposure to the US Henry Hub gas price, either under a tolling agreement or under a gas-linked long-term supply contract. The one thing that is becoming abundantly clear from developments in North America is the extent to which Asian buyers of LNG find it attractive to secure gas on contracts which are not linked to some form of oil. The two US projects that have been awarded full export licences have agreed long-term supply contracts with Gail (India), Osaka Gas, Chubu Electric (Japan), and KOGAS (South Korea). The lure of low-priced gas is real and very powerful.

If spot LNG prices become structurally lower-priced than contract gas prices, pressure will build to renegotiate those contracts and to replace them with some form of gas price indexation. This is the dynamic witnessed in Europe over the last two years and this will be increasingly seen going forward in the global LNG market. Whether the next seven years is a long enough period to see a full abandonment of oil-indexed pricing structures is a moot point, but if we do get something like 70 mtpa of hub-linked gas spilling into the global market from the USA by 2020, such strictures that serve to keep gas as a premium fuel are likely to be fully on their way out.

In terms of directional flows, the evolving pattern of trade will mean that north-east Asian buyers will be increasingly served with, first, Australian/south-east Asian LNG and then with North American gas. Qatar will come under increasing pressure to put volumes into that market and will need to see more of its volumes swing back into Near-East Asian, Middle Eastern and European markets. The same will be true for African volumes (north, west, and east) although Algeria, Nigeria, and Angola will all be able to compete for the growing Latin American market, as will US volumes.

And What About Eastern Mediterranean Gas?

This leaves Eastern Mediterranean volumes, which will be coming online in the midst of this potential global supply boom and will probably need to look to Europe as a primary destination, given its geographical proximity. Europe has a number of LNG facilities planned, so there will be some capacity to sell into, although this is definitely a market where hub-gas pricing is on the up and up and where hub exposure will be an important risk for the project to manage. However, where those long-term hub prices go is really a function of how Russia reacts to an increasingly competitive landscape. The importance of Gazprom's gas marketing decision-making cannot be underplayed, as by 2020 it will have the 63 bcm/year South Stream pipeline to fill up, as well as the already functioning 55 bcm/year Nord Stream. If it decides to go for market share, those gas prices could be very modest.

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What is clear is that while EU policy is clearly aimed first at minimizing the use of coal, providing a niche for gas to be a bridging fuel in that period, the competitive landscape for gas supply in the period around 2020 could well be very different from today. ■