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The Impact of Lower Gas and Oil Prices on Global Gas and LNG Markets

Executive Summary
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The aftermath of warmer than normal 2013/2014 winters in Europe and Asia, evidence of slowing Asian LNG demand growth through 2014 and the collapse of the oil price in late 2014 has resulted in a painful 'new normal' for key players in the global gas system, specifically LNG project investors and Russia/Gazprom. At one level we can rationalise the slowdown in Asian LNG demand and stagnant European gas demand as having a direct causal impact on European hub and LNG spot prices. The oil price fall has in parallel brought oil-indexed gas and LNG contract price levels down to levels unimaginable just two years ago. With project economics challenged and cashflows crimped, investors in new gas supply projects, especially LNG, will inevitably hold back, cut costs and await a more positive market outlook.

At a more fundamental level however, what we may be about to witness is a significant disruption to regional gas equilibria as a wave of new (Australian) LNG supply meets a slowing Asian market and a significant regional component (US/North America) re-connects with the global system in the form of 77 bcma (and counting) of new LNG export projects. Europe will be a passive recipient of excess supply at a time when its gas demand growth is at best tepid, but its import requirement may be rising due to declining domestic production.

This paper addresses the following questions:

What has been the impact of lower oil and lower gas prices on existing and future gas and LNG projects?

What is the outlook for the period to 2030 for markets connected by flexible LNG supplies given the uncertainty in regional demand outlooks in the light of new LNG supply currently under construction?

What is the impact of the probable delay to new LNG project FIDs given demand uncertainties and the apparent need to move from oil indexation to new contract price formation structures?

To what extent can Russia, using its market power in Europe to 'control' hub prices influence such outcomes?

While the 'new great game' dynamic addressed in the paper is certainly possible, and has a compelling logic, there is scant evidence in mid-2015 that Russia is immediately contemplating such a course of action. From a positive perspective, more flexible use of 'spare' West Siberian production capacity would moderate a potential early 2020s 'tight' LNG market situation (perhaps caused by a sudden acceleration in Asian LNG demand). From a less positive perspective, Russia's market power would, in this system extend beyond Europe. The impact of higher or lower Russian physical flows would certainly impact European hubs and also (by arbitrage) Asian LNG spot prices. In certain circumstances (eg overbuilt US LNG export capacity not fully utilised) European hub price levels could also, through arbitrage, influence the Henry Hub price, especially if US LNG exports continued on the basis of covering just variable shipping and regas costs. The moderating factor, however, is that if Russia maintains European hub prices at levels high enough to trigger new LNG FIDs, this



would create competing supply which once built has very low variable costs and so will tend not to respond to subsequent lower prices.

However, the lack of clarity on Russia's future preferred commercial behaviour adds a level of complexity most market participants would prefer to ignore. Gazprom is occupied on many fronts in both political and commercial spheres. At some point however the need to adopt a more market-oriented strategy is likely to rise on its list of priorities. While the timing of this is at present uncertain, the conclusions of this paper would strongly suggest that this is a development that players in the wider LNG-connected global system should be closely monitoring.