The End Of The LNG Glut

By Alan Mammoser - Feb 19, 2018, 11:00 AM CST

Predicting Demand is Difficult

Many reputable forecasters, who've anticipated an LNG supply glut for years, now expect a brief period of surplus at most, and gradual market tightening after 2020. But global demand, which has surprised market watchers to the upside and kept physical markets tight during the past four years, could cut this looming mini-glut short. Numerous factors are at play but a few key indicators will shed light on likely supply and demand conditions through the mid-2020s.

Looking near term, the International Energy Agency (IEA) expects that available LNG export capacity will greatly exceed demand through 2022. The IEA's recent medium term gas market outlook titled Gas 2017 says the surplus will reach its highest level in the year 2020, then gradually dissipate as tighter market conditions reappear in the early

2020s.

"It is relatively easy to see what's coming on the supply side, given the long lead times for liquefaction projects," says researcher Akos Losz of Columbia University's Center on Global Energy Policy, "but predicting demand is much more difficult."

"There is no question about the availability of supply," Losz says, "there is plenty of gas in the world ready to be tapped." Barring project delays, Losz believes that supply capacity is pretty much baked in for the next 2-3 years. The IEA report says that LNG export capacity will continue to grow rapidly, from 450 bcm (in 2016) to 650 bcm worldwide in 2022, with the most remarkable additions coming from the US and Australia. The latter will have the world's largest LNG export capacity in 2022, estimated at 120 bcm per year, followed closely by the US and Qatar at about 105 bcm each per year.

As for demand, the IEA report foresees worldwide demand rising from 353 bcm (in 2016) to 460 bcm in 2022. It anticipates import volumes shrinking in Japan, Korea and Europe, but rising in China and India. More demand is also expected from a group of new, smaller importing countries which together will be greater than China in scale, accounting for about 20 percent of the global LNG trade in 2022. Yet demand from all of these countries and regions will depend on variables that are hard to predict.

"Demand is more uncertain, even in the near term," says Losz. "This is partly because demand for gas – and LNG imports – is almost entirely driven by policy in many key importing countries."

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He anticipates a moderation of China's gas demand growth rates compared to the "phenomenal" increase last year, as the country completes its phase out of coal-fired boilers around major metropolitan areas. Whether China will continue the subsidies necessary to promote rapid switching from coal to gas in the residential sector is unclear. Japan's future LNG needs depend in large part on that government's nuclear policy. And the Dutch government's decision to cut production at the Groningen field by more than three quarters in just a few years (to limit the risk of earthquakes) is among the many policies that will greatly affect Europe's gas and LNG import requirements.

Meanwhile, predicting demand in smaller importing countries is challenging in its own right. "New entrants can now enter the market with little advance warning," according to Losz, thanks to the proliferation of floating storage and regasification units (or FSRUs).

Key Supply-Side Indicators

Right now, it seems unlikely that the current tight market conditions will continue in the rest of this decade. Losz says it is difficult to see enough demand to absorb what is still scheduled to come to the market from the US, Australia and Russia over the next few years.

If and when a mini-glut comes to pass, Losz thinks there will be two good indicators to show that it arrived. One will be an increase of LNG inflows into the most liquid northwestern European markets at fairly depressed prices, indicating European coal-to-gas switching. Another could be a periodic underutilization of LNG export capacity in America, as the exportation of US gas may—in some cases—become unprofitable.

These, singly or together, will be the primary mechanisms to balance a market in oversupply. Market watchers might also look for a substantial rise in Russian pipeline gas deliveries to Europe, particularly via Ukraine, although Losz thinks that Russia would be unlikely to engage in a gas price war in the near future.

Whether tight markets will re-emerge again in the early 2020s depends—to some extent—on investment decisions being made now for new and expanded LNG export facilities, as a typical LNG export project takes 4-5 years to build. A lack of such investment could occur together with increasing demand from China, India and possibly new and emerging LNG buyers in other parts of the world.

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Losz sees this as a distinct possibility, with a continuing expansion of demand combined with a lack of final investment decisions (FIDs) on new export facilities leading to a tight global market by the early 2020s. Therefore, he suggests another important indicator: the number of FIDs during this year and next. A lack of them would indicate available supply could fall short of projected demand by the early 2020s.

The IEA seems to concur. According to another recent report, World Energy Outlook 2017, the agency says there is risk of a "hard landing" for gas markets in the 2020s if uncertainty over the pace or direction of LNG markets deters new investment.

Robin Mills, head of Qamar Energy in Dubai, offers a more sanguine perspective on this point. "Companies seem to be getting ready to move ahead with FIDs which would enter the market around 2022-3," he says. "China's gasification, and then India's, I think are key points to watch, along with the success of the earlier-stage US projects in getting access to finance."

From Cyclical to Balanced

Looking beyond current questions about new investment in liquefaction, it is possible that future LNG markets need no longer be so strongly impacted by supply waves. While a period of surplus looks more likely than not over the next 2-3 years, Akos Losz thinks a more fundamental change may be going on that could smooth out the cycles of tightness and oversupply.

"You can argue that the LNG market is, by its very nature, bound to be cyclical, given the long time lag between investment and production," he says. "But maybe we have reached a point where we have enough incremental growth opportunities in the system that the expansion of supply no longer has to be so sharply cyclical."

"As there is so much gas waiting on the sidelines, I think there might be a chance to see something we haven't seen for a while: a more or less balanced LNG market for some time in the 2020s, without too much capacity coming online at once (in the form of another supply wave), but always enough new supply available before the market would become too tight."

A balanced market would see occasional widening of regional and seasonal spreads, as one region or another needs to attract more supply from time to time. But these spreads would not stay persistently compressed—as might be

the case in a glutted market—nor persistently wide, as was the case during the supply shortages in Asia after the Fukushima disaster in 2011.

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