

Domestic and Global Gas Conditions, 2017: Outlook and Issues

<Executive Summary>

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Outlook for natural gas prices in 2017

1. The softening in supply and demand in the global LNG market is expected to continue in 2017. However, with global crude oil prices expected to rise to \$60/bbl (see the “Domestic and Global Oil Conditions, 2017: Outlook and Issues of this year’s Forum on Research Works), long-term LNG contract prices, which are linked to crude oil prices, are also expected to switch to an increase. The price of LNG arriving in Japan is therefore expected to rise to the \$8/mmbtu range toward the end of the year. The price for LNG arriving in Japan in 2017 (the average price for the full year) is expected to be \$7.7/mmbtu (from January to October 2016, this was \$6.8/mmbtu).

2. LNG spot prices in Northeast Asian markets are expected to retain their current high level until the start of 2017. Although spot demand will presumably remain firm even after this in emerging import markets in South Asia and the Middle East, over 2017 as a whole, prices are likely to decrease as a result of an increasing softening of the balance of supply and demand. LNG spot prices are expected to fall to roughly \$6.0/mmbtu heading toward mid-2017.

3. If the gap between long-term contract prices and spot prices continues to widen as a result of the price trends above, it may encourage more vigorous discussion regarding the creation of new price indices and price formulas in Asian LNG markets.

Global natural gas/LNG supply and demand

4. Demand in major natural gas importing countries is expanding steadily. Increases in gas utilization in the United States and Europe, primarily for use in electricity generation, as well as improvements in comparative price competition in emerging

markets and the shift from coal to natural gas for environmental reasons in emerging markets, particularly in China, are working to boost domestic gas demand in Japan.

5. With this background of increasing demand for natural gas, global demand for LNG is expected to increase in a stable manner, especially in Europe, China, and India, etc. Amidst this trend, the presence of emerging import markets such as Egypt, Pakistan, and Jordan, is becoming increasingly strong. Importing countries such as these are all reducing initial introduction costs by installing LNG floating storage and regasification units (FSRU), and instead of concluding traditional long-term contracts, they primarily procure LNG through short-term and spot contracts based on bidding. With the increase in purchasers with this strong inclination toward short-term contracts and with high sensitivity to price levels, the global LNG market is requiring more flexible LNG supply. In 2017 as well, much of the surplus LNG will presumably be absorbed by European markets that have the storage capacity to take in extra volume. Global LNG demand is expected to be 266 million tons in 2016 and to increase to 286 million tons in 2017.

6. With regard to global LNG supply, large numbers of new facilities are scheduled to come online in 2017 mainly in Australia and the United States, meaning global supply capacity is expected to increase from 267 million tons in 2016 to 304 million tons in 2017, and this will mean that supply will heavily outweigh demand. For this reason, some of the new facilities are expected to have to postpone the commencement of their operations.

7. U.S. president-elect Donald Trump has been stressing the importance of promoting domestic resource development. There can be no doubt that his taking on the role of president will have a favorable effect on the expansion of domestic natural gas supplies in the United States. The economic stimulation provided by the so-called “Trump market rally” will work to boost demand. However, the electricity generation sector will gradually find it increasingly difficult to further raise thermal power plant utilization rates and the demand-boosting effects are expected to only be limited. For this reason, soft natural gas supply and demand conditions are expected to continue in the United States even after the inauguration of the Trump administration, and U.S. capacity to export LNG overseas is therefore expected to increase.

The upcoming full liberalization of the domestic gas market

8. Liberalization of the domestic gas market has been implemented incrementally from

1995, and in April 2017 the retail market, including the household market, will at last be fully liberalized. With the appearance of new competitors in the market, existing gas companies will certainly have to expend more effort than ever in streamlining their operations and reducing material costs. There will presumably be increased focus on the strengthening of domestic and international partnerships and expansion of trading functions aimed at optimizing material procurement.

9. As of early December 2016, only eight companies—mainly electricity utilities—have completed the registration process to become gas retailers. Compared with the situation after the liberalization of the electricity retail market, less progress is being made by new market entrants following the liberalization of the gas market. Some of the reasons behind this presumably include the fact that in order to commence operations as a gas retailer, companies need to be able to procure LNG at competitive prices and need to have secured a certain level of gas retailing capacity. With regard to demand switch, the impact from April next year of the relaxation of the restrictions on duplicate gas pipelines implemented as part of the gas system reforms, may result in industrial customers switching to new suppliers to a certain extent, but the number of household customers that switch to new suppliers is likely to remain low. Note however that even under such conditions, the impact of competitive pressures on gas prices will be something to watch closely.

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