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Challenges in Natural Gas/LNG Market Viewed from Europe

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On October 21 to 24, I participated in conferences in London and Oxford to discuss the future international energy situation and relevant challenges. Among various topics I discussed with other participants in the conferences, the discussions focused on the outlook and challenges of the global natural gas/LNG market. In the following, I would like to summarize particularly impressive arguments made mainly by European energy policy planners, natural gas/LNG industry stakeholders and experts at the conferences.

First, Russian natural gas supply to Europe via Ukraine has become a very important matter of concern to European natural gas/LNG market stakeholders, attracting their great attention. Russia is the largest natural gas supplier to Europe, using pipeline routes including those via Ukraine. Supply via Ukraine had been dominantly important for Europe. Since supply via Ukraine was halted due to the 2009 gas conflict, however, Europe has tried to diversify pipeline routes and gas suppliers to enhance its gas supply security. Given Europe's geopolitical relations with Russia as well as its concerns over energy security, however, Russian gas transit via Ukraine is still significant for Europe. As the present contract for Russian gas transit via Ukraine is set to expire at the end of this year, how to treat the contract from the start of the next year has become a great matter of interest.

Given arguments at the London and Oxford conferences, Ukraine and the European Union that hope to maintain a large-scale, long-term contract for Russian gas transit via Ukraine have widely differed with Russia that wants no such contract. Any solution to their difference or a compromise would be difficult due to Russia's discontent with the so-called Stockholm ruling on Ukraine's gas debt, Russia's complicated geopolitical relations with the European Union and Ukraine, and Russia's domestic situation involving Gazprom. This issue, though failing to attract attention in Japan, is an urgent one for Europe, as indicated at the conferences. Many stakeholders at the conferences indicated that some supply disruption could arise early next year in the absence of any fundamental solution to the difference. It was also pointed out that a short-term contract or arrangement instead of a long-term one could be agreed on. If any short-term supply disruption comes in winter, however, it may become a serious problem that would shake gas supply security and the geopolitical situation. A dominant view at the conferences was that record European gas inventories under the present market uncertainties, Europe-wide gas infrastructure development and Europe's potential LNG import expansion would prevent any great confusion regarding gas supply and demand in Europe, excluding some Balkan countries having difficulties in finding alternative gas suppliers, unless it is very cold. However, uncertainties about the three parties' talks toward the year-end and the possibility of some supply disruption would destabilize European gas prices. If any supply disruption affects the European market, it may spill over to global natural gas/LNG supply and demand. Therefore, future developments would be worthy of attention.

Second, the decarbonization of gas attracting attention in Europe was controversial at the conferences. As many major European countries have come up with very ambitious greenhouse gas emission reduction plans including those seeking “net zero” emissions, they are arguing that natural gas as one of the fossil fuels should be decarbonized for enhancing climate change countermeasures and promoting specific initiatives. The decarbonization of gas would require a transition from natural gas to biomethane, synthetic methane or hydrogen. Attracting interest regarding hydrogen is an option to achieve CO_2-free hydrogen by producing hydrogen from natural gas and subjecting subsequent CO_2 emissions to CCS (Carbon Collection and Storage). As any gas decarbonization option is technologically, economically and socially difficult to adopt on a Europe-wide basis and as gas decarbonization initiatives have just started, there are great uncertainties. For any case in which an option is realized to successfully decarbonize gas, it is difficult to estimate how much the option would cost and how energy prices to be paid by consumers would be affected. From a different viewpoint, it is conceivable that if the European gas market is decarbonized, it may have a unique position in the global gas market and to be isolated from the global gas market. I feel that we may have to consider implications of such development for the global gas/LNG market’s flexibility and Europe’s gas supply security.

If the European gas market is decarbonized and has an extremely unique position, the Asian LNG market may grow even more important for business portfolios of gas industry stakeholders in the world. However, it was pointed out that nongovernment organizations calling for enhancing climate change countermeasures have recently complained that LNG consumes massive energy in the liquefaction phase and is accompanied by gas flare in the upstream production sector, indicating problems with climate change. In this regard, it was argued that in response to such complaint, LNG industry stakeholders would have to prepare and publish reliable certificates on GHG emissions for each LNG project based on its total supply chain.

Third, global gas industry stakeholders’ hopes on and interest in the Asian LNG market’s growth and development are growing more and more, as noted above. Particularly, they indicated high interest in the Chinese market that has driven LNG market growth in recent years. Although Chinese LNG demand maintains double-digit growth, an economic growth slowdown, the deceleration of switching from coal to gas and the potential expansion of non-LNG gas supply options indicate great uncertainties about future LNG demand expansion. The degree of Chinese LNG demand growth would greatly influence the LNG market supply-demand balance and continue to attract global interest. Given that Southeast and South Asian emerging LNG consuming countries as well as China are expected to expand their demand in the future, participants in the conferences vividly discussed the issues related to the affordability of LNG prices. They questioned if current low spot LNG prices could secure future investment while stimulating demand, as did the IEEJ Outlook 2020. All stakeholders must make constructive arguments and initiatives to soundly develop the Asian LNG market.

Finally, it was pointed out that LNG buyers and sellers could activate their arguments and negotiations in consideration of the recently remarkable deviation between long-term contract and spot LNG prices in Asia. Gas market stakeholders in the world will remain conscious of and discuss and negotiate desirable, realistic and promising pricing mechanisms for the Asia market as a very important issue.

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