THE EDGE SINGAPORE
BUSINESS & INVESTMENT WEEKLY

HD **Corporate: Is Russia's deal with China bad news for Singapore's LNG ambitions?**

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WC 1,583 words
PD 9 June 2014
SN The Edge Singapore
SC EDGESI
LA English

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Singapore aspires to be a major hub for the trading of liquefied natural gas (LNG) in Asia. A lot of money has been invested so far. An LNG terminal that costs $1.7 **billion** has been built on Jurong Island and more money will be earmarked to expand its capacity as well as build another terminal, which will be operational by the next decade. On the production and trading side, Pavilion **Energy**, a Temasek-owned **firm** with an initial authorised capital of $1 **billion**, was set up to participate in the entire LNG supply chain. The **company** has already spent close to US$1.3 **billion** ($1.6 **billion**) for a minority **stake** in an offshore gas exploration concession off the coast of Tanzania.

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With big bucks on the line, the signing of a mega-deal for Russia to supply natural gas to **China** is seen by some quarters as likely to make a major dent in Singapore's ambitions to be a regional hub for LNG trading. Why? The US$400 **billion** deal with Russia's majority-owned **energy company**Gazprom will see it exporting 38 **billion** cu **m** of gas annually for 30 years once a new pipeline from Siberia to **China** is up and running. As a result, some **energy** players fear that Asia's largest consumer of **energy** will have diminished demand for their exports.

But Tony Regan, an **energy** consultant at Singapore-based TRI-ZEN International, doesn't believe the impact on Singapore will be that great. "The negotiations had been going on for about 20 years and it was expected that the deal would be eventually done," he says. "This isn't sudden new supply that's going to push out any other supply, so [**China**] will take this and will continue to take LNG [from elsewhere], because at the speed that its market is growing, it will need every [barrel] it can get, whether it's from Turkmenistan or Russia, from LNG or shale gas."

At the moment, **China** is the largest **energy** consumer in the world, surpassing even the US, which has a far larger economy. The Asian giant burnt an estimated 2,735 **million** tonnes **oil** equivalent of **energy** usage, accounting for nearly 22% of world consumption in 2012, according to the annual BP Statistical Review of World **Energy** 2013. The US lags well behind **China** in **energy** usage, at 2,209 **million** tonnes **oil** equivalent, or less than 18% of world usage in the same year. Although a large part — more than 68% — of **China**'s **energy** consumption is from **coal**, there is growing pressure to switch to cleaner fossil fuels such as natural gas, owing to mounting concerns over climate change and pollution.

All that will clearly happen in the not-too-distant future, once the Russian-**Chinese** pipeline is ready. And, as Regan points out, **China**'s **energy** consumption will only grow, especially its use of natural gas to power the economy. A key reason for Regan's optimism is **China**'s peculiar mix of central planning and free-market forces in coming up with its five-year plans for economic development. "When planners in **China** forecast demand [for **energy**], it's not a bottom-up process," he explains. "They look at supply, make their assessment of what is available and then say, 'Okay, we'll grow the market to absorb that', and that will also happen here."

China's consumption set to grow

If anything, the gas supply deal with Russia will only encourage the **Chinese** planners "to grow their market faster", says Regan. "It could mean we actually need more LNG, rather than less, to keep up with the fast-growing **Chinese** market." If that's the case, then Singapore, which wants to become an LNG trading hub, should have little to fear.

Karambir Anand, a principal and **energy** specialist at AT Kearney, believes the Russia-**China** deal will promote a market-driven pricing mechanism in the long run, which fits in well with Singapore's plans. "With the large volumes being contracted [between Russia and **China**], Asian buyers will have the opportunity to band together to think about an Asian pricing that can be set in a more transparent manner," he explains. Singapore would be a natural venue for that activity to take place, given the infrastructure and support systems available. And the development of a price-setting mechanism that offers an alternative to being locked into supply contracts indexed to the price of **oil** is what a growing pool of Asian buyers really want, both Anand and Regan point out.

The large volumes of natural gas and unconfirmed reports of its average price hovering around US$10 per **million** British thermal units (mBtu) could be the "tipping point" for Singapore to transform into a trading hub, according to Anand. The estimated price of US$10 per mBtu is already having an effect on LNG prices in the region. It has helped to drive LNG prices in Northeast Asia — Japan and South Korea are the world's largest buyers of the commodity — downwards in recent weeks. The spot price of LNG traded in Northeast Asia fell to US$13.20 per mBtu by end-May, according to **energy** news provider Platts. That is the lowest since last September, when LNG traded below US$15 per mBtu.

While there is a seasonality factor involved in LNG demand, Anand figures that news of the mega-deal will also influence the market in other ways. "You can already see that when Japanese utilities sign LNG agreements, [they are starting to think] 'let's not put all of our requirements on long-term contracts and **oil**-linked pricing'," he notes. "This [Russia-**China**] deal will move the markers in terms of price levels, pricing structure and gas benchmarks — all the things we have taken for granted will begin to be thought about in fundamentally different ways."

Anand uses the example of US shale gas to illustrate what he means. "Think about it this way — if it takes between US$6 and US$7 for liquefaction, transportation and regasification [for transporting shale as LNG], that sets a cap of about US$4 per mBtu on the price of the raw gas," he explains. This is because the price of US gas would have to be competitive against the average price of US$10 to US$11 per mBtu for Russian gas exports to **China**. "So, what that does is it gives you a bit of a collar and a cap on pricing for the [Asian] region," he says.

Australian projects under threat?

From his interaction with clients and other parties, Anand has already seen the impact of the deal on different players. This is especially so in Australia, where a number of large gas production and LNG projects are being developed. "Australia has several projects that are behind time and significantly overbudget," he says. "The minute there is a bit of strain on pricing — which this deal does put on the market — then a number of those projects could be looking at pretty tough times."

TRI-ZEN's Regan says Australian LNG projects — of which there have been at least 10 under construction over the past few years — have suffered because they are sited in remote locations and the country is an expensive place for doing business. As a result, labour and material costs have soared; moreover, low productivity and an unfavourable exchange rate against the US dollar — the trading currency of the commodities market — have also threatened the financial viability of already-fragile projects. "The cost overruns aren't just 5%, which might be acceptable. They are 20%, 30% to 40%, which are absolutely massive." That has led to some projects, such as the Browse LNG plant in Western Australia, being shelved last year, before its main operator, Woodside Petroleum, revived the project in August using floating LNG (FLNG) facilities that are cheaper to run.

By Regan's reckoning, the conversion of more expensive onshore facilities into FLNG ones is likely to save some of the Australian projects from being scrapped. FLNG facilities refer to massive vessels that are literally floating LNG plants. They are equipped with liquefaction and gasification facilities, while there are other vessels with tanks that store the products in either liquid or gaseous form. At the moment, FLNG facilities are custom-built in specialist South Korean shipyards that have the scale and know-how to construct the massive vessels required to house and operate the equivalent of their onshore siblings.

Apart from the Browse project, at least three more FLNG projects are underway off the coast of Western Australia. "The main reasons they are cheaper is that you don't have to pipe the gas to shore, you don't have issues with acquiring or developing land onshore, you have less onerous environmental regulations and the approval process is easier, which saves a lot of money," Regan explains. Aside from the infrastructural issues of a land site, "it's just much faster and easier to build", he adds. If the new equilibrium level for LNG is converging towards US$10 to US$11 per mBtu, then the Australians — or LNG producers for that matter — will need all the help they can get in ensuring their **operations** are still viable at what could become the new reference benchmark for LNG prices.

RE china : China | singp : Singapore | russ : Russia | austr : Australia | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRIC Countries | chinaz : Greater China | devgcoz : Emerging Market

Countries | dvpcoz : Developing Economies | easiaz : Eastern Asia | eeurz : Central/Eastern Europe | eurz : Europe | seasiaz : Southeast Asia | ussrz : CIS Countries

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AN Document EDGESI0020140611ea690000c

