

Feature Stories

US LNG Sets Sail Into Glutted Global Market

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The US joined the ranks of the world's LNG exporters last week with the shipment of a first cargo from Cheniere Energy's Sabine Pass facility in Louisiana. But Cheniere and the other LNG players that have sought to capitalize on the domestic shale gas boom by developing liquefaction capacity are entering a very different and much weaker global LNG market than they had been anticipating, raising questions over how much US LNG will actually be delivered to overseas customers, and how big an impact it will make on global LNG trade (PIW Jan.11'16). The landmark commissioning cargo, which will be shipped to Brazil, came from the first of five trains Cheniere is building at Sabine Pass, which will by the end of the decade be capable of delivering some 22.5 million tons per year (3.6 billion cubic feet per day) of LNG.

Together with three other US Gulf Coast liquefaction projects already under construction -- Sempra Energy's Cameron LNG, Freeport LNG and another Cheniere facility at Corpus Christi in Texas -- and Dominion Energy's 5.3 million ton/yr Cove Point LNG in Maryland, which is slated to come into service late next year, the US should have more than 60 million tons/yr of LNG export capacity available by 2020. The US has, in fact, exported LNG before, with shipments starting back in 1969 from Phillips' pioneering Kenai plant in Alaska, but the deliveries starting this year will be the first ever from the Lower 48.

The collapse in oil prices since mid-2014 means US LNG priced off domestic benchmark Henry Hub prices has lost much of the theoretical price advantage it had hitherto enjoyed over the largely oil-indexed volumes sold into key markets like Asia. As a result, some Asian buyers may choose not to take US cargoes and simply pay terminal operators like Cheniere the fixed liquefaction fee, which could potentially lead to US plant shut-ins. A US cargo would currently cost an Asian buyer almost \$8.40 per million Btu, assuming Henry Hub prices of \$2/MMBtu, \$3 for liquefaction and \$3 for shipping costs, excluding Panama Canal fees. By comparison, a typical Asian term cargo would cost \$5.40/MMBtu at an oil slope of 14%, based on Brent at \$35 per barrel and a 50¢ constant in the price formula. Asian spot prices were even lower last week at just \$4.50/MMBtu, their lowest level since Energy Intelligence started assessing prices nearly six years ago.

US LNG will also be up against substantial new supply from Australia over the next few years, which will be much better placed, in terms of shipping costs, to compete effectively in Asia. And with Asian demand falling and most US contracts with Asian buyers not starting until 2017-18, initial US exports could instead head for Europe, which has underused import infrastructure and active trading hubs (PIW Feb.15'16). China will remain a big regional demand driver, followed by India, Malaysia and Indonesia, says Andrew Slaughter of consultancy Deloitte. Michelle Foss, chief economist for the Bureau of Economic Geology at the University of Texas, agrees that China will be crucial to the near-term success of the US export industry, but says she expects Chinese demand for US LNG to be weaker than forecast as it turns to more nuclear and coal-fired power and cheaper Australian gas. Slaughter sees Europe as a good market, partly because of the desire to diversify away from Russian pipeline gas. Many Asian buyers are trying to form alliances with European firms to gain access to European regasification terminals or carry out swaps to avoid bringing US volumes back to Asia.

The launch of US LNG exports will also have a substantial impact on the domestic gas market, potentially creating additional demand for some 10 billion cubic feet per day of gas -- a significant increase in the context of current US gas demand of 85 Bcf/d, which should provide a modest boost to US gas prices (PIW Feb.22'16). No matter how marginal, any increase in US gas demand linked to LNG exports should help boost prices over the course of the year from recent levels of around \$1.80/MMBtu for benchmark Henry Hub futures. But that should not have a meaningful economic impact on the refiners and petrochemical producers whose profitability has been enhanced in recent years by the availability of cheap and abundant US gas, since the cost of the gas and natural

gas liquids they use for fuel, feedstock and blending agents is still likely to remain much lower than it is for their international competitors.

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