ENERGY CHARTER SECRETARIAT
СЕКРЕТАРИАТ ЭНЕРГЕТИЧЕСКОЙ ХАРТИИ

LNG Global Congress

AN EXAMINATION OF THE LIKELY GEO-POLITICAL DEVELOPMENTS THAT CAN AFFECT INTERNATIONAL DEMAND AND SUPPLY FOR LNG

09:10, Keynote Geopolitical Address by Ambassador André Mernier,
Secretary General of the Energy Charter

Wednesday 28th September 2011

Hilton London Tower Bridge
London, United Kingdom

Good morning Ladies and Gentlemen.

Let me first thank the organisers for providing me with the opportunity to speak in the name of the Energy Charter Secretariat on the current and future situation regarding LNG. I hope to consider with you the likely geo-political developments that can affect international demand and supply for LNG.

Obviously, it is difficult to understand today's situation of LNG without considering the gas market as a whole. Please allow me to address this point first.

Global production of gas in 2009 has been around 3100 bcm. The bulk of that (in fact something more than 80%) is pipeline gas. Only 9% is LNG. The largest volumes are therefore mainly transported through fixed infrastructure, mostly onshore. However there are a few underwater pipelines like Blue Stream, Nord Stream and some others. These underwater infrastructures are usually of relatively short distance. It does not therefore change the fact that being fixed this form of infrastructure shapes regional continental markets. This is true in the US, in Latin America and certainly in Europe where the grid is dense, aged and reliable.

Thus, as I have said, LNG is in terms of global figures of less importance than pipe gas. This nevertheless needs to be qualified at least by two remarks. The LNG business benefits at the moment, and I believe for the foreseeable future from a very positive trade situation.

This is due, among other factors, to the economic development in Asia, doubts or reluctance about the future of nuclear energy and in certain regions, the difficulty of building pipelines in sometimes physically and politically hostile environments.

Another plus point of LNG is its flexibility – both in terms of pricing, volume and timing of delivery.

By comparison, the mechanism for pricing in pipe gas is relatively rigid. It certainly fluctuates in line with oil, but in a way which means that pipe gas prices have no independent life, certainly not in Europe. One can speculate about how long this will last. But for the moment that is the situation and the recent moves by buyers to renegotiate part of the imported volume has been stubbornly resisted by sellers and such efforts have succeeded only marginally.

As far as volumes and timing of delivery are concerned, LNG avoids the nagging problem of transit and access to the grid. Already it is *de facto* creating an embryo spot market and in doing so, offers the flexibility that markets and the economy in general favour. In short LNG has many advantages even if, for the time being, pipelines will remain by far the primary way to transport gas.

Looking to the future, a word maybe about the dynamics of the trade. In 2010 the European Union imported 407 bcm of which only 40bcm was LNG. Worldwide LNG was 270 bcm in 2008 and should most probably reach 450 bcm in 2015. So the dynamics translate and rely on a global confidence in the LNG. Of course new pipe gas infrastructure is also being built and the latent competition is there, certainly in Asia.

I am not very fond of scenarios which too often have been given the lie by events, but yet it is the only way to explore the future in a critical fashion. And as far as LNG is concerned, a reliable scenario is that the volume increase in LNG would almost equals those of pipeline in the next 20 years.

Indirectly, these trade dynamics also bring pressure for more flexibility or even a break to the link between oil and pipe gas price in long term contracts.

From a geopolitical point of view, which is my topic today, many questions need to be answered for analysing and drawing conclusions on LNG situation and potential.

The first question is of course; who are the producers of LNG; where are they located right now.

At the moment, Qatar remains by far the most important country for LNG with a total liquefaction capacity of 25% of global capacity. In two years Qatar has more than doubled its capacity which is now at 105bcm, a very significant figure if we accept that in mid 2011 total global capacity is around 380bcm.

But of course Qatar is not alone. Algeria, Malaysia, Indonesia and Australia are also significant producers of LNG.

Let us look now at who buys LNG. First of all, it is those who need energy in general and gas in particular. There we find the names that always appear in energy policy *fora*.

Asia is the main client and in the first place always Japan and Korea and China, as they seek energy for their booming economies, and in particular because of their need for electricity. In this respect, I have found two telling figures among the myriad of data at our disposal. Half of the gas that China will import will be for electricity production. Yet for its electricity production, gas represents only 9%.

Other countries like India are also natural clients for LNG. Their natural resources are so limited that it is imperative that they import gas. This is a factor of their geology. As for their geography, they have long coasts and therefore easy and natural access to the sea.

China of course is also a continental country, but the distances between gas sources, for instance in Siberia or Central Asia, and its economic regions are enormous. Such distances make the constructions of pipelines costly and difficult in many ways. The same could be said of Japan, even if Sakhalin will at some point mitigate this dependence on the sea. In addition to this geographical incentive toward LNG, Japan has to compensate for the electricity capacity lost in Fukushima. The choices that Japan will make are not yet clear or certain. Taking the optimistic view first: some damaged reactors come into operation after maintenance. The pessimistic one: all 54 reactors are decommissioned.

Whatever the choice made by Japan, the need to compensate for lost electricity capacity will remain. It is almost certain that it will be compensated for by gas, more precisely by Combined Cycle Gas Turbine. In any case, there will be additional gas input in Japan, between 30 and 50 bcm.

If we look at India, a similar situation can be observed; insufficient national resources, but easy and abundant access to the sea. Like China, India is also a continental country and could also envisage being supplied by pipelines from Central Asia. But there again distances are enormous and the political and security problems numerous and extremely difficult. Think for instance, about the difficulties of a pipeline from Central Asia through Afghanistan and Pakistan. Therefore the practical conclusion if for the short term is: yes, there is a bright future for LNG in Asia, because of geology and because of geography, also because of the prices. But I will come to that later.

So, having considered who is producing and who is buying let me examine the trade movements more precisely. First of all, what do we know about the new producers and the new capacities? And there again Qatar comes first. In two years it has expanded its capacity from 52 bcm to 105bcm against the background of a total liquefaction capacity of 370 bcm, of which 300 bcm were effectively trade.

It has to be recalled that if Qatar remains the first supplier, it will be challenged by significant newcomers like Australia (additional capacity of 50bcm for 2015), Malaysia or Algeria (with 12 bcm for 2013). Not to mention Angola or Papua New-Guinea. Even Russia is looking at possibilities in Vladivostok or Sakhalin.

All this demonstrates the enduring massive importance of the Asian market for LNG suppliers, but also the massive importance of LNG for Asian countries. The link is vital and for suppliers and for consumers. This is also illustrated by the ratio of liquefaction-regasification capacity. At world level, regasification capacity is twice the level of liquefaction capacity.

This figure is even more telling if we look at where this regasification overcapacity is actually located. In fact, almost half if it is in only two countries, Japan and Korea. This in itself is an additional element of flexibility in favour of LNG. In other words, from the viewpoint of customers, LNG is an additional security of supply.

Other figures confirm this optimistic view for the future of LNG. In particular, the increase in the number of LNG vessels demonstrates the confidence of the LNG investors. Today, the LNG fleet counts around 360 vessels, when it was only 171 in 2004. The number of vessels has thus more than doubled in 6 years. The number is expected to reach 405 in 2016.

Even in Europe, which is not the primary target of LNG, 6 new regasification stations have been built and more are being planned. This is addition to the 19 terminals currently in operation. LNG is therefore contributing substantially to the diversification of sources of import in the European Union. In addition to that, it is completed by an LNG storage capacity of 7 mbtu. This trend should continue both in Europe and in Asia.

In Europe, because of the geopolitical uncertainty in the Southern-Mediterranean countries, one has to consider the gas market as a whole and not only the LNG contribution which is *grosso modo* of 17 bcm coming from Algeria which was barely affected by the troubles. Moreover for Egypt and Libya, more affected, only oil was important, although in relatively small quantities, Libya counting for 600.000 barrels a day and Egypt for 740,000 barrels a day.

The current political turmoil is nevertheless encouraging a *de facto* quest for more flexibility with a move where possible away from fixed infrastructure. One has to recall that, for precisely the same reason of political instability and perceived hostility, Europe switched in the 1970s as much as was possible from the Middle East in the direction of the Soviet Union which was considered as stable and reliable. I would add that even if the Soviet Union may not have been as stable as anticipated, it has proved to be reliable even at the height of the Cold War, and during the collapse of the communist bloc.

In Asia of course Fukushima is in everyone’s mind and will certainly influence the energy mix in Japan in favour of gas. To what extent, as I already said, nobody can tell pending an official Japanese decision. The recent election of Mr. Noda as Prime Minister indicates a possible come back of nuclear which should be viewed after all as a pragmatic decision.

Nevertheless, it is already the case that Japan imports almost all of its natural gas in the form of LNG; and that imports this August are up to 23% compared to August 2010.

From a geopolitical point of view, the increase should not affect the supply sources of LNG for Japan. Australia and Malaysia with Qatar will continue to supply more than half of Japanese LNG needs.

Finally, no analysis of LNG trade could be complete without a look at the prices movements worldwide and its effect of the flux.

There again, Asia is the main player. Without going in to the details, suffice it to say that prices in Asia are substantially higher than in Europe, and certainly than in the US. Roughly, one can say: if US is 6 mbtn, France is 11 and Japan 15.

These realities push the LNG trade towards Asia as far as producers like Qatar are concerned. This is well illustrated also by the construction figures of regasification capacity which is much more active in the Pacific. In any case, general figures are absolutely clear: in September 2011 64% of LNG is consumed in Asia, 30% in Europe and 6% in America.

This illustrates once more that most energy equation are determined by three decisive factors: geology, geography and price.

Before concluding I would like to say a few words about piracy. This problem is not a minor one in maritime traffic. The zones of piracy are known, but fortunately LNG vessels seem to be immune from pirates, probably because they are considered as too dangerous, too difficult to handle. Let us hope it will stay that way.

My brief conclusion would be: yes, there is a very positive outlook for LNG. This can be noticed in every region of the globe, but the bulk of LNG trade and investments is already, and will increasingly be, in Asia. In the other regions, pipe gas will remain the primary choice, but not exclusively. The more so given that LNG offers, as far as price and supply are concerned, a welcome flexibility announcing/ foretelling a spot market for gas which can only but develop.

I thank you for your attention.