



RUSSIA TAKES ITS PLACE IN THE LNG PRODUCTION CHAIN

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Today the traditional energy industry is facing a complicated period of volatility and uncertainty. This is true for the oil, gas and coal markets. Since 2014 oil prices have fallen by more than half, a development which has impacted the markets of other energy sources, in particular, natural gas, because more than 50 per cent of gas supplies are still linked to oil prices in some markets. However, despite such factors as an over-supply of hydrocarbons, the rapid rise of renewable energy sources and the growth of their share in the energy balance, coupled with the ever-increasing role of climate issues on the global agenda, the world will remain “carbon” in the next 20 or 30 years, with demand for oil and gas continuously growing, albeit at a slower pace than in past decades.

It is safe to suggest that natural gas remains the most promising energy source. It is more environmentally-friendly and affordable than oil and most importantly, it is becoming increasingly accessible to consumers. The important role of natural gas in implementing the agreements of the United Nations climate conference in Paris (COP 21) is noted more and more often, even at the government level, which allows gas to lay claim to the decrease in coal’s share in the world energy balance.

Logistics have been a constant challenge for the gas industry. The traditional pipeline transport method restricted the potential growth of the demand for gas in many remote markets to which the building of pipes was unviable. However, the rapid development of LNG technologies is already helping to minimise the impact of this factor and allowing the gas market to expand on a global scale, becoming more competitive and more liquid. World liquefaction facilities can produce over 300 million tons of gas per year. With aggregate regasification capacities amounting to over 750 million tons a year, it allows producers to be more flexible in choosing among gas supply lines and markets. The process of supplier diversification is already underway in key markets. Signs of this trend can be identified in China (LNG and natural gas from Central Asia and Russia) and Europe, which makes the world gas market even more competitive for its participants, including traditional gas exporters.

The growing accessibility of LNG will continue to have a substantial long-term impact on the world energy market. At present the share of LNG in the world gas trade is about 34 percent (337 out of 966 billion cubic

metres), but if we were to also consider the projects still under construction, its share could surpass 50 per cent at the beginning of the next decade. In the past 10 years the number of LNG importers more than doubled to reach 33 countries, a number which may grow even further as indigenous reserves continue to diminish and oil and coal are replaced with natural gas as an energy source.

In the meantime, the gas industry is facing new challenges: a potential overproduction that is impeding new investment, and artificial barriers to free competitive trade. Whereas overproduction is a result of a decade of high prices, technological development and a large flow of investment into the industry against a background of slower growth of demand for gas over this period, the second challenge is a result of a short-sighted policy.

Politicisation of the EU gas market

The growing politicisation of the gas market in the EU and restrictions on Russia’s new infrastructure projects, as well as a policy of diversifying suppliers at all costs, serve in fact as an impediment to the development of an open market and create additional risks for traditional suppliers. In the future, it may have extremely negative implications, ranging from price spikes in the event of a local shortage to energy security threats. Today, these restrictions are aimed against the most competitive players in the market and are economically unjustified.

The gas market is on the verge of entering a new cycle, characterised by the merging of several regional markets with their own rules into a common global market. As gas becomes more and more accessible, the link between the prices for gas and oil will gradually disappear, leaving us with a new reality to accept. Owing to a gas surplus, a high price premium in the Asia-Pacific market has already become a thing of the past. The ratio of transport costs will play a larger role in determining the price differential for various regions unless a gas deficit re-emerges in the market.

LNG will play an increasing role in the world gas market. Over the next five years existing capacities (451 billion cubic metres a year) will be augmented by new liquefaction facilities with a total capacity of over 150 billion cubic metres a year. For the most part, they will be launched by OECD countries (the US and Australia). This in turn could potentially make gas deliveries to the world’s largest gas market – Europe – one of their primary options.



LNG plant at Sakhalin in Russia's far east

In this context it should be noted that due to low Henry Hub gas prices in the US and easy access to financial resources, the landed cost of US LNG in Europe at the current level of oil prices, according to expert estimates, will amount to US\$4-\$4.8 per million British thermal units (MBTU) while the average price in European cash markets will amount to US\$4.2-\$4.3 per MBTU, resulting in the cash cost of delivered US LNG into Europe being at the margin. With that said, we believe that suppliers should, if possible, develop both supply mechanisms and make decisions based on the specifics of the pricing environment. Now that the energy markets are dominated by uncertainty and the high gas prices that had facilitated rapid growth of LNG trade are no more, pipeline gas can remain competitive in traditional markets owing to lower costs.

Russia has one of the world's biggest and most competitive resource bases, with over 48 trillion cubic metres of proven gas reserves, and it has not yet reached its maximum production and export potential. It borders two of the world's largest gas markets: Europe and Asia. Russia has a well developed gas transmission infrastructure and

historical economic ties with the former, and is carrying out one of the most ambitious gas transport infrastructure projects – the Power of Siberia pipeline – with the latter. Owing to this beneficial geographic position and competitive resources, Russia will be able to bolster its supplies to major gas markets even at low prices.

Russia is paying due attention to the development of LNG, which may make its gas exports more flexible, attract investment and secure a larger share of the market for the country. In accordance with Russia's Energy Strategy 2035, its LNG capacities may reach 70 billion cubic metres in 2035 (around 15 per cent of the global LNG output) compared to 14 billion cubic metres in 2014. With the proper incentives, this market's potential can be even greater.

Russia remains open to partnerships in the gas sector with particular attention given to the LNG and gas-chemical sub-sectors. Its unique geographical location, abundance of resources and low costs are competitive advantages that place its gas projects among the most attractive in the world in the eyes of investors. ■