

GASTECH - March 24, 2014

Session 1 – Day 1 - Strategies for Securing Asia’s Gas Demand

Ladies and Gentlemen, I am pleased to speak on behalf of GIIGNL, the International Association of LNG Importers. Founded more than 40 years ago, on the outset of the LNG industry, GIIGNL’s membership has grown to 74 members from 24 Countries, nearly all the companies active in LNG imports or the operation of LNG terminals. The association is a forum for exchange of information and experience among executives and experts of the Member Companies, to the benefit of the LNG Community.

Each year we publish a statistical report about the LNG Industry, that has become the reference document, the main source of data on LNG to companies, analysts and researchers. It is widely distributed and could be downloaded from our website.

2013 could be considered a transition year. LNG traded volumes remained fairly stable, around 237 Mt, but new trade patterns seem to emerge. Asia imported 10.9 Mt more compared to 2012 – mainly from Qatar. 35% of additional volumes to Asia went to China, the remaining part mainly to Korea. Malaysia and Singapore also joined the ranks of LNG importers and imported 2.4 Mt of LNG. Meanwhile, Japanese and Indian imports remained flat year on year. Demand in Japan was actually constrained by high prices and the yen devaluation, allowing higher penetration of other sources of energy. Demand also increased in South America, strongly related to climatic factors.

Europe remained the swing provider to the world LNG market, in a context of depressed local demand and with the rate of utilization of the regasification terminals in this region at a historical low. European players continued with innovative transactions in search of business: re-loadings, two-port loadings, ship-to-ship transfer to mention a few, while developing new markets for LNG as transportation fuel. Let’s remember that from 2015 onwards in the Emission Control Areas, the North and Baltic seas and the Channel in fact, only fuels with sulfur content of 0.1% can be burned.

Total LNG production remained flat. Few new plants entered into operation. We have seen unplanned outages in Angola, Norway, Nigeria, Algeria, political unrest in some countries and shortfall in feed gas, particularly in Egypt, as priority was given to domestic consumption. Production curtailments also limited the availability of

flexible LNG and hence the volumes of short term trade, though showing a small growth versus last year, in absolute terms as well as percentage of total trade, around 27%.

We have seen, mainly in Japan, at the beginning and towards the end of 2013, cargoes of LNG sold above the oil parity. Claims of overpriced LNG are justifiably heard all around Asia. But, what could be considered the right price of LNG or gas in general? The economic theory says that the right price is the price where demand and offer meet. But this could be true in a perfect market. In the gas world the only market that somewhat approaches this concept is the US market, the Henry Hub, with a multitude of producers and buyers, storages, interconnected pipelines. NBP and TTF in Europe have some elements of a perfect market, but the offer could be considered quite oligopolistic in nature. The LNG market is far away from being a perfect market.

Another definition, a classic one, of the right price could be the price that consumers are willing to pay, having available alternative sources of energy with which natural gas could compete. But – in Asia mainly – consumers sometimes do not have alternative sources of energy effectively available and, in addition, prices are often fixed by regulators or other authorities that fix the gas prices considering many other factors not necessarily related to the gas markets but to social and political considerations.

In the situation in which we are today of tight supplies, most probably the prices in the short term will continue to be fixed as they are fixed today, that is: direct negotiations between the few suppliers that have cargoes available and a buyer forced by the necessity of supplying its own customers, with the price depending from the relation between buyer and seller, the availability of surplus gas in the LNG chain and the actual need for gas. Consequently, when alternative sources of energy are available, those will be chosen instead of gas. It appears clearly that in Asia nowadays there is a demand for gas that cannot be satisfied at the current prices and therefore coal consumption is still increasing.

In the long term contracts another question arises in addition to the compatibility of the initial price with the market : it is the indexation, how the price will evolve in time. In a way, this means fixing the price of gas in a market on the basis of the

supply- demand forces in another market, the oil market for instance, or the gas market in another region. Traditionally, in Asia, indexation was to imported oil, the JCC. This was the historical choice, probably based on a concept of replacement of fuels. This made much sense in the power generation sector. Today this choice appears to be an expensive one, due to an increase in oil prices not entirely justifiable only by market forces, and brought large differences with the prices of LNG in other markets. The new availability of LNG from the States brought the possibility of indexing the price of gas to Henry Hub. The underlying assumption is that the shale gas revolution in the States would bring an excess of production and therefore the stability of the Henry Hub prices at today's values. This assumption may prove to be not necessarily true. We have seen the HH prices in January jumping to 5.90 \$/MMBTU from 3.90 the preceding month, due to the cold spell in the States and gas sold in the New York region at 135\$/MMBTU and frozen wells as well. Probably it would be prudent to consider a basket of different indexations, to HH, to oil, JCC or Brent, to other gas markets, even considering the importance for many supplier to maintain indexation to oil.

This price system for LNG in Asia does not appear satisfactory, but, in a way, it is the only one possible today. How could the situation change? Could it be possible to fix a global spot market price where prices in the different regions would only differ by marginal costs of liquefaction and shipping? Could it be possible to fix a market LNG price in Asia?

The solution, it appears to me, is to create an LNG market in Asia. But Asia is a large area. The region has three separated markets, with their distinct dynamics. Japan, Korea, Taiwan are isolated, mainly supplied with LNG, with limited scope in growth. The emerging giants China and India have a growing demand that could be supplied through domestic production, pipelines and LNG. South East Asia – Malaysia, Indonesia, Brunei – are large LNG producers with a growing domestic demand and limited opportunity of interconnected pipelines.

To create a competitive, sustainable and secure gas market in Asia the structure of the market should change and different processes should be put in motion:

- From public ownership to a private one
- Less vertically integrated companies
- Less government interference in the gas market

A monopolistic and public market structure may be a necessity at the take-off of a natural gas market, when it is necessary to realize capital intensive infrastructures and accept low returns. In this phase we may see monopoly rights to transmission and distribution, supply obligations and regulated gas prices.

The next step to create a functioning gas market would require the possibility for competitors to build transmission pipelines and LNG terminals, with the possibility to sell directly gas to end users and distributors. Further evolution would lead to the unbundling of transport and marketing functions, third-party access to infrastructures and competition on sales. The role of governments should evolve from that of initial investor to that of regulator and anti-trust watch dog, letting the market set the wholesale price level for gas.

Naturally, to create an Asian market, all the countries should be open to parties from over the world. Financial institutions are strongly needed, willing to cover financial and operational risks. All the countries should create the necessary conditions for them to operate.

The change of the structure of the market would not be sufficient without heavy investments in infrastructures. Markets in Asia are isolated one from the other, sometimes even within the same country. Interconnections are needed, connecting countries to producers and country to country. In many instances projects of an Asian interconnected pipeline network have been presented, as of interconnected power grids. Not much has been done. A good sign seems to be the announced agreement between China and Russia for a gas pipeline that would bring in China gas from Siberia, after 15 years of negotiations.

Well, this is what I could say in the allowed time

Thank you

Domenico Dispenza