Evolving Relationship between Parties in the LNG Market

Hiroshi Hashimoto, Head of Gas Group, Institute of Energy Economics, Japan - IEEJ, +81 70 7405 4398, hiroshi.hashimoto@tky.ieej.or.jp
Co-authors: Yusuke Hidaka and Seiya Matsukura, Gas Group

Overview

The global LNG market has experienced the most turbulent period in its history from 2020 onward. The market saw unprecedentedly low spot prices in the Northeast Asian traditional LNG market in the first half of 2020. The Henry Hub spot gas prices, the North American benchmark, and the TTF (Title Transfer Facility) spot gas prices, the Western Europe's benchmark, also reached historical lows around the same period.

As TTF briefly went below HH at a point and stayed at low levels for a prolonged period in summer 2020, LNG exports from the United States became uneconomic at that time. Even though price sensitive LNG markets such as India increase LNG imports for several months, they did not necessarily absorb all uncommitted LNG outputs at that time. A number of LNG cargoes were cancelled at that time, which had also been rarely seen in the history of LNG business. Cancellation here means that a buyer refrains from offtaking a cargo with payment of a reservation charge at the LNG export facility forgoing any recovery right of that cargo months later, unlike a take-or-pay arrangement with a later make-up right.

However, the balance of the LNG and gas market changed quickly later that year. Robust recovery of gas demand from the third quarter of the year 2020 around the world, which was faster than what most observers had anticipated, combined with seasonal demand fluctuations in the Northern Hemisphere winter which was amplified by the long-lasting trend of increasing gas demand there, as well as increasing number of unplanned and scheduled outages at various LNG production plants, created short-term imbalances of demand and supply in the LNG market.

At that time, although the imbalances were short-lived, the impact was acute. Spot LNG prices shot up to a record high of over USD 30 at one time in early January 2021 in Northeast Asia, responding to urgent needs of volumes from electric power generators in the region, who have no other choices but to rely on spot LNG cargoes to cope with increasingly more acute electricity demand fluctuations in winter.

As the temperatures rose in the Northern Hemisphere and the peak season passed, energy demand subdued, and prices went down in the shoulder period from April to June 2021. However, the underground storage inventory levels across Europe were lower at the beginning of the injection period and gas demand maintained strong as performances of other energy sources were weak. At the same time European domestic gas production kept its long-lasting trend of decline and LNG production facilities around the world experienced hiccups in 2021, too. China continued to increase its LNG import at high speed.

Those factors caused an even faster and greater upward trend of spot gas prices around the world in the latter half of the year 2021 than that of 2020. Notably in September 2021, the spot prices in Northeast Asia (assessed spot LNG prices) and Europe (TTF) nearly doubled, respectively, just in a month. They were both 6 - 7 times as more expensive as one year earlier ones. Since the end of July 2021, spot gas prices in the two regions have been constantly much more expensive than crude oil prices on heating value basis, which is also a historical phenomenon.

Although LNG buyers especially in Northeast Asia managed demand fluctuations and market balances better in 2021 than one year earlier based on bitter experiences of the previous year, the past year still has been a difficult for the market players, with constantly high prices of LNG - both short-term transactions and long-term contracts. Pricing trends have been evolving, including stronger influences from the European higher prices on the Asian spot LNG assessments, as well as somewhat apparent decoupling from the actual LNG market fundamentals.

In late December 2021, TTF shot up to nearly USD 60 at one time, leading to a massive shift of LNG cargoes toward Europe in January, partially helping the balance in the European gas market.

The global LNG market is expected to observe more interactions between different regions, as more consuming markets are emerging and supply sources expand, with some legacy LNG sales contracts expire. Market players' compositions, business models, and their behaviours are all evolving.
Methods

The Gas Group of the Institute of Energy Economics, Japan - IEEJ regularly follows LNG market information through various publications, statistical information accumulated by statistical information organisations including IEEJ's own, governmental customs offices in various countries and regional authorities, to analyse market and price trends in gas and LNG markets.

The group also conducts regular and ad-hoc meetings and electronic communications with market players and other energy industry research organisations to supplement publicly available information to solidify the group's analysis of the gas and LNG markets in the world.

Results

Behind the recent developments in the LNG market - some of which have been unprecedented and beyond expectations - the authors have observed structural shifts in relationship between LNG market players.

Although traditionally big LNG buyers and sellers continue respecting their relationship with traditional counterparties, some of those parties have come out of their fixed roles to assume different roles in the LNG market. Traditional buyers sell more secondary LNG cargoes to other buyers and traditional sellers buy more LNG cargoes from third parties more regular basis. Trading houses assume more roles as project developers on both producing and consuming sides, as well as trading commodities - both LNG and gas-fired power outputs.

As many players optimise their own positions depending on market conditions, traditional volume and demand adjustment under fixed term contracts have gradually decreased. Some forms of good-faith arrangements have now been converted into more commercial-oriented deals with prices on them.

Conclusions

LNG market players have recognised structural shifts in the LNG market with more flexible volumes and arrangements with expansions and evolutions of LNG supply sources, as well as mushrooming LNG consuming markets in Asia and Europe. Since traditional LNG project development models of vertical integration from wellhead production to final consumption are about to go, the market needs to find alternative ways to secure funding to develop additional LNG value-chains to meet expected gas demand in the future.

Long-term contracts are expected to continue playing key roles to underwrite LNG production projects, although contracts length and final consuming market commitment may differ much from traditional ones. To make different arrangements possible, different types of alliances between parties should increase in the future.

This is particularly important for Japanese players, who have been and will be key players in the LNG market, as one of the biggest LNG consuming markets in the world and the most important players in the market dealing with more than 100 million tonnes per year of LNG - not only buying but also selling and trading cargoes. They are expected to contribute to the healthy development of the global LNG market in the years to come, through alliances with players in other countries. Potential collaborations include joint procurement arrangements - by combining markets with different seasonal demand profiles could mitigate fluctuations of market balances, swapping volumes depending on market conditions, as well as joint infrastructure development in emerging markets.

References

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