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INDUSTRY DIRECTION™

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Natural gas soars 700%: Shortages of the fuel are rippling throughout the global economy, threatening recessions and a further wave of inflation (Part 1 and 2)

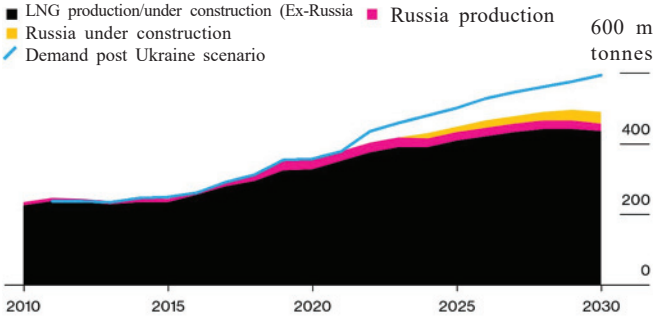
Natural gas is widely used in energy generation, transportation, commercial, and household sectors, as well as in energy-intensive industries such as chemical, iron and steel manufacturing. The United States, Europe, Russia, and China, the top four natural gas consumers, together accounted for 53% of global consumption in 2019.

Fired up sector

Natural gas is the hottest commodity in the world right now. It's a key driver of global inflation, posting price jumps that are extreme even by the standards of today's turbulent markets – some 700% (by 5th July, 2022) in Europe since the start of last year, pushing the continent to the brink of recession. It's at the heart of a dawning era of confrontation between the great powers, one so intense that in capitals across the West, plans to fight climate change are getting relegated to the back-burner. In short, natural gas now rivals oil as the fuel that shapes geopolitics.

Mind the gap

LNG demand expected to outstrip supply as world shifts away from Russia (Fig.1).



Source: Credit Suisse

Fig.1

The war in Ukraine has catalyzed the gas crisis to a new level, by taking out a crucial chunk of supply. Russia is cutting back on pipeline deliveries to Europe – which says it wants to stop buying from Moscow anyway, if not quite yet. The scramble to fill that gap is turning into a worldwide stampede, as countries race to secure scarce cargoes of liquefied natural gas ahead of the northern-hemisphere winter.

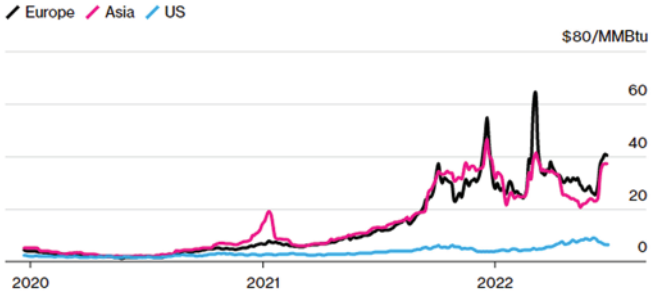
As Europe's economic powerhouse faces the unprecedented prospect of businesses and consumers running out of power the main Nord Stream pipeline that carries Russian gas to Germany is due to shut down on July 11 for ten days of maintenance, and there's growing fear that Moscow may not reopen it. Poorer countries that built energy systems around cheap gas are now struggling to afford it (Fig.2).

The rise of natural gas

Natural gas used to be a poor cousin of oil, commodity that used to change hands in fragmented regional markets. Many countries have turned to natural gas as part of a transition to cleaner energy, as they seek to phase out use of dirtier fossil fuels like coal and in some cases nuclear power too. Major producers – like the US, which has quickly risen up the ranks of LNG exporters to rival Qatar as the world's biggest – are seeing surging demand for their output. Forty-four countries imported LNG last year, almost twice as many as a decade ago. Now, even though globalization appears to be in retreat across much of the world economy, the gas trade is headed in the opposite direction. The globalization is in the crossroads; who are the governments that can afford to keep the price in check under the existing domestic tax systems for their people?

Fig.2

Benchmark natural gas prices have skyrocketed in Europe and Asia – and edged higher in the US too.



Source: Bloomberg

Note Europe = TTF futures; Asia = JKM Swap futures and US = Henry Hub futures. MMBtu = million British Thurmal Units.

Alarming rises

There were already plenty of signs of extreme tightness in the market. War and Covid may be roiling every commodity from wheat to aluminum and zinc, but little compares to the stomach-churning volatility of global gas prices. In Asia, the fuel is now about three times as expensive as a year ago. In Europe, it's one of the main reasons why inflation just hit a fresh record.

IEA estimates

Global natural gas consumption is expected to contract slightly in 2022 and grow slowly over the following three years as Russia's war in Ukraine pushes up prices and fuels fears of further supply disruptions, according to the IEA's

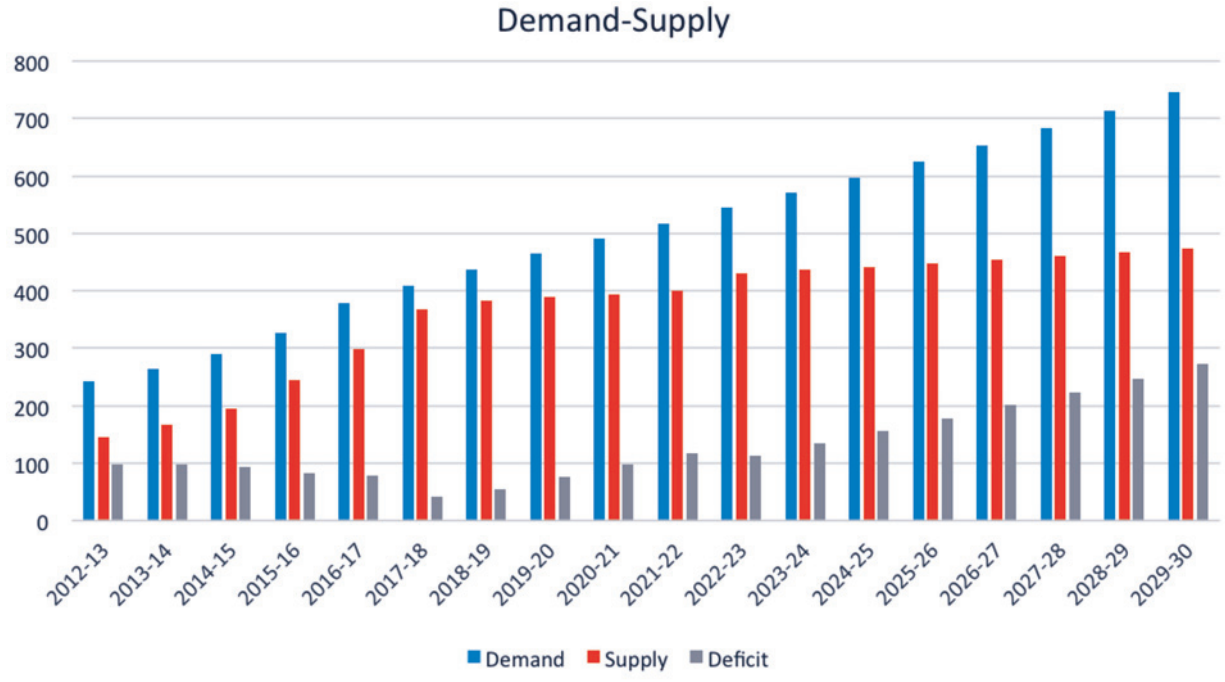


Figure. Natural Gas: Demand-supply dynamics in India – GAIL Voice

latest Gas Market Report, 5th July, 2022. Today's record high gas prices are depressing demand and causing some gas users to switch to coal and oil, while recent sharp cuts in Russian gas flows to Europe are raising alarms about supplies ahead of the winter. The turmoil is damaging natural gas' reputation as a reliable and affordable energy source, casting doubts about the role it was expected to play in helping developing economies meet rising energy demand and transition away from more carbon-intensive fuels. The recent developments have led to a considerable downward revision of gas' growth prospects. Global gas demand is set to rise by a total of 140 billion cubic metres (BCM) between 2021 and 2025, according to the new Gas Market Report – less than half the amount forecast previously and smaller than the 170 bcm increase seen in 2021 alone.

The downward revision in gas demand growth in the coming years is mostly the result of weaker economic activity and less switching from coal or oil to gas. Only one-fifth of it comes from efficiency gains and substituting renewables for gas, highlighting the need for greater progress on clean energy transitions. Faster roll-outs of renewable power generation and stronger efforts to use energy more efficiently would ease pressures on energy prices and help price-sensitive emerging markets access gas supplies that can deliver rapid improvements to air quality and carbon intensity.

New facility creation

To meet all the new demand will require a massive wave of investment in supply. That's already under way. Among the urgent infrastructure needs:

Export facilities

The rush for LNG is accelerating projects in North America and beyond. Last month, Cheniere Energy Inc. greenlighted a terminal expansion in Texas. In April, a Canadian LNG project backed by Indonesian tycoon SukantoTanoto got the go-ahead to begin construction. In Qatar, Exxon Mobil Corp. and Shell Plc are among energy giants with stakes in a $29 billion project to boost LNG exports. "You have global gas prices so high that they incentivize the signing of new long-term contracts," says Samantha Dart, head of natural gas research at Goldman Sachs. "We are seeing those announcements coming left and right, with a lot of US proposed liquefaction facilities."

(to be continued)