Trade war: could LNG feel the chill?

US LNG exports to China have taken off in recent years, but there are fears they could be hit by the ongoing trade war. Eric Yep investigates the potential knock-on effects for Chinese buyers, US sellers and shipping markets

The ongoing US-China trade war has raised concerns about a key driver of LNG shipping demand – the trade flow between the US and China – but it is also expected to further the commoditization of LNG as it creates more trading opportunities and the need for shipping optionality.

China in early August threatened to impose a 25% tariff on US LNG imports, in retaliation for another round of US tariffs on $200 billion worth of Chinese products. LNG market participants have indicated that China's proposed tariffs on US LNG, and the subsequent readjustment of trade flows, is probably the biggest disruption the industry has faced since Japan's Fukushima earthquake in 2011, and bigger than the trade embargo on Qatar in 2017.

The biggest market tapped by US LNG so far has been China, where government anti-pollution policies are pushing end-users to switch from coal to gas. Average LNG shipping distances have increased the most for LNG originating from the US in the past five years, to 9,268 nautical miles/voyage in 2018, from 3,771 nautical miles/voyage in 2014, according to S&P Global Platts Analytics.

Beijing did not give an implementation date for the tariff, but the uncertainty left Chinese buyers scrambling for substitutes and approaching independent trading houses and oil majors for options to divert their US spot cargoes, and swap them for non-US LNG ones.

If implemented, the tariff will take between one and two months to kick-in, which leaves a narrow window for buyers, sellers and traders to adjust their business accordingly.

The market now calls for a greater role to be played by intermediaries like LNG traders, and for shipping optionality to absorb the impact of trade flow disruptions. This would support the growth of both the spot LNG and shipping markets, and they are interlinked. Historical trade flows also suggest that disruptions can actually increase ton mile demand, as substitutes are imported over longer distances, such as Asian demand pulling in gas supplies from the northern hemisphere.

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Demand factors like China's coal-to-gas switching, peak winter and natural disasters have previously pushed S&P Global Platts JKM prices high enough for Asia to attract LNG from as far as Statoil's Hammerfest LNG terminal in Norway, and Russia's Yamal LNG project in the Arctic. "This year Chinese spot buying has been on average just under five cargoes/month – however, in January that was the equivalent of 23 cargoes," said S&P Global Platts Analytics, highlighting the scale of China's winter demand.

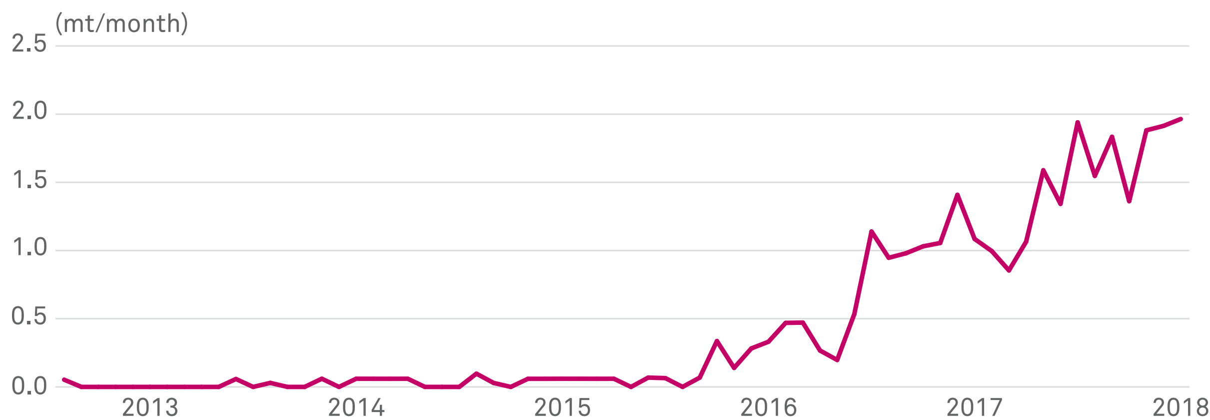
Shipping demand risks

The US-China trade war has raised some concerns about a contraction in shipping demand as Chinese buyers realign their purchases of spot US LNG cargoes, and replace them with LNG from the Middle East, Nigeria, Southeast Asia or Australia, which are closer to Chinese ports. The risks were exacerbated by US commitments to make it easier for European countries to buy American LNG by reducing trade barriers, in recent announcements from Washington. US-Europe shipping distances are shorter and the NATO alliance has a vested interest in reducing Russia's grip on Europe's gas supply.

But the fact that China will remain a growing demand center will have knock-on effects on LNG pricing, including LNG shipping rates, according to S&P Global Platts Analytics.

"While China is trying to manage its procurement in the light of potential US tariffs, the fact remains that if they start buying spot volumes, prices will move. While we don't expressly forecast shipping rates, our current expectations for LNG demand in Northeast Asia suggests shipping rates in

US LNG exports to China



Source: S&P Global Platts Analytics

the Pacific to reach $82,000/day [this winter]," according to S&P Global Platts Analytics.

LNG vessel spot rates started 2018 at a high of $85,000/d, then eased to a year-low of $45,000/d in May 2018. By June 2018 rates had risen to $95,000/d in Europe again on summer demand, nearly 2.5 times more than the previous year, before slipping to $75,000/d in July-August. This compares to LNG vessel spot rates of over $120,000/d in 2012-2013 when ship supply had tightened.

Trade war impact

The real concern is the long-term impact of the trade war on Chinese LNG investments in US projects, and the competitiveness of US LNG in the context of new LNG projects in other countries. US-based LNG exporter Cheniere Energy said the tariff may affect talks with Chinese buyers about future contracts, but its existing long-term contract with PetroChina will not be impacted.

"The early contracts of PetroChina are heavily weighted towards the winter. We're hopeful that the US and China can come to some resolution quickly," Cheniere CEO Jack Fusco said in August during an investor earnings call, noting that in the long-run Chinese tariffs may slow down discussions with other Chinese investors. "From a high level, our business is a very long-term one, and it is well understood that China needs US LNG," he added.

Separately, S&P Global Platts reported that another deal for state-run Sinopec to invest in the $43 billion Alaska LNG Project, appears to be on schedule for commercial agreements to be signed by the end of 2018, as officials expect the trade dispute to be resolved by the time the project is operational in 2024. Under the proposed deal, Sinopec would purchase 75% of Alaska LNG's planned 20 million mt/year of production, and Alaska Gasline Development Corp will hold 25% of output, or 5 million mt/year, for other potential purchasers, primarily in Asia.

But market participants have their doubts. "Long-term market consequences are likely to be felt on new supply developments as it would restrict the target market for developers of new US LNG projects trying to find new long-term contracts," consultancy Wood Mackenzie said. However, it added that plenty of appetite exists from other buyers in Asia and Europe for second wave US LNG projects.

This was evidenced by Cheniere Energy signing a new sales and purchase agreement in August with Taiwan's incumbent LNG buyer CPC Corp for 2 million mt of LNG/year over 25 years from 2021. The SPA is expected to support Cheniere Energy's export expansion plans in the US Gulf Coast. ■