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Balancing the Global Gas Market:
Northwest Europe as the Pivot Point?

Shankari Srinivasan
IHS



Balancing the global gas market: Northwest Europe as the pivot point?

- The global gas market is moving from a period of tightness to oversupply
 - Premium markets in Asia, and elsewhere, are unable to absorb the full volume
 - Deliveries to Europe expected to climb very sharply particularly in 2017-2018
- The response of Europe's traditional pipeline suppliers (especially Russia) will drive global gas prices in the medium term
 - Will Russia continue to act as the “accommodating” supplier supporting prices around today's levels?
 - Will Russia seek to defend market share, potentially pushing prices down to levels at which LNG supply would reduce?
- Weak demand in the Russian domestic market and in Europe, and rapidly growing contracts for US LNG, may trigger a change in strategy

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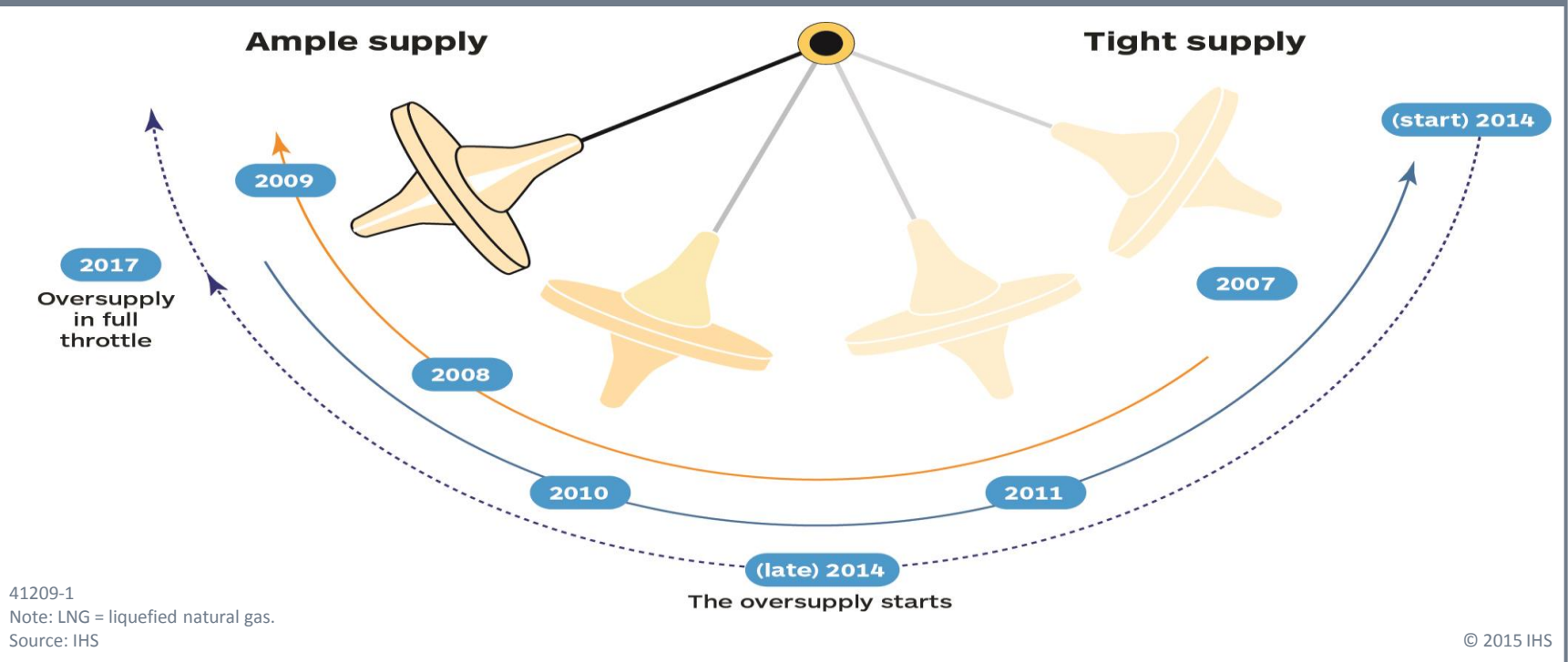
- The emerging global oversupply
- Europe: The balancing market
- Price vs. volume: A new answer to an old question?

The emerging global oversupply

- The global gas market will move from tight to loose in the next 2-3 years
- Production growth is expected to exceed demand in premium markets
- Deliveries to Europe set to grow as a result

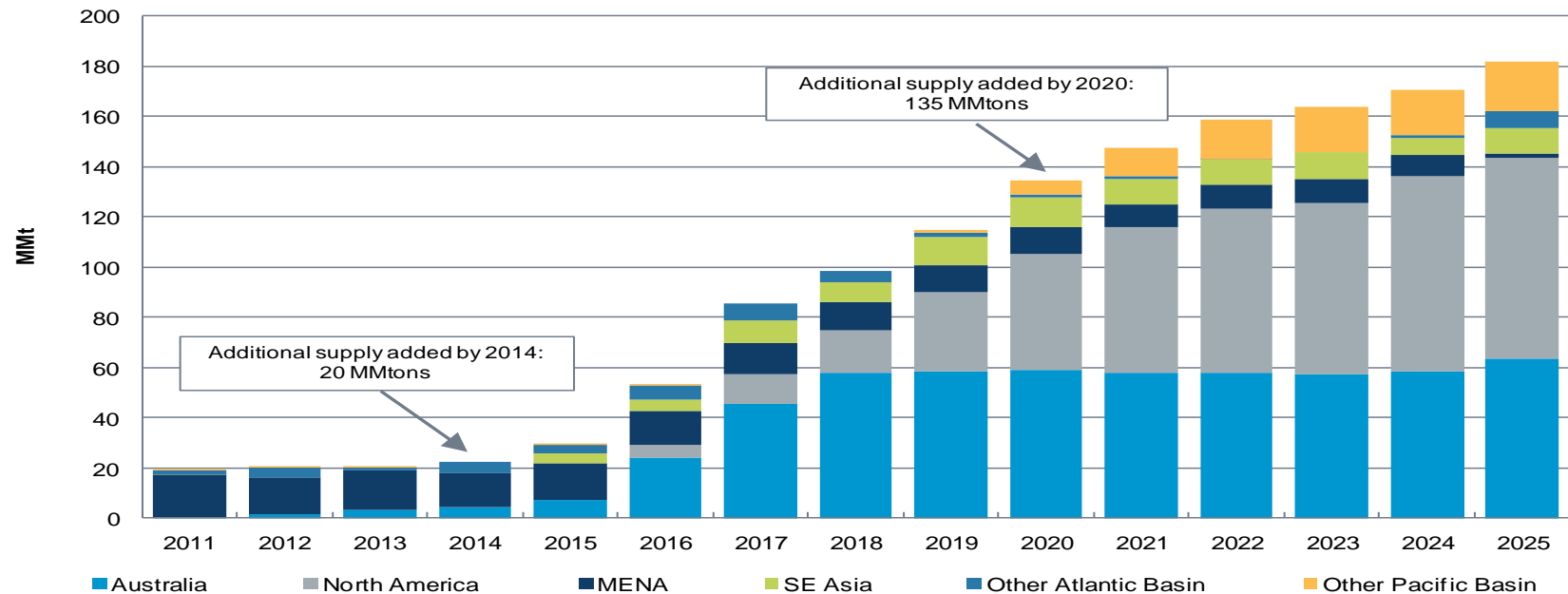
The LNG market is swinging toward looseness

LNG cycles before and after Fukushima



Global LNG supply set to grow significantly from 2016

Incremental global LNG supply relative to 2010

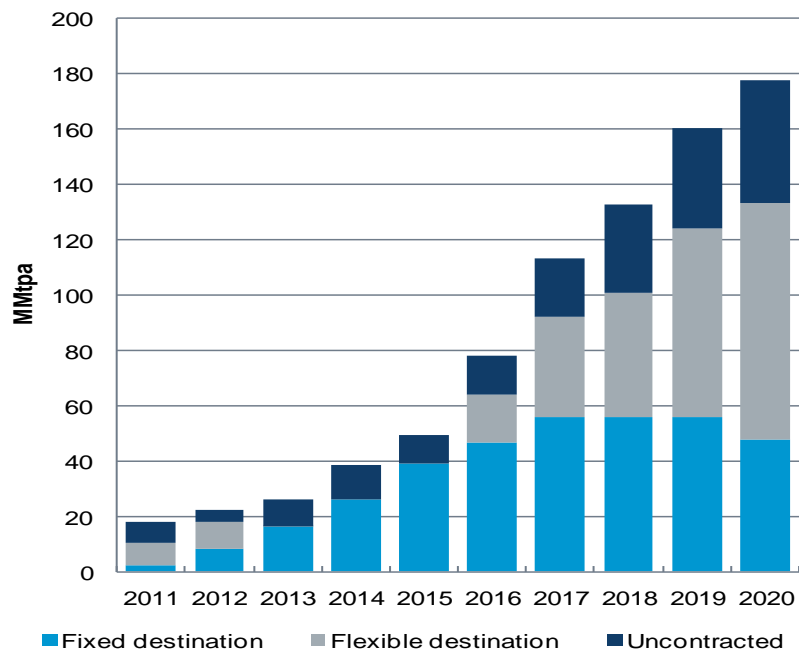


Note: Global LNG supply in 2014 is set to reach ~240 MMt.
Source: IHS Energy

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Part of the growth in global supply is non-dedicated and looking for markets

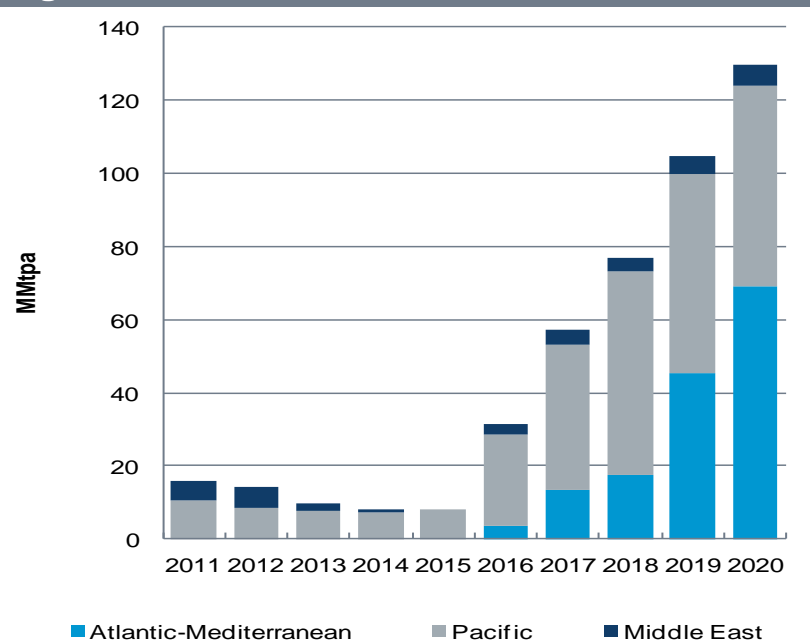
Incremental supply over 2010 by contract status



Source: IHS

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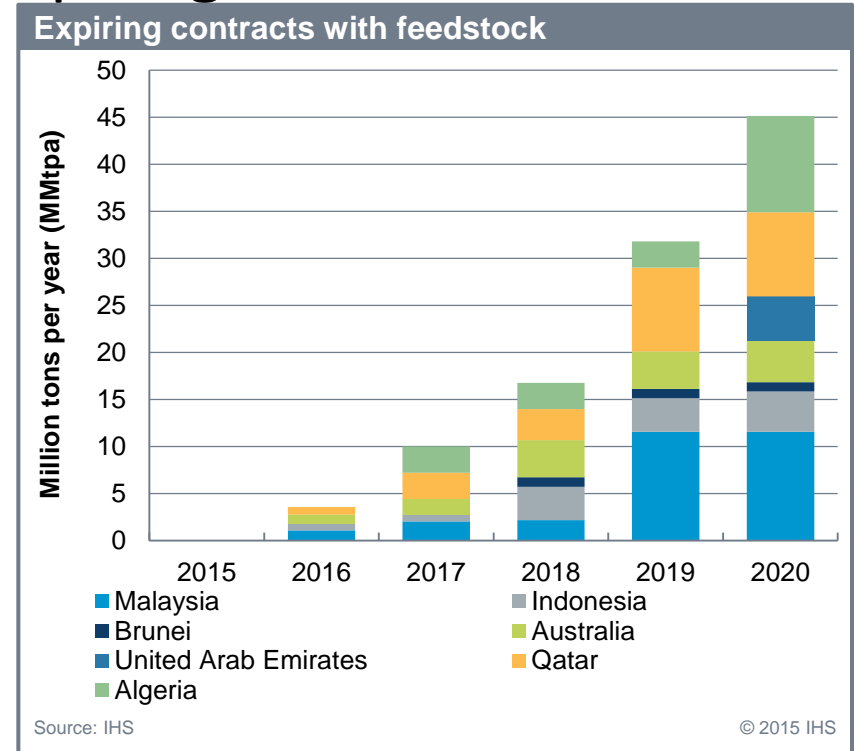
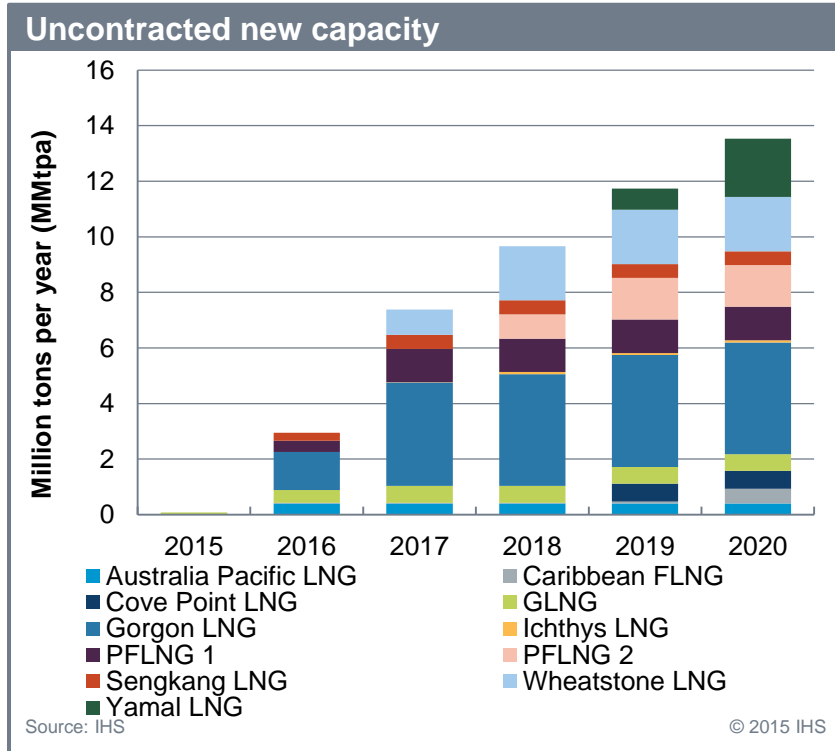
Incremental flexible and uncontracted supply by region relative to 2010



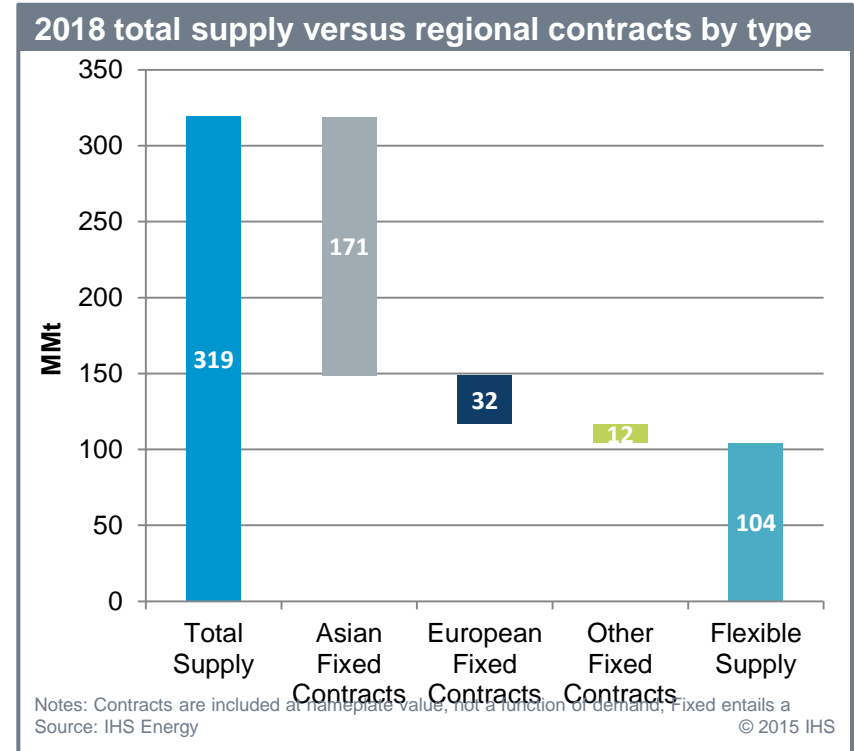
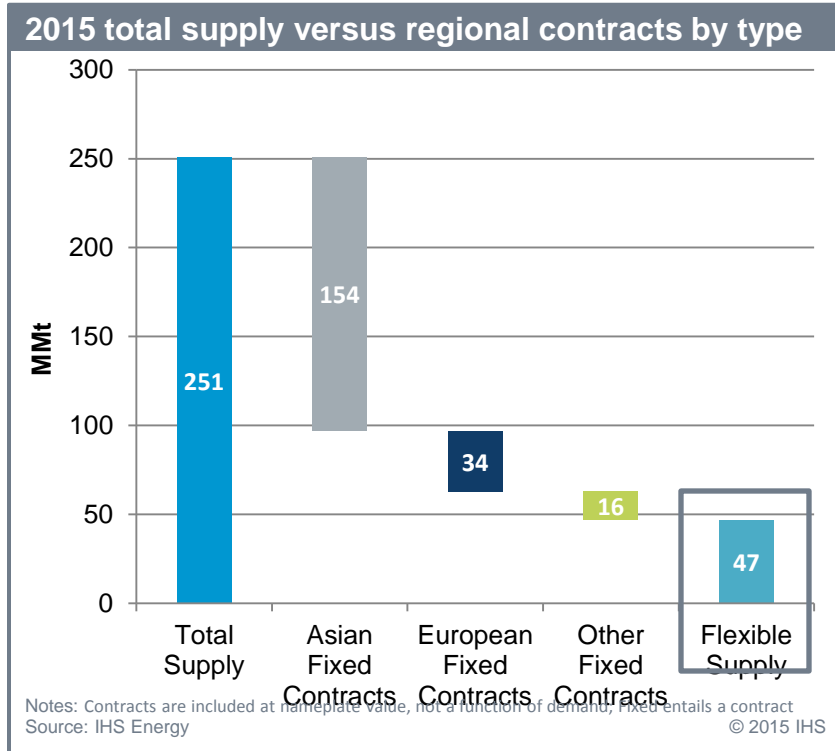
Source: IHS

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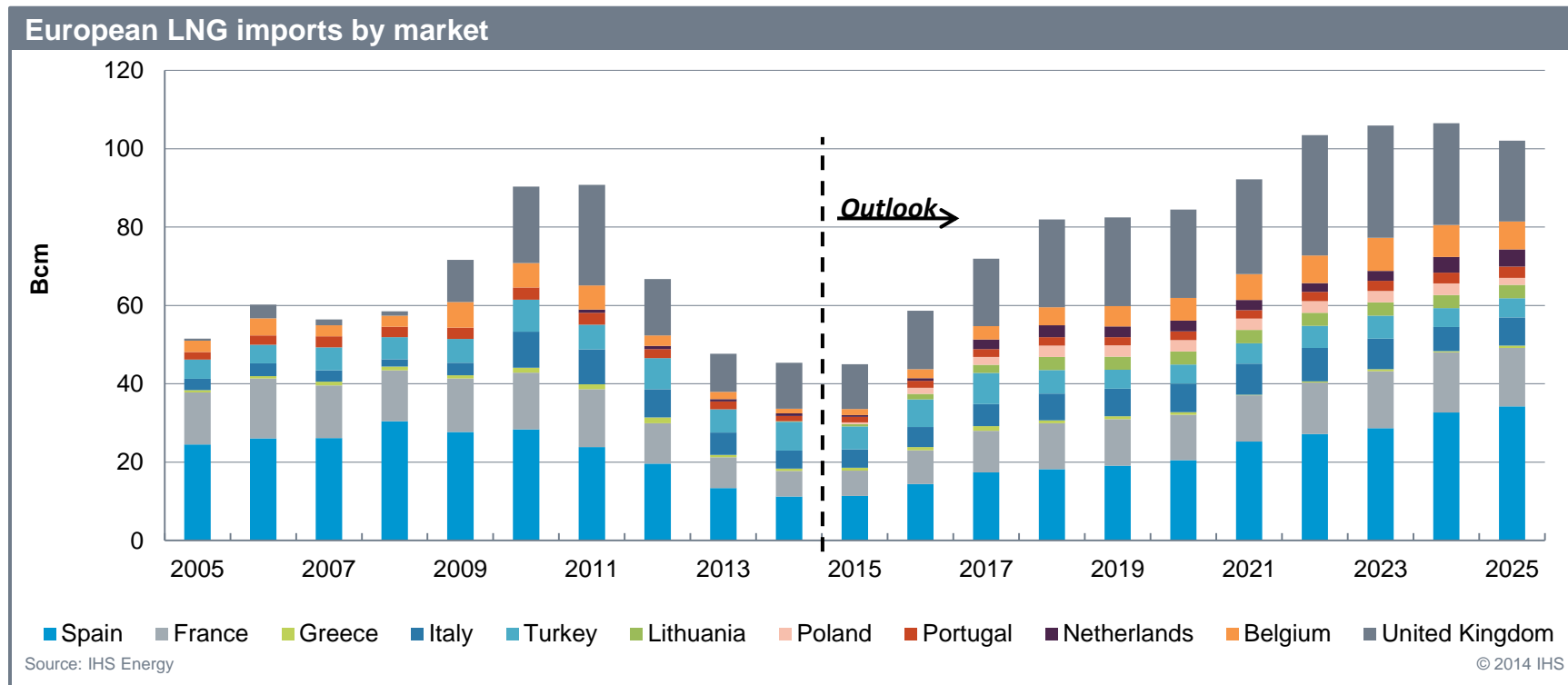
Global supply pressures come from new sources and expiring contracts



Flexible LNG supply is set to grow strongly in the rest of this decade— increasing the volume of gas available to Europe



LNG imports into Europe likely to start to pick up substantially from 2017 as global LNG supply increases



Europe: the balancing market

- Europe with its deeply liquid traded markets, significant demand and flexible supply sources is uniquely placed to balance the global gas market
- However, Europe's ability to absorb excess LNG supply may be less than in the past
- Expectations of the future supply gap have been repeatedly revised down and the growth of renewables has reduced the price elasticity in the power sector

The European gas market: The intersection of global LNG and pipeline supply

Europe's unique balancing role

Large gas market
~500 Bcm



Liquid traded
markets



Third party access
to gas infrastructure



Underutilised
regas capacity



Purchase contracts
with significant
volume flexibility



Price responsive
demand



LNG unable to find a market elsewhere is expected to arrive in Europe,
but how will the European market, and Europe's incumbent suppliers, respond?

Slow gas demand growth limits supply gap

“The European Exception”—gas demand is expected to grow only slowly, in contrast to most other regions where growth is strong

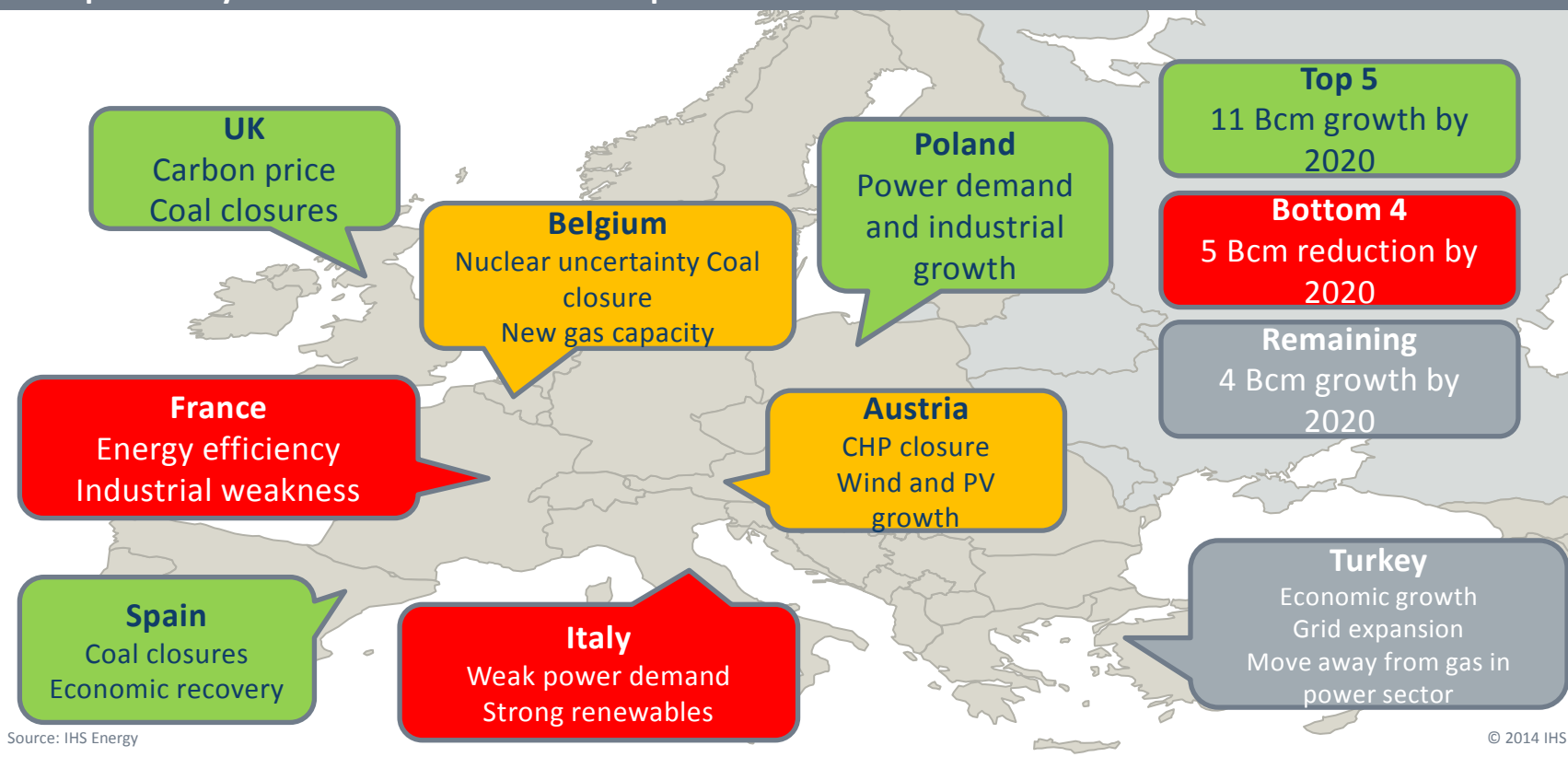
- Perception of gas in Europe has changed in the last year: geopolitical concerns trumping environmental benefits
- Space for gas in power generation limited by weak power demand growth and renewables.

Indigenous production declines continue to provide an opportunity for external producers

- But supply gap likely to be smaller than expected
- Greater competition between suppliers as a result—especially Russia and LNG

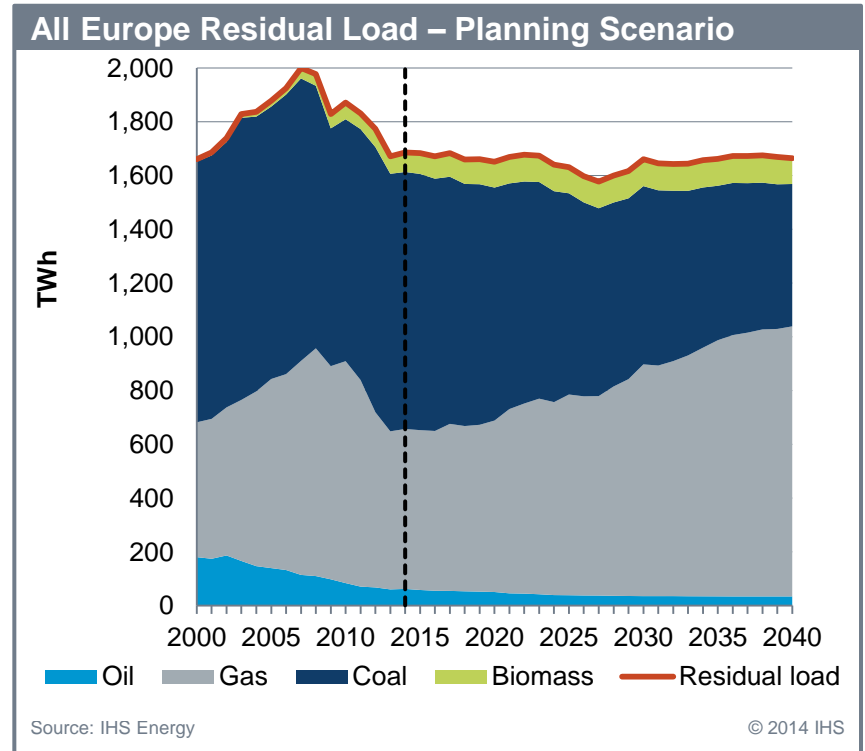
Gas demand recovery in Europe—slow and uncertain

Examples of key demand drivers around Europe between 2015 and 2020

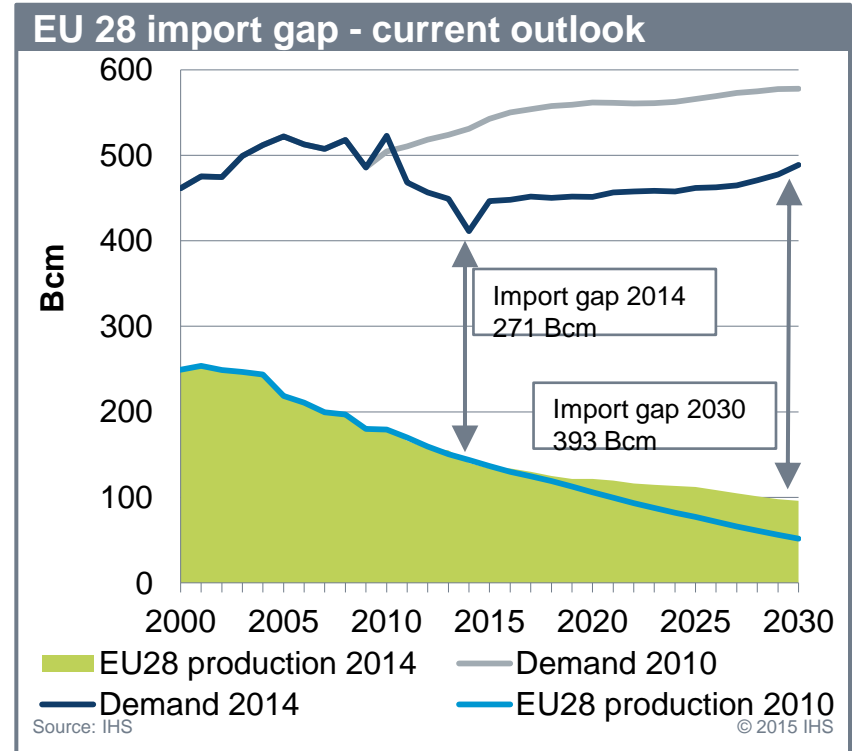
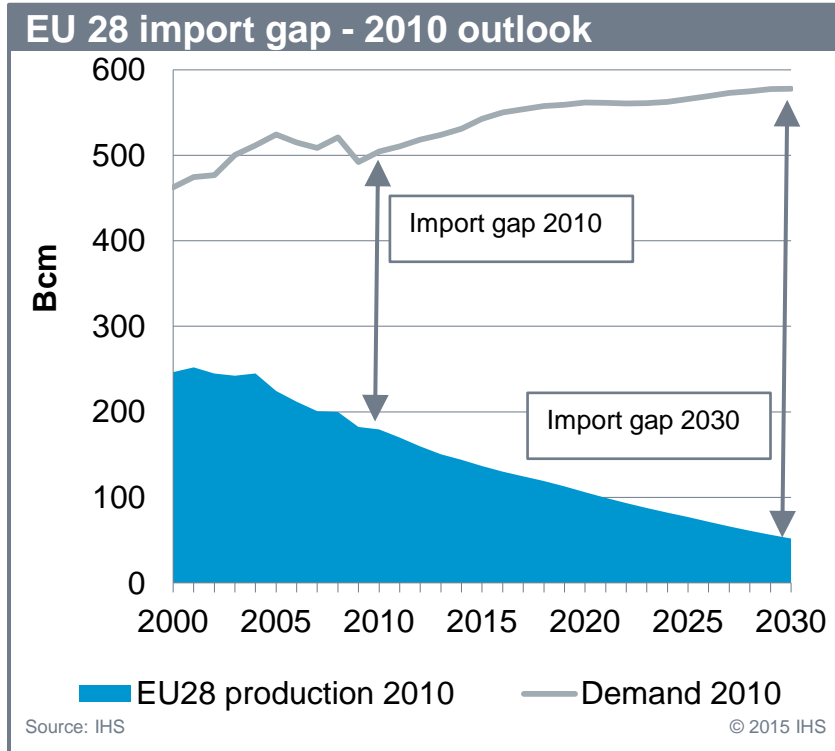


Power sector gas consumption structurally lower than prerecession—does not return to 2008 peak until 2030

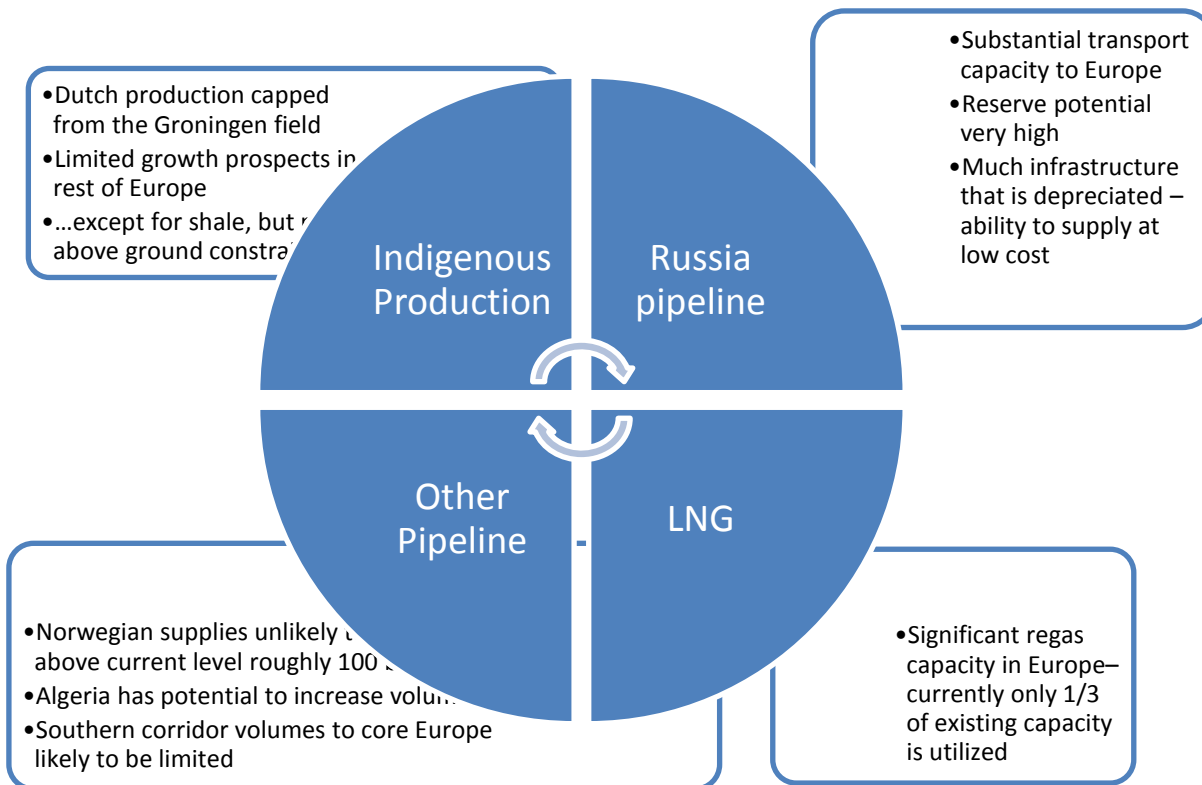
- **Residual load** – power supply not met by ‘must-run’ generation
- Residual load a function of
 - Power demand
 - Renewables growth
 - Renewables load factors
 - Nuclear generation
 - Imports/exports
- Gas competes with coal within this space



The outlook for EU28 import requirement in 2030 has dropped 133 Bcm (25%) since 2010



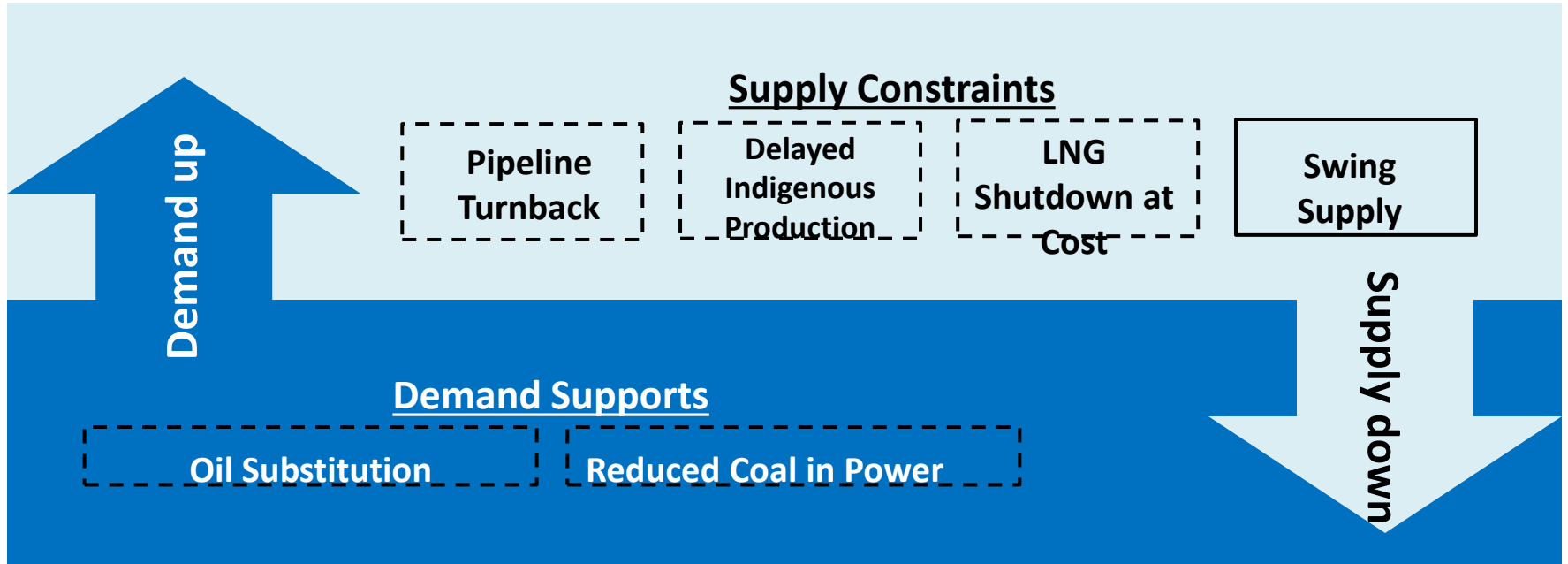
Many producers—with very different profiles—are looking to supply the European market



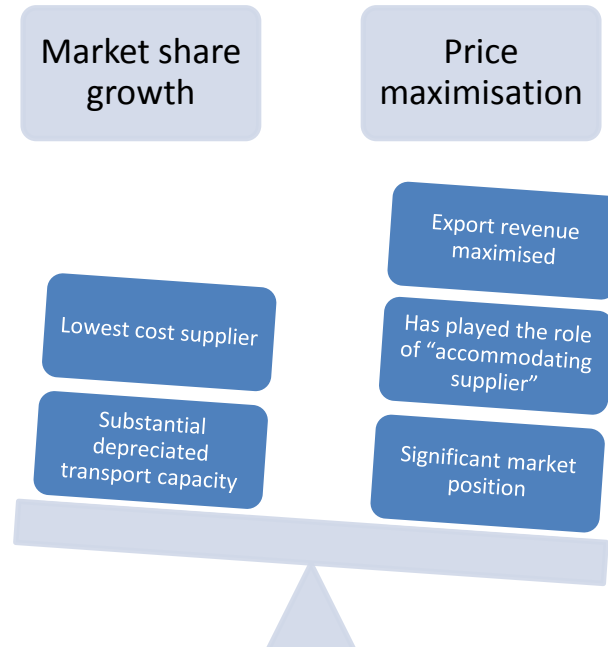
Price vs. volume: a new answer to an old question?

- Russia has traditionally sought to maximise prices rather than maintain market share
- The combination of shifting geopolitics, market fundamentals and contracting structures may change the choice in the coming years
- Should Russia chose to compete for market share, gas prices in Europe (and in the wider spot LNG market) could fall significantly

Global gas market's levers to balance the market

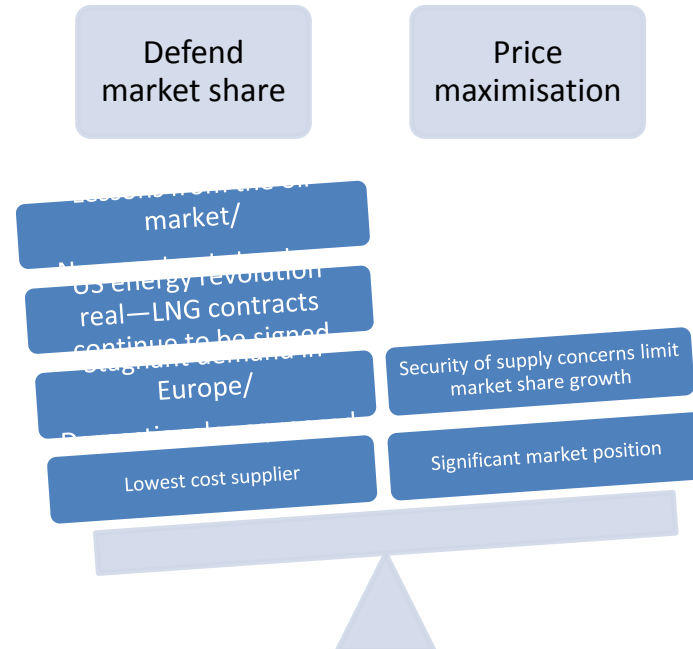


The *traditional* Russian supply choice: Price maximisation over market share growth



Strategy most clearly seen following the 2008 recession and the flood of LNG to Europe, but also seen earlier—e.g. when major Norwegian infrastructure brought on

The *new* Russian supply choice?: Defend market share



Previous periods of oversupply in the gas market were felt to be short-lived—if this time it is sustained (or Russia believe it to be so) the supply choice could change

Contact us



Americas:

+1.800.IHS.CARE (+1.800.447.273);
customer care@ihs.com

Europe, Middle East, and Africa:

+44.(0).1344.328.300;
customer.support@ihs.com

Asia and the Pacific Rim:

+604.291.3600;
supportapac@ihs.com

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