

The burning question

Eric Yep



How will Asia manage fuel supply risks this winter?

- More than 75% of Asia's seaborne LNG demand linked to oil prices
- Responding to gas shortages with fuel switching, demand destruction at high prices
- Winter temperatures to impact level of competition for flexible LNG cargoes

Asian utilities, power generators and gas importers are bracing for unprecedented fuel supply disruptions this winter, with their European counterparts no longer ruling out the possibility that Russia could fully turn off gas supply to the region.

Natural gas accounts for around 24% of global energy supply, and just 11% of Asia's energy mix. But the dependency in Asia is concentrated in a few countries that pivoted to seaborne LNG for electricity generation.

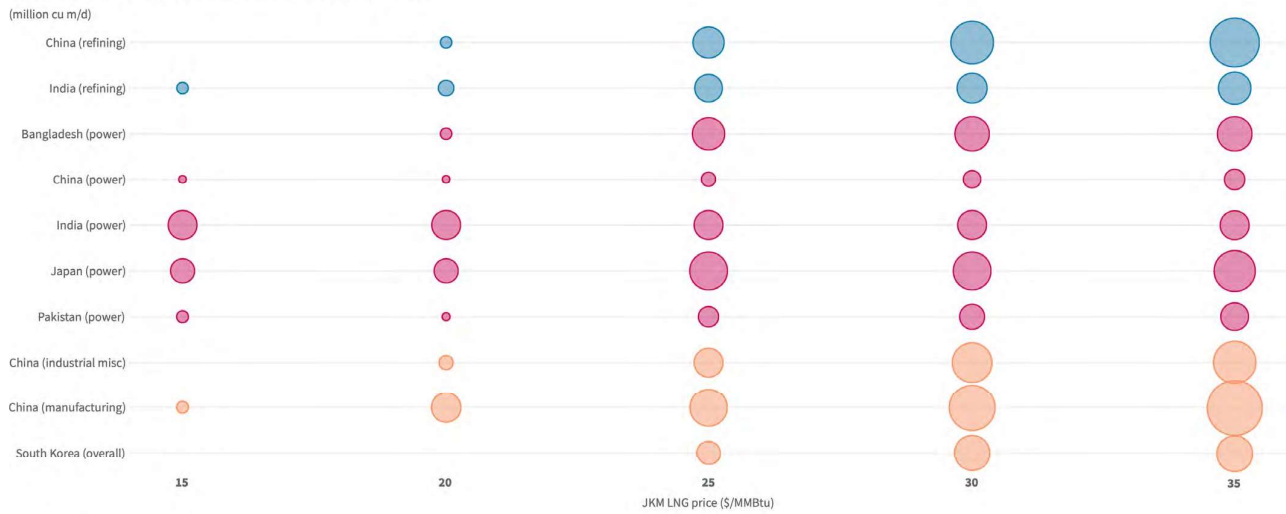
These countries have initiated a range of contingency measures, some of which kicked in to meet the recent peak summer demand season. They include short-term gas procurement strategies, electricity and gas rationing to essential services, load shedding and enforcing restrictions on power consumption.

Combined with fuel switching to alternative fuels like coal, oil, nuclear and renewables, and demand destruction at high prices, these factors will contribute to Asia's response to managing gas shortages this winter.

S&P Global Commodity Insights expects that winter temperatures, in the early gas procurement season as well as deeper into winter, will impact the level of competition between Northeast Asian importers and European buyers for flexible LNG cargoes.

Over three quarters of Asia's seaborne LNG demand is still linked to oil prices, and assuming an average Brent price of around \$100/b, most LNG supply stays around \$20/MMBtu. The remaining spot LNG will be at JKM prices, with early winter deliveries already starting just under \$60/MMBtu. S&P Global expects demand destruction to scale up at different LNG prices, with maximum demand destruction seen in Chinese refining and power generation in South Asia and Japan.

Gas demand destruction at different LNG prices



Source: S&P Global Commodity Insights

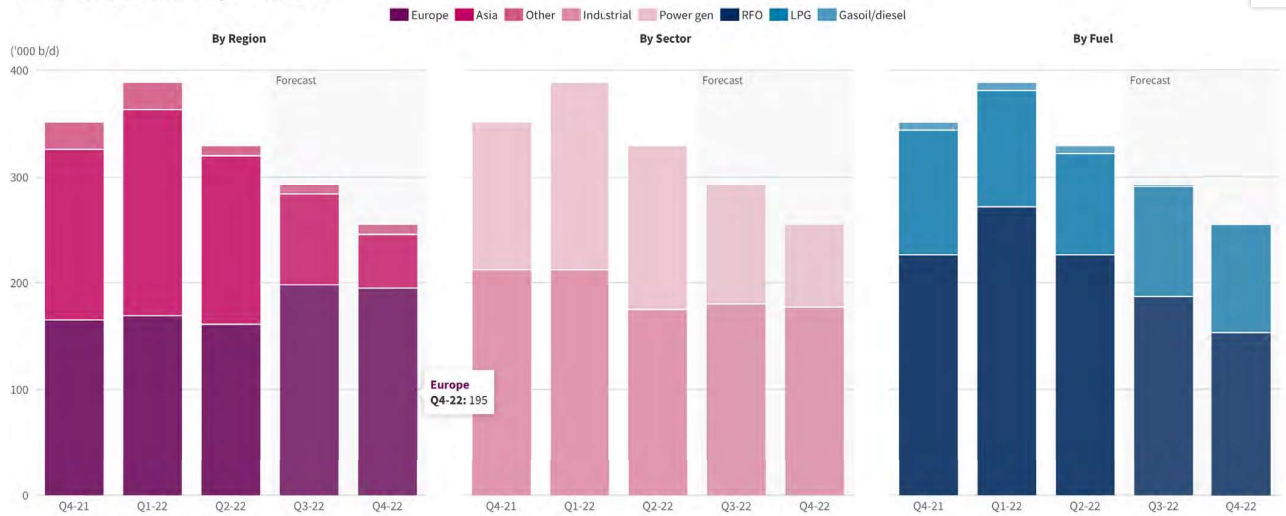
Asian economies like Japan, Singapore, Pakistan and India spent decades clamping down on oil usage in power generation and substituting it with cleaner fuels like natural gas.

But desperate times have prompted many of these countries to bring back what little dormant oil-fired generation capacity is left to combat power shortages,

and much of the gas-to-oil switching has already been maxed out since last winter's price spike.

In several countries, oil-fired power generation is constrained by emissions regulations or by downstream supply limitations; but non-power generation is likely to account for a big portion of the gas-to-oil switching.

Gas-to-oil fuel switching accelerates

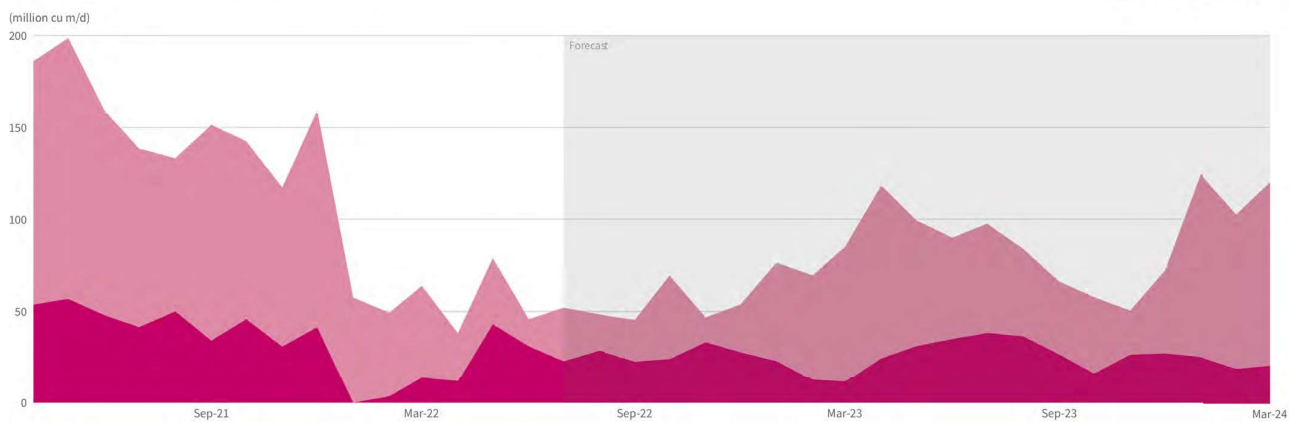


Source: S&P Global Commodity Insights

Asia's spot LNG procurement has nosedived since the Russian invasion of Ukraine, with the bulk of spot volumes diverted to Europe in the first half of 2022. India and China accounted for most of the decline in spot procurement, and price-sensitive importers like Bangladesh, Pakistan and Thailand are expected to be impacted by rising spot LNG prices this winter.

However, S&P Global expects Japan and South Korea to be established markets that are less price-elastic than many emerging markets, and with LNG demand that is likely to be prioritized to make sure homes are heated. It expects winter LNG prices to remain elevated above shoulder season levels, reflecting greater levels of competition for LNG into winter as spot demand emerges from mature Northeast Asian buyers, and to a lesser extent, China.

Spot LNG procurement in emerging Asia plummets



Note: Based on assumptions of spot volume. Rest of Asia includes Vietnam, Thailand, Singapore and China. Source: S&P Global Commodity Insights

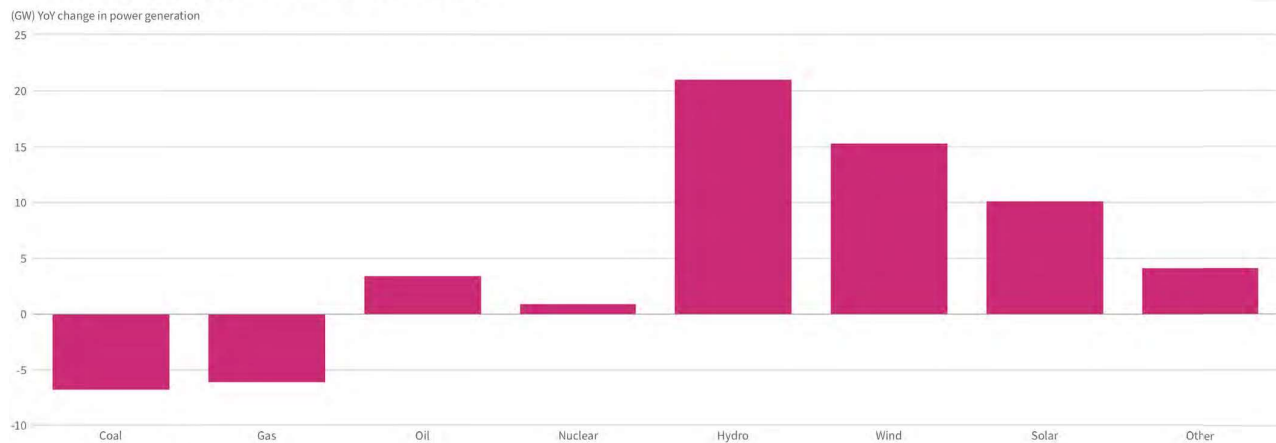
Asia's use of coal and gas declined in the first half of 2022 amid high spot prices that diverted trade flows to Europe, while gas-to-oil switching took hold. High output from renewables also reduced the thermal gap in H1, according to Andre Lambine, power analyst with S&P Global.

China's power consumption is expected to grow around 5%-6% in 2022, with national power supply and demand generally balanced, the trade body China Electricity Council said in its China Electric Power Industry Annual Development Report 2022, released July 6.

China's power consumption in H1 also slowed due to zero-COVID policies impacting industrial demand and slower economic growth. But summer demand and extreme weather conditions sent peak power loads in several provinces to record highs in July and August.

Lambine expects H2 to see a rebound in thermal power generation in Asia, especially with peak winter demand around the corner, coal-fired power generation gaining traction in several countries like India and the price of spot coal cheaper than spot LNG.

Asia uses less coal and gas in H1 2022 due to high prices



Source: S&P Global Commodity Insights

“With JKM at current levels, many downstream buyers are unable to procure LNG on the spot market, especially in China. However, colder than normal temperatures could force players to buy more-expensive volumes as LNG remains an important and flexible form of supply,” said Jeff Moore, Manager, Asia LNG at S&P Global.

“We have heard of many end-users testing the water ahead of winter this year as there is certainly a sense that prices could go even higher, driven by an increasingly

tight market in the Atlantic. If we enter a scenario where Northeast Asia needs to draw on significant volumes from outside the region this winter, it’s possible prices could test all-time highs,” Moore said.

“That said, even during last winter when temperatures dipped below normal in Northeast Asia, there was enough alternative fuel switching and volumes in storage that it didn’t force Asian end-users to increase their LNG spot procurement significantly,” he added.

Spot LNG is now the costliest powergen fuel

