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SUPPLY-DEMAND

European Buyers Comfortable With Spot LNG Reliance

European buyers appear to be comfortable relying on spot LNG procurement and managing the pricing volatility it brings rather than committing to long-term LNG contracts, market players told Energy Intelligence during the E-World energy trade fair in Essen last month. Despite the importance given to energy security following the crisis exacerbated by Russia's ongoing war in Ukraine, European buyers are banking on new LNG supplies coming online in the second half of the decade to push spot prices lower and rebalance the current tight market.

While it makes sense to have dedicated longer-term supplies to complement spot procurement, European players see three main obstacles for long-term contracts to be signed, namely the EU's long-term climate policies, lower demand expectations and financial risks involving pricing terms on offer, according to Gregor Pett, chief economist at German utility Uniper.

There is an expectation that LNG supplies will be more abundant in five to 10 years, meaning there will be more spot cargoes available to cover Europe's demand, which itself is not expected to increase significantly, according to Frank van Doorn, the head of energy trading at utility Vattenfall. Europeans are concerned about the risks that this strategy brings over the next few years but appear to be "not worried enough" to conclude long-term contracts, he said. "Having a diversified approach in their portfolio is not an issue. It's rather the two years or three years that we need to bridge the gap," according to Joerg Selbach-Roentgen, the CEO of MET Germany, the German branch of the Swiss-based MET Group. "That's the difficulty, because you have to find a solution until then, how do you mitigate price risks in those shorter terms."

Pricing and flexibility terms on offer appear to be one of the sticking points for European buyers. The main LNG suppliers offer US benchmark Henry Hub or oil-indexed prices, which creates risks for European buyers that prefer volumes linked to European indices. "For financing reasons, players investing in liquefaction plants are normally required to commercially hedge at least a major part of the volume, and they are not willing to take spread risks. This is especially the case for US terminals," Switzerland-based Axpo Solutions' head of Continental Europe Merchant Trading, Marco Saalfrank, said. "A European player would normally not take a risk on the location spread towards a European index, at least not on a long-term basis."

Weak Industrial Demand

Industrial consumers and utilities are particularly reluctant to sign up for long-term supplies, as they are not used to signing anything longer than five to ten-year supply contracts, Selbach-Roentgen said. "There are only a few players able to do this and there still needs to be a lot of convincing, advising and explaining to industrials and big Stadtwerke utilities [in Germany] because for them it's something they've never done before," he added.

Meanwhile, European natural gas demand is not expected to bounce back as anticipated following the price volatility of the past year. "Depending on who you talk to, some [industrials] seem to be really keen on somewhat growing their business again. Some are very scared and are openly talking about going elsewhere," Selbach-Roentgen said. Despite the current gas price slump, European industrial gas consumers are reluctant to reactivate their activities due to the expectation of higher prices in the medium term. "Talking with our customers, what they clearly see are the currently lower prices in the short term, month ahead etc, but they also see the price in the winter and in the longer term, which are still high," Saalfrank said. "Obviously customers have a more mid- to long-term view."

Volatility Expected Until 2026

Pricing volatility is expected to be most acute in the years up to 2026, when the next wave of global LNG project start coming

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Supply-Demand *>> continued from page 1*

online, market players said. Scant Asian demand and a weak global economy into 2024 will keep prices bearish if no unexpected events occur, such as a colder winter. "The market is putting a very high-risk premium on prices, if you look at next year or 2025," Saalfrank said. Prices during the winter 2023/24 should not go as high during winter as last year, unless infrastructure outages potentially drive prices higher, according to Pett.

"There is a significant risk that the situation may not be as comfortable as it appears at the moment," van Doorn said. There is no doubt gas stocks will be full ahead of the winter, but the other three factors which helped Europe last year – abundance of LNG, substantial decrease in demand and a mild winter – might not materialize this time around, he said.

"I think the situation is better than we had last year, last summer, looking at winter 22/23," German market area manager Trading Hub Europe (THE) managing director Torsten Frank said. "But nevertheless, there are still some scenarios where we might have some problems, where we have not enough gas, depending on different situations." However, THE doesn't plan to issue a tender to fill German storage for 2023 at the moment due to the comfortable market situation. THE bought around 4.5 billion cubic meters of gas to inject into storage last year, of which 1.13 Bcm had been sold as of Mar. 31, 2023, THE said. "If the market is working fine, that there is no need for THE to go into the market because this, then, is the signal that the market is working and stable again," Frank said.

Staff Reports

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