

The role of the EU in acquiring new gas supplies

Clingendael International Energy
Programme: CIEP Gas Day 2010



Market participants?

The role of the EU in acquiring new
gas supplies

Economic zone?

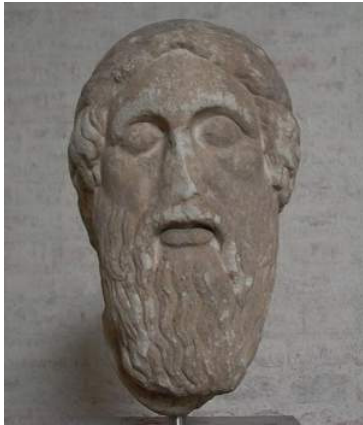
Commission? Oettinger?

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Given the somewhat unclear title, we simply take the liberty to discuss this question with a very wide scope ...

The current perception of the European gas industry was voiced several centuries ago:



The minds of the everlasting gods are not changed suddenly

Homer, Iliad

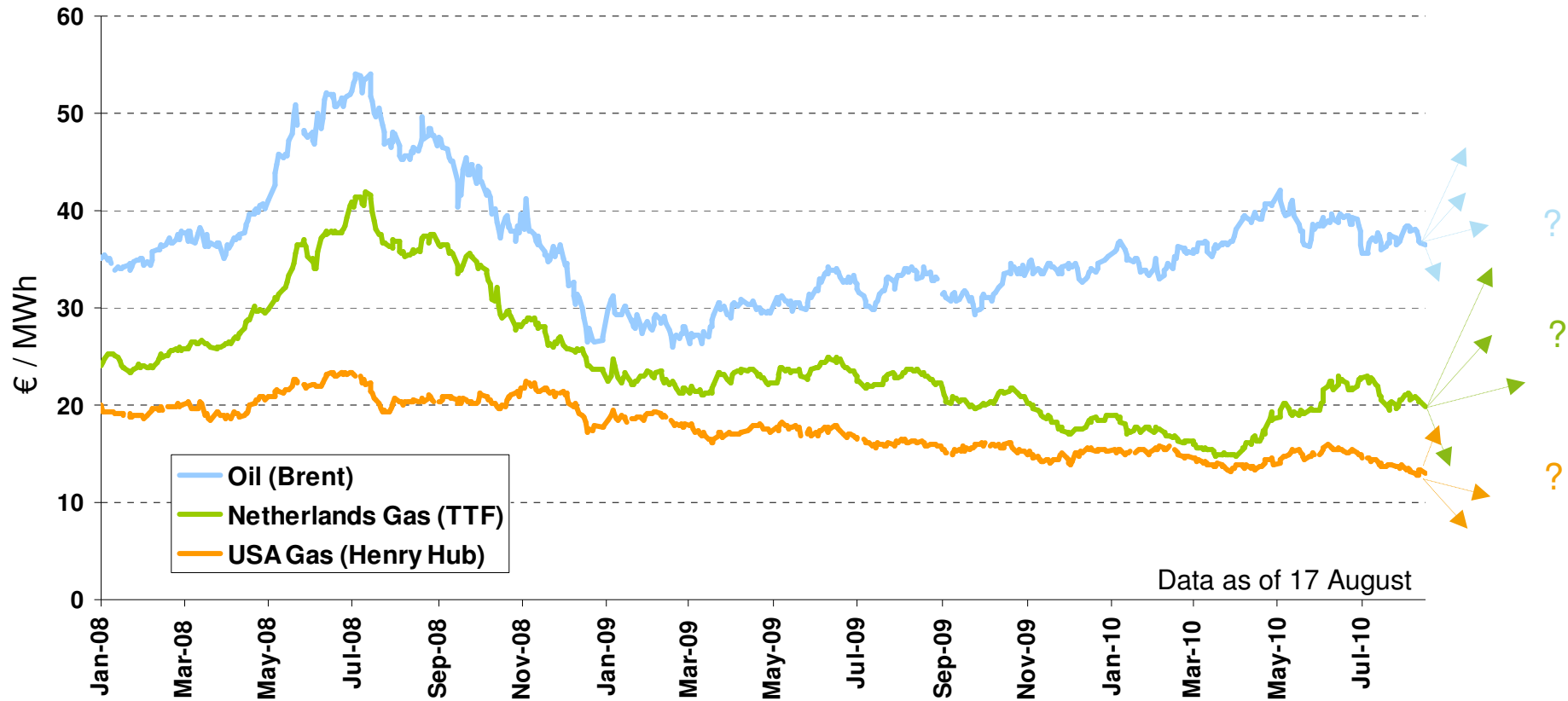
Now, here's a story of change

'80% approach' no longer good enough?

- > Europe's traditional 'competitive advantage' – close proximity and pipeline connections to major gas sources - seems to have become a disadvantage in 2009
- > For the first time in the history of the industry, on the back of the economic crisis, **Europe's overall import levels fell below the 'minimum take'**. Demand was at 528 bcm – a level not seen since 2003
- > Disparity between cheap spot gas and expensive pipeline (oil indexed) gas, forced Europe to try to decrease contractual 'minimum takes' where possible
- > **Recovery of demand** – due to a better economic climate, cold weather and greater power generation from natural gas – will be all about timing
- > Demand, which is already increasing, is set to peak in the forthcoming winter (how strong will the winter be?): will it make Europe willing to pay some **80% oil-parity for peak LNG** and will there be more LNG Cargoes **arriving in the UK at 60% oil parity** while some sellers still get **100% oil-parity for deliveries to Asia?**

Question: Is Europe still competitive? Has it been opted out of the global market already?

Natural Gas to Crude Oil Spread



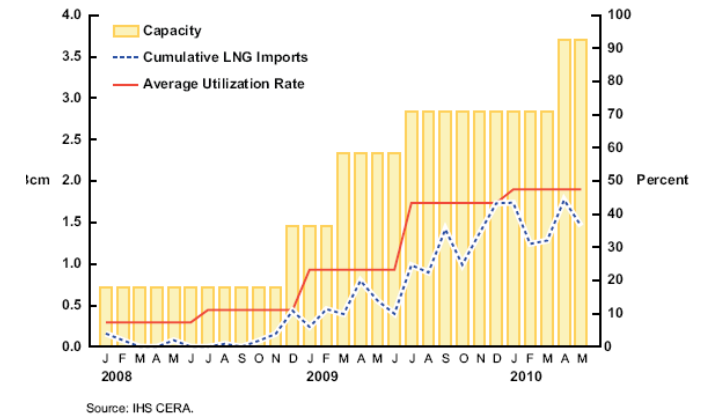
LNG increasingly important in Europe

- > While it is too early to call the crisis over, the robust recovery of some European economies already shows an increase in demand for natural gas today
- > Pipeline imports continue to be significant and the main source for baseload gas deliveries. However, growth in LNG will continue
- > Greater liquefaction capacity (Qatar) combined with more European re-gas capacity (UK & Italy) will lead to a supply surge in Europe: volumes expected to rise

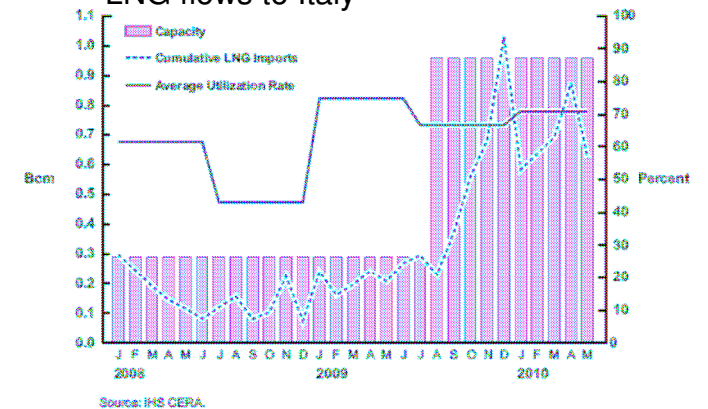


Is Europe willing to pay the global price or is Europe setting the global price?

LNG flows to UK



LNG flows to Italy



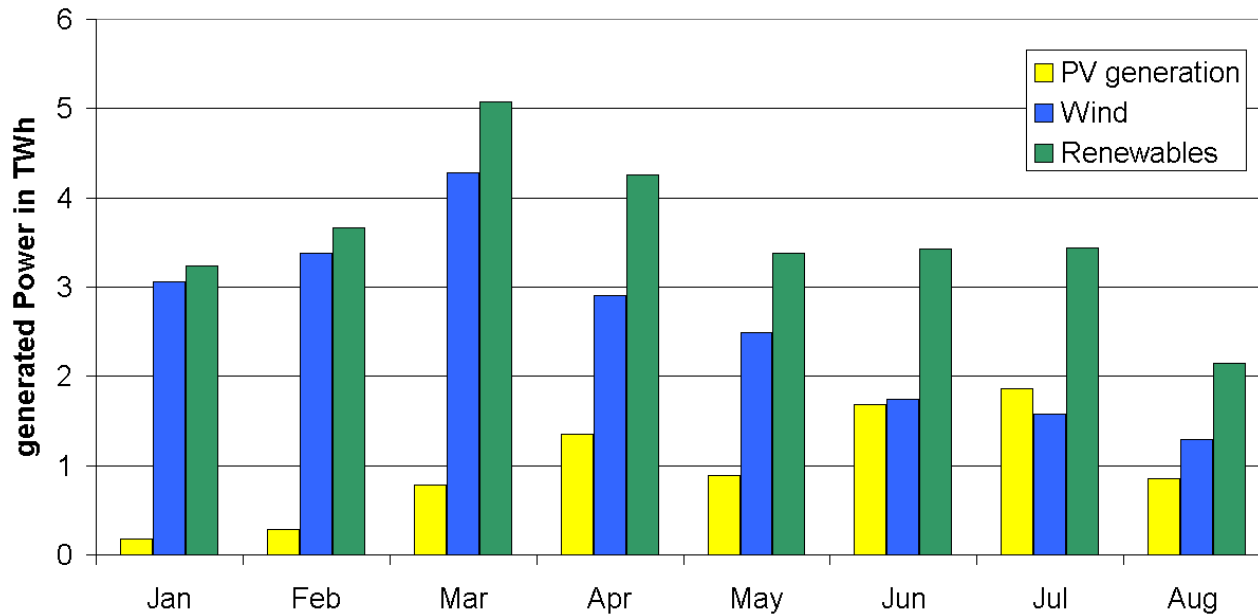
It's not about Europe, it's about Asia

- > High growth is expected to continue in Asia and some traders could translate this into bullishness of the global energy complex
- > But with new global liquefaction capacity, export options for producers could be quickly saturated, additional “niche” markets for LNG – beyond Argentina, Brazil, Kuwait, etc. could be developed
- > India and China are also **diversifying their energy portfolio**: China built a pipeline connecting to Turkmenistan gas reserves and is starting to develop its own shale gas potential; also plans to connect Turkmenistan (Russia's swing producer) to India via Pakistan are progressing
- > Producers will sooner or later discover that potential to sell ‘oil-parity gas’ is slim, while Asia's negotiation basis will strengthen: the greater the supply choice, the better the chance of attractive prices
- > In other words: Western-Europe is expected to remain an important market for (peak) LNG deliveries long-term at the global price benchmark which is currently the NBP

Demand: more change lies ahead ...

- > It is clear that the former 'stable' European gas landscape is now global and cyclical - following **supply and demand shocks** that steer primary energy flows through the respective price signals
- > **The market has changed drastically**: renewable energy is gaining market share, decentralised energy production, electric cars & smart grids, smart metering and consequently a highly flexible power generation are all on the rise

Monthly Renewable Supply in Germany in 2010 (so far)



Supply: examples of today's "industry" leaders:



Gazprom?



Turkmengaz?



Socar?



Sonatrach?



EGAS?



- > We have already learned that demand is somewhat „unpredictable“ but we can also observe a trend where supply negotiations are becoming increasingly “politicised” – meaning that most possible supply negotiations are now carried out with national gas companies (rather than private companies)
- > Consequently the question “where does the future gas supply come from” **becomes a political question** in the end ...

When the gas play becomes a political one

- > What is somewhat problematic: national governments tend to want to transact with governments, not energy companies – so it often actually requires politicians to get involved into “the gas play”: this means that in the global challenge for (energy) resources, the EU commission and national governments in Europe need to get more deeply involved
- > Thus even if Europe is prepared for taking on this gas supply challenge on a political level: there remain diverse national interests, no common energy policy, no “masterplan”, there is no clear mandate
- > It is consequently appreciated much by the industry that the new energy commissioner Oettinger has now taken on the challenge and increasingly extends his involvement: he started speaking to potential supply countries with a common “European voice”, thus making supply negotiations possible and “opening the doors” abroad
- > We need market forces to signal how much gas is needed, when it is needed and what its value will be, but require political support and involvement when the challenge becomes a political one
- > In other words: we need the private energy / gas sector and the respective EU government bodies to work hand in hand to succeed in acquiring new, reliable energy sources globally

Summary

- > The energy and **gas business is increasingly less predictable**; only the rule “nobody is bigger than the market” remains as well as the need for increased flexibility
- > All those who do understand this - and the changes that the gas market continues to go through - will be **beneficiaries, if not victims of change**
- > Europe’s privately owned energy companies **require strong political support** to be able to play in the global supply league, the Commission is actually on a good way to deliver this support
- > Coming back to my entry statement about “gods” not being ready for change, maybe this is a good way of looking at it today (voiced by a politician, by the way):



Personally I'm always ready to learn,
although I do not always like being taught.

Sir Winston Churchill

(the man who split Kirkuk from Kurdistan to get a hold of the oil resources for use in his battleships, enabling him to destroy the “Kaiser’s fleet” in World War I)