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UK Natural Gas Prices, Already at Historically High levels, Set To Rise

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A recent article in the UK's *Sunday Times* warns that, although UK natural gas prices are already at historically high levels, they are set to increase by 25% by next winter. Part of the problem is that the UK is increasingly dependent on imports of liquefied natural gas (LNG), and this winter (2007/08) Japan has been paying twice as much for spot LNG cargoes as the UK has. The implications looking forward are that to secure spot LNG cargoes in future, residents of the UK should be prepared to pay much more for their gas. Meanwhile, in its latest weekly podcast, Platts explains why there are essentially three seperate markets for LNG supplies, and media reports suggest that Russia will be soon be hiking its gas prices for exports to Europe. In other words, barring economic meltdown, natural gas prices are set for double digit increases, annually.

On 09 March 2008, the *Sunday Times* published an excellent article explaining why the UK gas supplies are about to get much pricier, see Price war threat to UK gas supplies. The sub-title of the article sums up the situation pretty well:

> Global demand is forcing LNG suppliers to divert tankers from Britain to countries happy to pay more, which will have knock-on effects on homeowners' power costs

The article goes on to describe the preparations the UK is making to import lots of LNG, then quotes Frank Harris, from the energy consultancy firm Wood Mackenzie, as saying that most of the hoped-for LNG may not arrive:

> "We saw UK gas prices come under pressure a bit last year," said Frank Harris, head of LNG at Wood Mackenzie, the energy consultancy. "There was a view that as the terminals in Wales come on stream and the capacity at Grain increases that prices would crash. That was based on the simple economics of supply and demand. But the way the global fundamentals are moving mean that nothing like the volumes of LNG that could potentially flow through the UK are actually going to arrive.
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> "Look at South Hook, where you have these new facilities that are going to be capable of taking 15.6m tonnes a year. I reckon, realistically, we're not going to see more than about half of that come to the UK. The rest will be sent to meet higher spot prices all over the world."
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> Expectations of an LNG-led gas-price slump have well and truly abated. Next winter, wholesale gas prices are expected to jump 25% to about 69p a therm, based on today's forward prices.

The article also makes the important point that despite the UK is now a major net natural gas importer (the UK imported about a third of its gas requirements this past winter, Dec - Feb), the pipelines between the UK and the continent are still used primarily for exporting gas:

> Meanwhile, Britain's own gas supplies continue to fall. North Sea gas production slipped 12% last year, according to Oil & Gas UK, an industry trade body.
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> While there are several gas pipelines linking Britain to the Continent, these are still being used primarily to export British gas. Most of the gas in countries such as Germany and the Nether-lands is secured from the likes of Russia's Gazprom on long-term contracts that are priced relative to oil. Soaring crude costs have pushed gas prices higher across continental Europe. So European utilities have been sourcing UK gas at lower prices via the pipelines.
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> But if remaining North Sea supplies are being exported, the nation's dependence on imported gas can only increase.

It is ironic that the UK energy regulator Ofgem recently announced an inquiry into why UK domestic gas and electricity prices are so high, Ofgem investigates energy prices (The Guardian, Fri 22 Feb). To paraphrase the words of Mike Tholen, from the *Sunday Times* article, we ain't seen nothing yet:

> As Ofgem, the gas regulator, continues its probe into the UK gas market, after recent record price rises, one thing seems clear.
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> "The unfortunate truth for British consumers is that we are about to enter a period of much more expensive energy," said Mike Tholen, economics director of Oil & Gas UK. "That's going to feed back to everyone's gas and electricity bills."

Coincidentally, last Thursday's *Platts'* podcast, The evolution of LNG pricing, was on how LNG is priced in the three main markets i.e. SE Asia (Japan, S. Korea and Taiwan), Europe and USA. I have been following LNG for a few years now, and this is the clearest explanation of LNG pricing I have come across. 5 mins long.

Meanwhile, the *Financial Times* reports that European gas prices may rise because the Central Asian countries want to increase the price they sell gas to Russia, Central Asian gas prices set to rise in 2009. Gas supply and price forecasts start getting really complicated when Ukraine is involved, but the FT summarizes the situation as well as is possible:

> Ukraine, which shifted away from Moscow to seek closer relations with the US and European Union after the Orange Revolution of 2004, has bargaining power by virtue of its control over a vast pipeline system that serves as the main channel for Russian gas exports to Europe. Officials in Ukraine, itself a major importer of Central Asian gas resold by Gazprom, have said they could raise transit prices for gas to compensate for higher import prices. The difference would be passed on to consumers in Europe.
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> The prospect of further gas prices are a major concern in Ukraine, which has struggled to adjust to the higher gas prices.

> US officials have in recent years urged energy-rich Central Asian states to back pipelines that would bypass Russia, as part of an effort to undercut Russia's grip over gas and oil supplies in the region. Last year, Mr Miller warned that US geopolitical jockeying in the region could lead to higher prices for Central Asian gas.

The idea that Europe could or should become less reliant on Russian gas is an illusion. One of the reasons that the European Union used to repeatedly promote for justifying the yet-to-be-built Nabucco Pipeline was 'security of supplies', in other words gas imports from sources other than Russia. But this particular reason went by the wayside when the Nabucco consortium announced late last year that it was looking to Russia to supply gas for the Nabucco pipeline. But that is the subject of another post. Europe, and in particular the UK, will be looking for all the gas imports they can get, whatever the source.