Press Clipping

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Roadblocks Abound on LNG's Commoditization Path

Plenty of signs suggest LNG is heading toward commoditization, but there are also many obstacles to overcome to get there.

LNG has traditionally been sold by a relatively small group of sellers on rigid "point-to-point" term agreements priced off crude oil or European gas hubs a huge impediment to commoditization. But contracts have been getting more flexible, with fewer or no destination restrictions and diverse pricing mechanisms, and more volumes are being traded on a spot basis.

In Asia, the world's largest LNG market, traders have also made significant progress in developing a gas price benchmark (IOD Aug.27'18). Meanwhile, paper trading liquidity has also surged as market participants seek hedging tools to manage growing spot exposure.

But experts say true commoditization remains a ways off, with flexible trades still limited compared with other markets like crude and oil products. Lack of contract standardization, expensive storage relative to other commodities and resistance to the S&P Global Platts' Japan Korea Marker (JKM) also stand in the way of LNG commoditization.

The JKM is the most commonly used and referenced Asian LNG price, with a growing number of market participants already seeing it as the regional benchmark. But even so, trading liquidity remains capped. JKM trades account for just 1%2% of the LNG market, says Sarah Behbehani, the senior vice president of LNG trading at Japan's Jera Global Markets. "To call yourself liquid ... [you'll need] probably 17%18% [of the market]," she said at the LNG Supplies for Asian Markets (LNGA) conference in Singapore.

Growth in physical JKM spot trades, however, has been "incredible" over the past two years, Gordon Waters, the global head of LNG at utility Engie, said at LNGA. But while it is "relatively easy" pricing front-month spot deals off the JKM, such liquidity dips considerably for deliveries further out, he acknowledged.

There is particular resistance to the JKM from traditional Northeast Asian consumers. Japanese importers, for instance, are keen on the Japan LNG Cocktail (JLC), a monthly aggregate of the costs of delivered LNG into the country, Behbehani said. The JKM's paper derivatives liquidity is not really a draw for Northeast Asian buyers, as "they do not hedge anyway," she said (IOD Mar.26'18).

LNG sellers are similarly less enthusiastic about selling volumes off an Asian index like the JKM. Many seek oil-linked pricing, seen as essential in advancing project financing and ensuring quick cost recovery when operational.

"We prefer to sell on oil-linked contracts. The JKM is not on our radar," said Sean Rodrigues, Oil Search's country manager for Japan.

In December, however, Vitol inked a nonbinding deal with US Tellurian to buy 1.5 million tons per year of LNG for 15 years on the JKM, which is believed to be the first longterm deal priced off the index.

Tellurian will supply the LNG via its offtake volumes from the proposed Driftwood LNG plant in the US Gulf Coast. The firm is optimistic about LNG commoditization. A changing market with diverse pricing indexes, contractual flexibility and geographic diversity will facilitate liquidity, said Tellurian's senior vice president of LNG trading and marketing, Tarek Souki (IOD Oct.24'17).

But costly land-based LNG storage also poses a challenge and could slow commoditization, as could boil-off issues which make floating storage less viable.

Still, storage facilities are "enablers of trade" and while expensive, would be good investments as they can also be used for purposes like break-bulking, says Javier Moret, RWE's global LNG head.

Furthermore, the value of storage is also relative to LNG market growth with LNG markets overall short on such facilities, their value increases when markets expand, Vitol's LNG Trading Manager Sid Bambawale noted.

Royal Dutch Shell recently said it expects overall demand for energy to increase by 18% by 2035, with gas seen meeting 40% of this additional demand and LNG the fastest-growing gas supply source (IOD Feb.27'19).

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