

Natural gas: That sinking feeling

The downward pressure on the European gas market has been relentless. A milder winter, along with weakness in the Asian LNG market, has seen EU inventories recover to more than comfortable levels. With seasonal peak gas demand now behind us, a sustained rally looks unlikely in the near term



Gas storage tank

Weakness in Asian LNG

Spot North Asian LNG prices have been under pressure since September, with the market down around 55% since then. A milder winter in North Asia certainly did not help market sentiment, while growing LNG supply continues to weigh on the market. Australian LNG exports have steadily increased, as further capacity comes online, with exports over 2018 increasing by 22% year-on-year to total 69.6mt. US exports grew by 53% YoY to total 22.7mt over 2018.

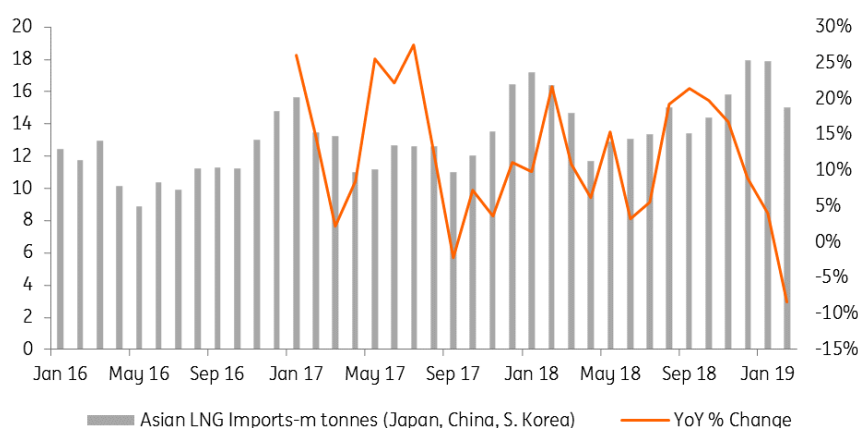
This additional supply comes at a time when import demand growth in Asia is slowing. Japan, the largest importer of LNG has in fact seen year-on-year declines in imports for the last four months. The fall in imports is driven by the restart of nuclear capacity in the country. Over 2018, four nuclear reactors in the country were restarted, taking the total tally of operating reactors to nine. The ramp up of nuclear reactors is likely to weigh on LNG demand over the course of 2019, during a time when LNG supply is only set to grow.

Meanwhile, Chinese import demand has remained fairly robust, with 2018 LNG imports growing by

41% YoY in 2018 to total 53.84mt. These growth rates are a little bit lower than what we saw over 2017, when imports grew by 46% YoY.

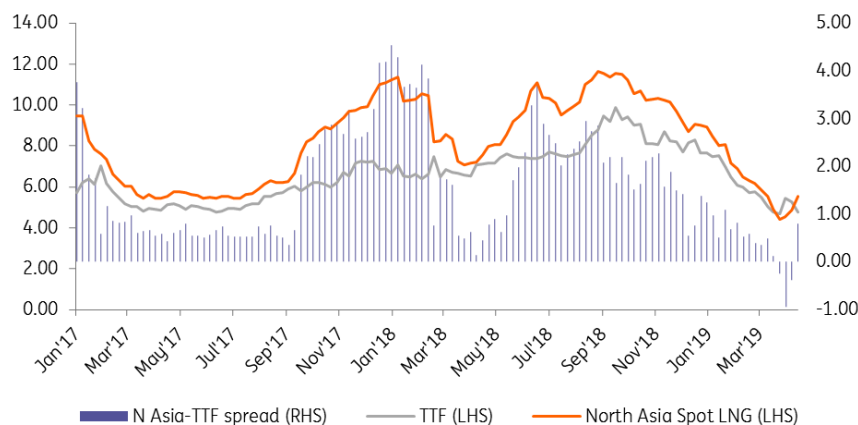
The strong premium that we have seen the Asian market trade to Europe has largely disappeared, and in fact the Asian prices have been trading at a discount to European gas prices at times recently, making Europe a more attractive home for US LNG.

LNG Asian import demand slows



Source: Bloomberg, ING Research

European and Asian gas prices (US\$/MMBtu)



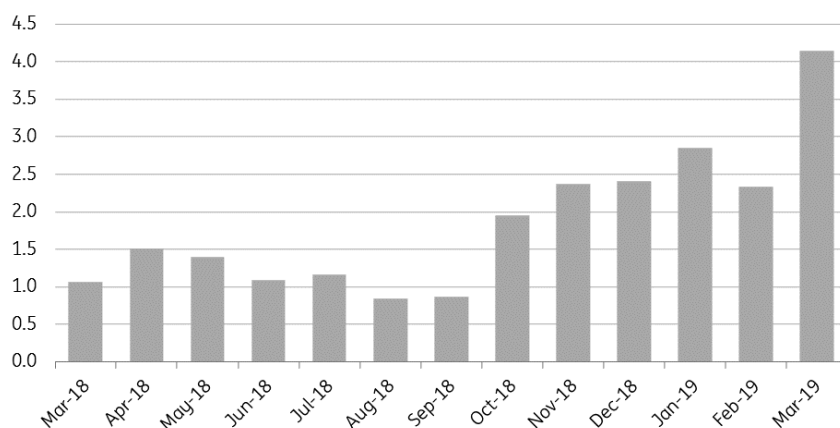
Source: Bloomberg, ING Research

LNG weighs on Europe

This additional LNG has weighed on the European gas market. Latest data from the EIA shows that US LNG exports in January increased 66% YoY to total 2.67mt, with 43% of this making its way to the EU. More recent Bloomberg tracking data shows that North West European import flows from all origins over March broke above 4m tonnes, a 289% increase YoY. At the same time, exports have been largely absent, with some flows in December but the bulk seen between May and September last year. Given that, in the short term, there seems little reason for this dynamic to change, LNG is likely to continue capping European gas prices.

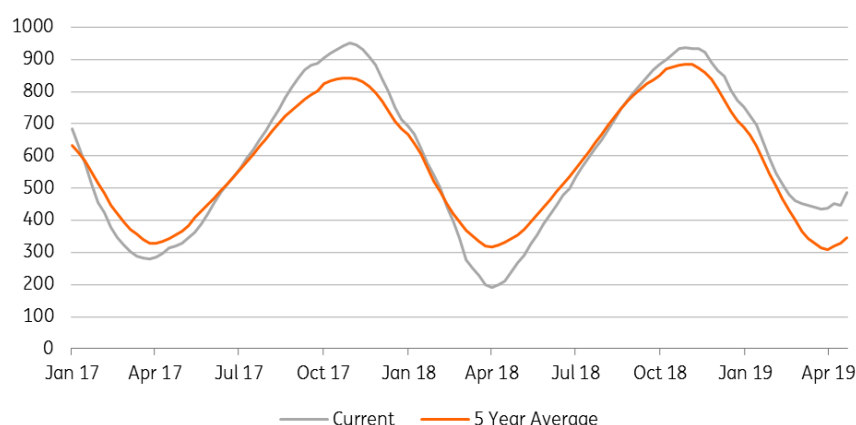
This has also meant that EU gas inventories have recovered significantly over the last year. In 2018 there were concerns over tightness in inventories, with stocks at a nine-year low ahead of the injection season, however they are now back at a five-year high for this time of year, and as a result, prices are unlikely to see much support from injection demand.

NW Europe LNG imports (m tonnes)



Source: Bloomberg, ING Research

EU gas inventories (TWh)



Source: GIE, Bloomberg, ING Research

Where will support for European gas come from?

Other than unplanned outages, it is difficult to pinpoint a catalyst which will push European natural gas prices higher. One factor which could offer some support though, is from the power generation sector.

EU carbon prices rallied to as high as EUR27.47/t over April, up almost 114% YoY, largely driven by the introduction of the Market Stability Reserve at the start of this year, which had the aim of taking excess allowances off the market. The strength in carbon prices along with the weakness in gas prices, has meant that clean spark spreads are more attractive than clean dark spreads in many parts of Europe, and could support a switch from coal to gas. This is also one of the factors behind the weakness in the European coal market.

The market is also likely to find support at levels where it starts not to make sense to ship US LNG to Europe. On a TTF basis, we calculate this level to be around EUR 13.60/MWh- levels which we briefly saw in early April.

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