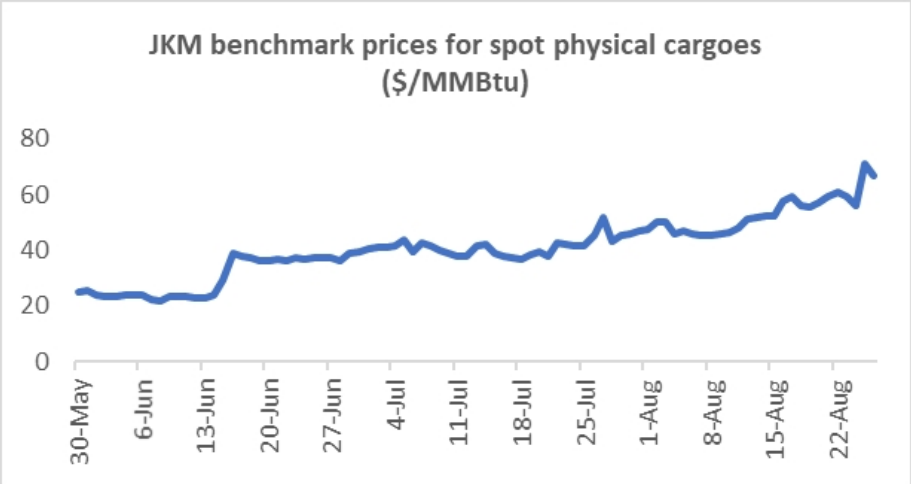
ASIA: Record high LNG prices threaten fragile post-pandemic recoveries

- Record high LNG prices have resulted in large cuts to LNG imports across Asia with varied impacts depending on spot market exposure, fuel-switching options, and economic responses.
- Countries in Southeast Asia tend to be the most exposed, whereas countries like India, China, Japan, or South Korea have more fuel-switching options or can pay higher prices.
- Responses have included switching to higher-emitting fuels and introducing fiscal incentives, all of which come with certain risks to energy transition targets and economic growth.

Among the many energy sector impacts of the Ukraine war, the Asian LNG market has recently seen marked changes. Asian buyers have switched roles with European counterparts, emerging as the new LNG market balancers following months of Russian pipeline gas supply cuts to Europe. Faced with soaring LNG prices, China's zero-Covid policy, and a slowdown in China's housing sector, regional LNG imports have fallen more than 7% year to date and are likely to remain subdued. The combination of high prices, fuel switching, and policy responses will threaten post-pandemic economic recovery, possibly trigger some LNG demand destruction, and test decarbonization commitments longer-term.

The current Asian LNG picture

Japan Korea Marker (JKM) benchmark spot prices for Asian LNG (see chart) largely have come down from post-Ukraine invasion highs in the $70-80 per million British thermal units (MMbtu) range. Nevertheless, they remain historically high and could test new records if Asian buyers return to the market this winter for significant additional LNG volumes. For now, signs point to prices settling at $40-50/MMBtu moving into early winter as regional buyers, led by China, seek alternatives. Some of the largest curtailments in LNG purchases have occurred in China, India, Pakistan, and Bangladesh, motivated by various factors given the diversity of issues across these energy markets and economies.



Source: Platts S&P Global

The economic impact for countries across the region depends on various factors:

- The exposure to the LNG spot market (highest in Southeast Asia, where buyers are price takers with limited switching options, while China and India have more alternatives)
- The ease of fuel switching (India, China, and options for Japan and South Korea too)
- The availability of financial resources or fiscal tools to manage the higher cost burden (subsidies, tax cuts, and other incentives across India, Japan, South Korea, and Indonesia, but not always with positive effects)

Complexities and politics of fuel-switching

Limited gas storage options in Asia have forced LNG buyers to seek alternative solutions. Industrial and power sectors in Asia tend to have more flexibility than residential users, but even risks to the former can increase in a protracted gas market crisis scenario.

Gas-to-coal switching has long been a cheap alternative in Northeast Asia, but record-high coal prices and policies supporting higher gas usage and domestic gas development mean that switching this year, particularly in China, will do little to reduce fuel bills. LNG in China is facing notable competition from new domestic coal and gas and significant gains in renewable capacity. Still, rising gas prices have not produced a major shift back towards coal as previously expected, and the pace of new coal plant approvals has slowed. With the increased availability of cheap regional sources of pipeline gas and Russian LNG (often resold at much higher prices), buyers will more definitively move away from the spot market.

Meanwhile, fuel oil, LPG, and domestic gas sources are offsetting some LNG usage in India as high prices threaten to delay LNG regas projects. Oil-fired power generation has seen a massive uptick across South Asia, although blackouts are becoming more problematic in certain markets, absent adequate demand-side solutions.

In Japan, concerns about supply security have motivated efforts to boost LNG storage, ramp up fuel oil imports, and bring mothballed thermal power plants back online in January ahead of peak winter heating demand. Seeking to balance supply stability against ambitious decarbonization commitments, Prime Minister Kishida is also pushing to increase the number of online nuclear reactors to 10 (from 5) by end-2022 and to 17 by 2023 and has opened the door to building next-generation reactors by the 2030s instead of phasing out nuclear power by 2040.

In South Korea, new conservative president Yoon also has reversed his liberal predecessor's promise to phase out nuclear and is promoting LNG infrastructure expansions to support smoother LNG procurement efforts. But utilities and heavy industry are straining under high gas prices and have turned to alternatives like LPG, while failing to curb coal use despite voluntary limits introduced last year.

Across Southeast Asia, plans to move away from coal mean that power demand growth will necessitate investments in additional capacity, largely fueled by gas and renewables. Declining domestic gas production in the Philippines and Thailand, the risk of disruption to Thailand's Myanmar supplies, and high generation needs in Vietnam and the Philippines are forcing consideration of a range of renewables and nuclear options, in addition to LNG, but none of these solutions is immediate.

A patchwork of policy responses

In many cases, fuel switching alone will not resolve problems arising from high commodity prices, high levels of energy import dependence, or even extreme weather, and additional economic policy measures are being introduced. But with projections showing a deceleration in growth and moves to tighten fiscal policy across the region, further options to support consumers are increasingly limited.

Japan narrowly avoided power cuts in the Tokyo region in spring and summer, but the latest forecasts anticipate power reserve levels this winter will surpass the 3% threshold for stable supply. Even so, utilities are incentivizing industrial

customers to reduce power usage; the possibility of a colder-than-average winter means a December cold snap would bring a high probability of power shortages.

India's government has tried to reduce petrol and diesel taxes to protect consumers. But increases in gas prices further complicate matters by pushing prices on other key domestic commodities; for example, high gas prices have raised prices for urea and potash, key inputs into fertilizer production, putting pressure on the fertilizer subsidy bill. The combination of higher commodity prices, geopolitical volatility, and outflows of FII are forcing interest rate hikes and creating a challenging policy environment.

In many instances, response measures have taken the form of subsidies. Japan is paying fuel subsidies to distributors to lower consumer gasoline prices at the pump, while South Korea is subsidizing diesel for commercial drivers of trucks and taxis. In Indonesia, ballooning fuel price subsidies have nearly tripled from original budget levels but also absorbed shocks of rising costs. Should the deficit threaten its fiscal credibility, the government may have to push some subsidy burden to the balance sheets of state enterprises, but with the promise of some relief in 2023. And with elections looming, Thailand may be unwilling to expose its consumers to energy price shocks, thus requiring an extension of electricity subsidies.

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