Report No 13. Oil and Gas in Asia 28/2/2022

The story for investors

This report sets the background of oil and gas markets in Asia against global developments including Ukraine. Further reports will focus on individual Asian countries and China in particular. Asia is a big market for oil and LNG, but it also contains several oil producers/exporters including China. But on a net basis, Asia is a major importer. The current crisis, meaning rising oil and LNG prices, has significant consequences for Asia in terms of weakening trade balances and, possibly, of GDP growth but also through its impact on CPI inflation and on climate policies. The rising trend in oil and LNG prices may last longer, given the combination of secular shortages as the world shifts away from fossil fuels. This has led to less investment in fossil fuel but also substitution effects, such as the shift from coal to LNG in electricity production.

Investment conclusions

The conditions in the energy markets facing Asia till at least the end of 2022 will be characterized by higher and even rising prices for oil, LNG and possibly coal, propelled by conditions predating the Ukraine invasion and, hence, aggravated by it. The macro impact on individual countries will be differentiated depending on energy import dependency, which varies widely, with similar conclusions holding for the impact of the price rises on inflation. Climate policy conflicts will develop with coal maintaining its cost advantage to LNG, but with solar, wind and hydro keeping their climate importance. Asian oil corporates may face differentiated impacts given also the widespread state control of Asian oil companies.

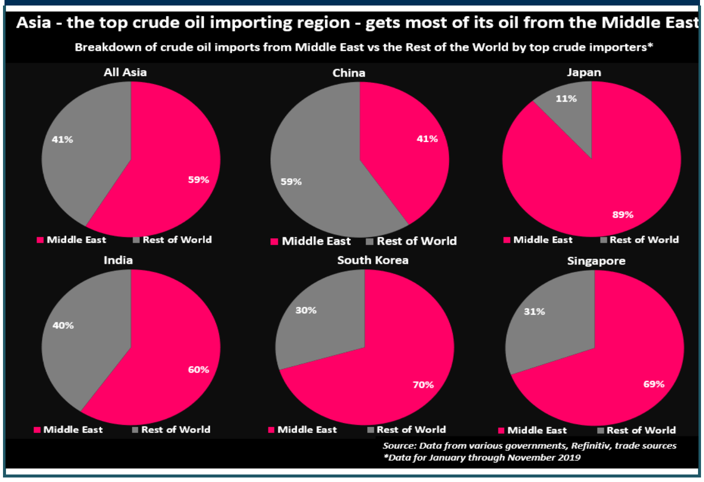
Oil and LNG in Asia: the markets

Starting with **oil.** Asia accounted for about 8.5% of global oil output in 2020 but it consumes about 38.0% of world's output, led by China's consumption. **China** is a leading producer in the region pumping 5.0 ml barrels per day, compared, however, to Saudi Arabia's current 9.75 ml. **India** follows a distant second producer with about 0.77 ml but a big net importer, being the third largest consumer of oil in the world after the US and China. **Indonesia, Malaysia and Thailand** bring up the rear with, respectively, 0.74 ml, 0.59 ml and 0.41 ml barrels daily output each. However the important quantity here is **consumption of oil** which, in order of magnitude in 2020, the US led the world with 17.1 ml barrels daily, China 14.2 ml and India with 4.5 ml with S.Korea at the 7th and Singapore at the 12th positions with 2.5 ml and 1.3ml barrels daily respectively. Singapore is a special case because of its distillery and petrochemical sectors which account for its large consumption. **The source of imports** varied significantly. As Fig. 2 shows, the Middle East dominated, except in the case of China. The reason why this information is important is that diversified sources make these countries less subject to geopolitical pressures and risks, such as the current situation with the disruption of oil (and LNG) supplies from Russia given its invasion of the Ukraine. **The case of LNG** is more complex as the demand for gas has now accelerated because of its substitution for coal in the production of electricity despite the fact that, as a fossil fuel, it has high CO^2 emissions but less than those of coal. In Asia the **major importers** on LNG are Japan and China (See Fig. 2).

In sum

China is among the top four LNG buyers from the U.S for every year since exports began in 2014 but in 2019, the biggest sources of its imports were **Australia, Qatar, Malaysia, and Indonesia** **Asia, led by China and followed by India and S.Korea are important oil and LNG markets and will continue to stay so given their climate policies and economic growth.**

Fig 1: Asia, sources of oil imports, 2019 (Reuters)



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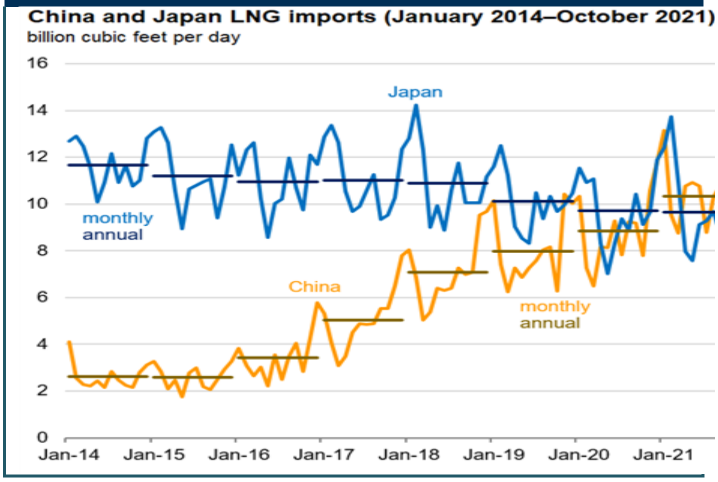
The complex analytics of the Asian oil and gas interplays

First, as the Factbox shows, the prices of all the main sources of energy have been rising. After the volatility in 2021, **oil prices** have been rising partially propelled by OPEC's supply policies. The Ukraine invasion may have an indeterminate impact on oil. If Russian oil is banned, and the ban is effective, oil prices may rise because Russia ranks between 3rd and 4th largest oil producer. But if black markets develop for Russian oil, prices could come down. **Second**, similar considerations may apply to LNG where Russia has been ranked globally as the second or third larger producer and fourth larger exporter (2020 Statista, EIA). Significantly, and perhaps very cynically, the sanctions imposed so far on Russia, exempted the **supplies of LNG** and the pause on the Nord 2 will not affect supplies, as it is not open yet. The EU was most careful over this issue as to avoid hikes in its own energy costs.

FactBox: Prices of Oil (red), LNG (green) and Coal (black)

There is also the complex issue of the different prices of LNG itself which is not captured in graphs such as in the Factbox .A high percent of LNG prices, but not all, are set off the back of oil prices, and differentials exist in some regional prices. But prices have gone up. **Third**, **Coal prices** will continue to reflect healthy demand for power production, especially from China, and fall- back positions on fears of disruption in LNG supplies. The rise in the prices of LNG, before the Ukraine invasion, reflected a complex interplay of supply constraints, cold weather, low inventories and rising demand from climate considerations. **Fourth**, **and in sum,** Asian importers of oil, LNG and coal will likely face higher and possibly rising prices for the rest of 2022.

Fig 2: China and Japan: Imports of LNG 2014-21 (EIA)



Consequences for Asia continued

Specific impacts on Asia: Inflation and growth. Higher oil prices have a differentiated impact on Asian economies, more so for Asian oil producers where the negative impact of higher oil prices on CPI is partially counterbalanced by the positive effect on GDP as oil exports benefit. But Asia's net import position leads to an overall negative effect. Government policies, however, matter. S.Korea introduced temporary tax cuts on auto fuels in 2021. Indian subsidy policies are far more complex, however. Fuel price subsidies have been coming down for several years now while prices of LNG and kerosene are politically sensitive as poor households can use these fuels for cooking. In the case of India, these subsidies may rise, especially in a year of elections. **Climate policies.** We have indicated that higher LNG prices may affect power-generating policies by favoring coal use, despite the rise in the price of coal.Climate-wise this trend could be positive for green energy producers, solar, wind and hydro. **Corporates**. These price trends will be broadly beneficial for Asian oil companies. The following is by no means an definitive list: Sinopec, China National Petroleum, China National Offshore Oil, Eneos, SK Holdings, Petronas, PTT, Indian Oil, Pertamina and Reliance. Most of these are state owned or controlled and, of course, have specific and individual characteristics and policies.

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