Entering the Next Phase in the U.S.-China Trade War
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Data Sources Used in This Publication
EIA
U.S. Department of Energy
PointLogic

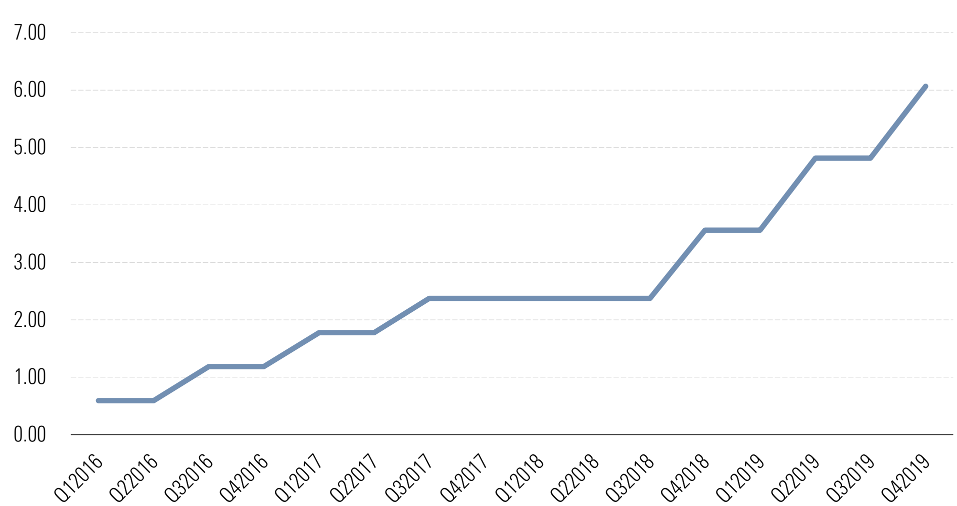
Escalating Trade War

When President Trump and President Xi met on the sidelines of the G20 Buenos Aires summit in December 2018, the fear of trade tensions between the United States and China took a brief reprieve. The two leaders agreed to suspend the implementation of new tariffs and to begin negotiations. Since December, the U.S. and China negotiated what was expected to be a new trading framework between the number one and number two global economies, but negotiations recently hit an impasse. Just last week, the United States increased tariffs from 10% to 25% on $200 billion of Chinese goods, and the Chinese have done the same on $60 billion of U.S. imports, escalating a trade war that will certainly affect U.S. exporters. This note will look at the impact to U.S. LNG in the face of this ever-escalating trade war.

LNG Capacity Growth

The U.S. Gulf currently has three operating LNG terminals with a combined capacity of 3.5 Bcf/d. By the end of 2019, expansions and new facilities will add another 2.5 Bcf/d bringing total export capacity to 6.0 Bcf/d (Exhibit 1). U.S. LNG is finding markets across the world, but Asia remains the nation's top buyer. Over the last three years, Asia accounted for 41% of U.S. originated shipments, with Europe/Central Asia in a distant second at 17%.

Exhibit 1 Gulf LNG Export Capacity (Bcf/d)



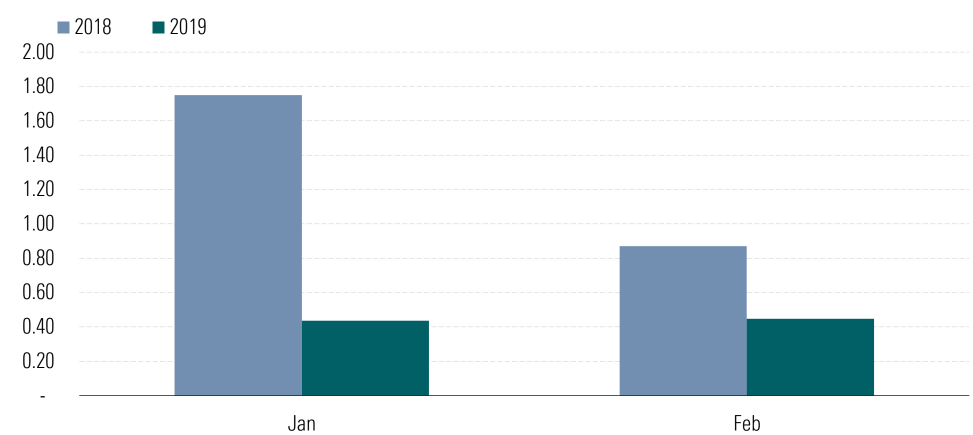
Source: EIA, Morningstar

The data highlights the prominence Asian buyers have, and will continue to have, in driving global demand for LNG and in turn the future of U.S. export projects. Asian buyers from Japan, South Korea, and China have been courted by export terminal operators looking to secure long-term contracts, a requirement to receive final investment decisions (FID). While American counterparties have been courting Chinese partners, the contentious environment has made the task more difficult and riskier. As the U.S. ramps up its export capabilities, trying to take advantage of low-cost domestic natural gas production, an escalating trade war with the future number one buyer of LNG only complicates the picture for U.S. companies looking to expand.

Falling Exports to China

Data from the Department of Energy through February 2019 show U.S. LNG exports to China down significantly from last year. January and February exports were down 75% and 49%, respectively (Exhibit 2). According to Reuters, March and April 2019 have also seen zero vessels going to China from the U.S. China was the second largest importer of LNG in 2018, and demand for the fuel is expected to grow in 2019. First-quarter 2019 saw LNG imports increase 21% year over year in China, while U.S. exports to China collapsed. The Chinese state continues to convert coal consumption to natural gas, creating long-term opportunities for exporters of LNG, but the fall in U.S. exports shows they are casualties of the administration's trade war.

Exhibit 2 U.S. Exports to China (MTPA)



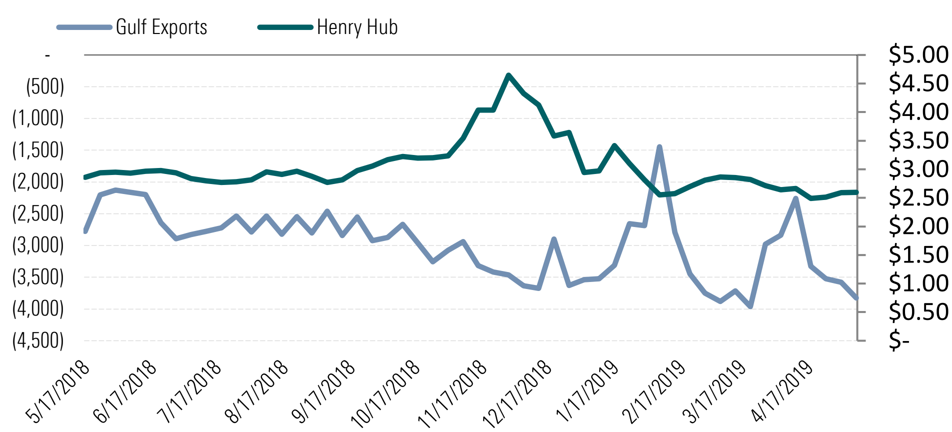
Source: Department of Energy

In response to the Trump administration's escalation of tariffs on Chinese imports last week, China announced its intent to further increase the tariff on U.S. LNG from 10% to 25%, starting June 1. The additional tariff will put U.S. exporters at a greater disadvantage, pushing Chinese buyers further away. One silver lining for the operating portfolio of LNG terminals is that Chinese companies have not jumped into the deep end of investing in long-term contracts with U.S. counterparties, which may insulate U.S. producers in the short term. It is clear that any growth story for U.S. LNG cannot be written without China. What is uncertain, is whether the current environment is the beginning of a long-term trend or a blip in the timeline in what would otherwise be a bullish story for U.S. natural gas.

Impact on Henry Hub Prices

Demand for LNG; however, still represents a very small part of the overall U.S. natural gas market. At roughly 4.0 Bcf/d of exports, LNG represents about 5% of demand. Even though LNG's share is small, significant changes can create short-term volatility. When natural gas flows to Sabine Pass fell in February and April causing exports to decline, the NYMEX spot month contract also moved down. Shortly after exports decreased in early February, the spot month Henry Hub contract also fell $0.30/mmBtu as the molecules meant for the seaborne market were forced back into the domestic market (Exhibit 3). This relationship shows that LNG's impact on Henry Hub prices is more likely to be driven by operational changes in the supply chain than any changes to U.S. trade policy, at least until export capacity grows significantly—which is years away. The fact that most facilities have not placed vessels into China this year means the current price impact should be minimal as the two countries continue negotiations.

Exhibit 3 Gulf Export Flows (MMcf/d) and Spot Month Henry Hub ($/mmBtu)



Source: PointLogic, ICE

Conclusion

The escalating trade war between the United States and China should have little short-term effect on natural gas prices. The impact will be felt in the pace of LNG projects without final investment decisions. While negotiations are ongoing, when and how this dispute ends remains a huge question, putting additional uncertainty into the market. With the U.S. continuing to ramp up capacity, reduced access to the largest potential importer of LNG puts companies looking for final investment decisions in a holding pattern, delaying projects from coming online. While the escalating trade war is not likely to impact natural gas prices in the short term, delays in resolving the trade challenges between the United States and China will surely limit the ability to expand the demand for U.S. natural gas.

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