The Global Energy Scene - Gas and Energy Transition

IENE, Athens

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Dr Charles Ellinas – Senior Fellow Atlantic Council - CEO eCNHC

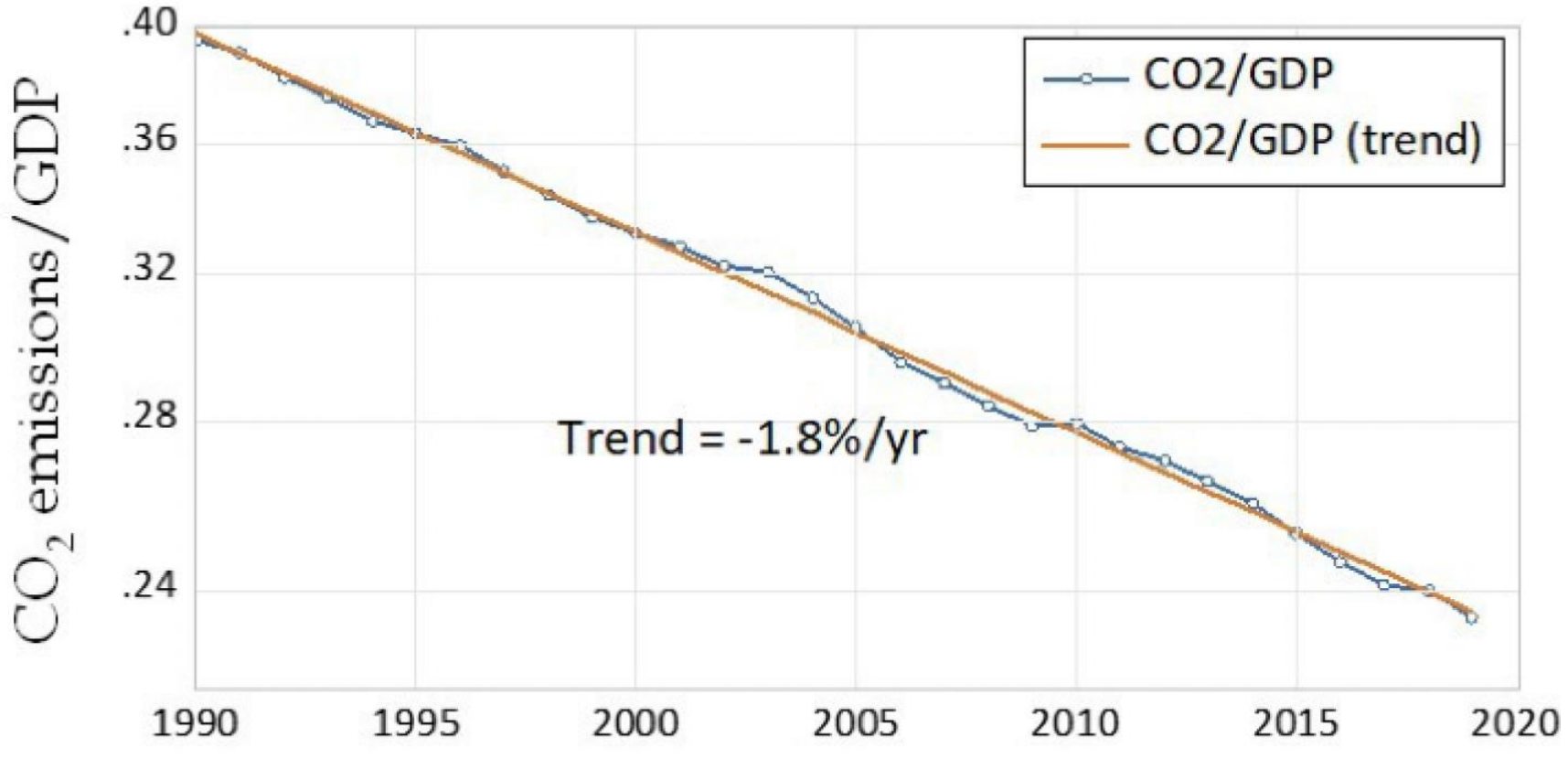
Introduction

- What I will be presenting comes from two key events last month. COP26 in Glasgow and FLAME, Europe's biggest natural gas/LNG conference in Amsterdam – which I attended
- These events covered the latest developments both in terms of climate change and energy developments
- I will delve into the outcomes of both events in as far as they relate to today's conference

Climate change

- Energy transition is unstoppable, particularly in Europe. Despite the current energy crisis, calls for faster energy transition during COP26, including calls for more drastic action, are intensifying
- For the first time, COP26 referenced directly fossil fuels, opening the way to limit their use in future COPs, introducing uncertainty and short-termism, affecting longer-term investments in oil&gas
- But increasing renewables and reducing gas for flexible power generation will lead to increased price volatility, as clean energy technology has not yet scaled-up to replace gas. Something we are experiencing in Europe
- Politicians need to be honest about the cost implications of dealing with climate change. Their actions are making energy transition a costly and volatile process. But the rate of decarbonization has remained unchanged
- Uncertainties and regulatory risk discourage investment. Industry needs clarity and stability to invest

Rate of decarbonisation 1990-2019



Despite many COP agreements,
the rate of decarbonization has remained unchanged

Impact

- Governments and activists become too hanged-up on net-zero and forget about how to get there in an orderly, reliable and affordable manner - practicalities and social impact of climate change matter
- Consumers are price-sensitive and will react if prices stay high. It is essential to do cost-benefit analysis of each and every solution, otherwise it could backfire
- Security of energy supply does not come automatically. As we go further and further into renewables, intermittency will become more challenging until new technology becomes available to address it. Something that may take time
- In response to the energy crisis and COP26 we need the East Med energy market to be reformed and the right regulatory framework to deal with it. Clear policy and regulations are essential

Some sobering thoughts

- The often-repeated statement that ‘renewables is good – gas is bad' is too simplistic. Intermittency challenges this
- The claim by politicians that “decarbonisation will not be costly” is turning out to be nonsense. It is facing intermittency and the costs to deal with it
- We need a transition that deals with security of energy supplies and decarbonisation simultaneously and in a balanced way – this is an inconvenient truth for activists who pick on the first but ignore the second
- Producers of fossil fuels reduced production last year due to Covid-19 and are holding back now leveraging their advantage for higher prices
- Any claim that they were unprepared for the rapid economic recovery this year or that there are insufficient reserves does not stuck-up

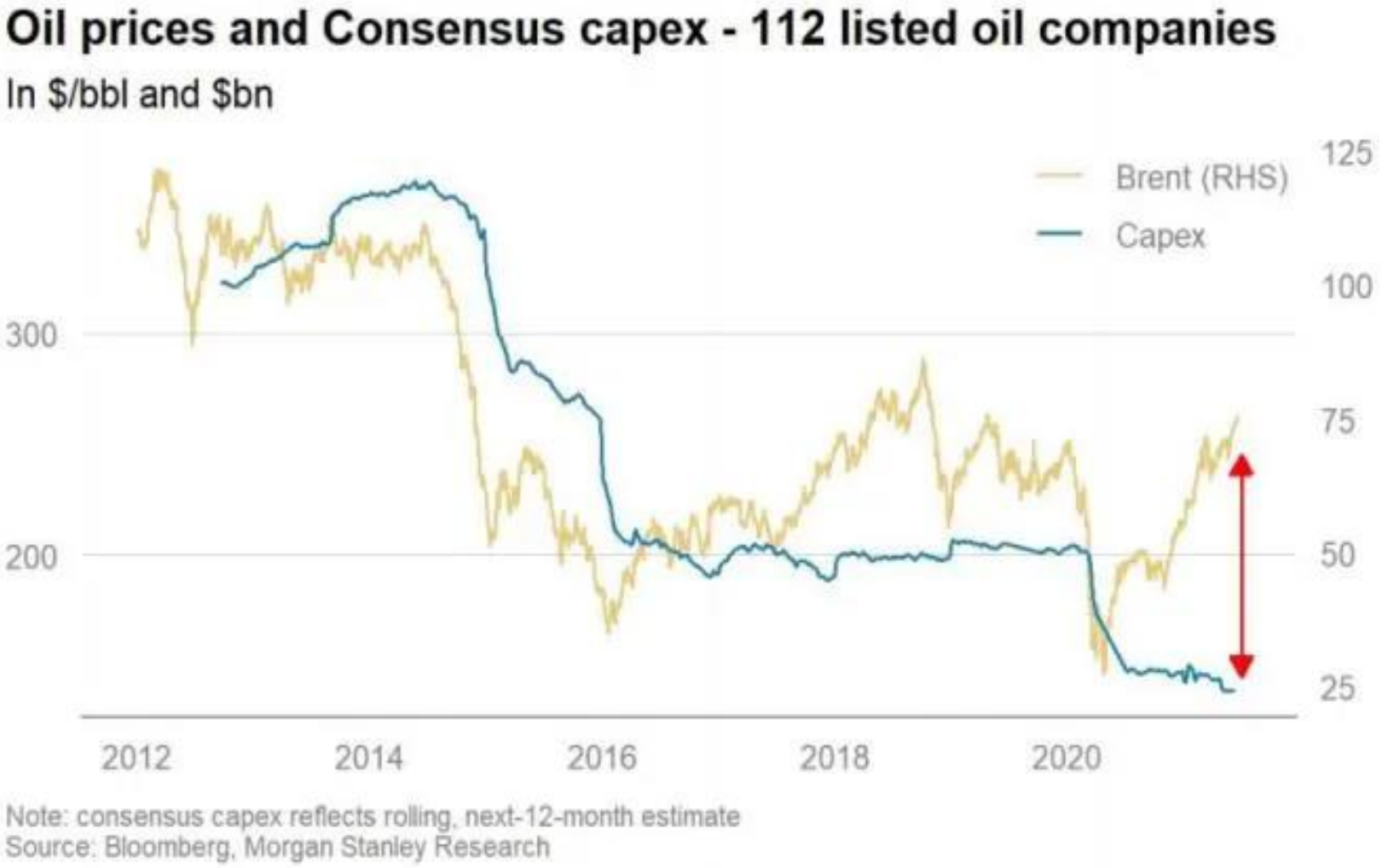
What does this mean for oil&gas

- Gas is important for energy security, supporting orderly energy transition, until renewable generation scales-up and hydrogen is ready to play a serious role. But the gas industry must move fast to low-carbon and eliminate methane leakage
- A word of caution: batteries are playing an increasingly important role in dealing with intermittency and as capacities increase inevitably they limit the role of gas as back-up
- There is a lot of pressure on international oil companies to curtail investment in new oil&gas, coming from investors, environmental and climate activists and governments – NOCs ready to step-in
- The IEA supports this, saying that current oil&gas investment is now broadly in line with net-zero requirements and does not expect the level of future investment to change significantly

More on oil&gas

- Indeed, majors, including ExxonMobil and Chevron, are not planning any significant increase in capital spending in the foreseeable future, beyond the current massively reduced levels – down by 60%-70% compared to the highs of 2014 – that must also include spending on low-carbon projects
- In fact ExxonMobil is considering abandoning some of its biggest future oil&gas projects. This does not bode well for the East Med.
- IEA said that available oil&gas reserves are sufficient to cater for future demand as this adjusts in response to pledges made at COP26 – the world does not need more oil&gas exploration. But existing discoveries still need to be developed to cater for depletion
- European majors are influenced by their investors who are pushing them further towards clean energy and net-zero by 2050. US majors rely heavily on external finance and are under increasing pressure to decarbonise while maintaining high dividends

Listed oil company capex 2012-2021



Gas demand, production and trading

- Gas buyers and consumers were traumatised by high prices last winter and they see a repetition now, but worse. This is not helping gas. It encourages users to look for alternatives and accelerates the drive for energy efficiency
- With the world needing even more energy, this winter oil&gas producers are in a strong position and are leveraging this to keep prices high
- But high gas prices in Europe should drop down to normal levels by spring, especially once Gazprom deliveries increase further with NS2
- With investments in doubt, this unsettled energy situation will continue as transition progresses, leading to increased volatility
- Green hydrogen, bioLNG and other green technology will have to become price-competitive against other fuels if they are to gain energy market share. That will take time
- The expectation is that most future natural gas demand will be in Asia, displacing coal and enabling renewables

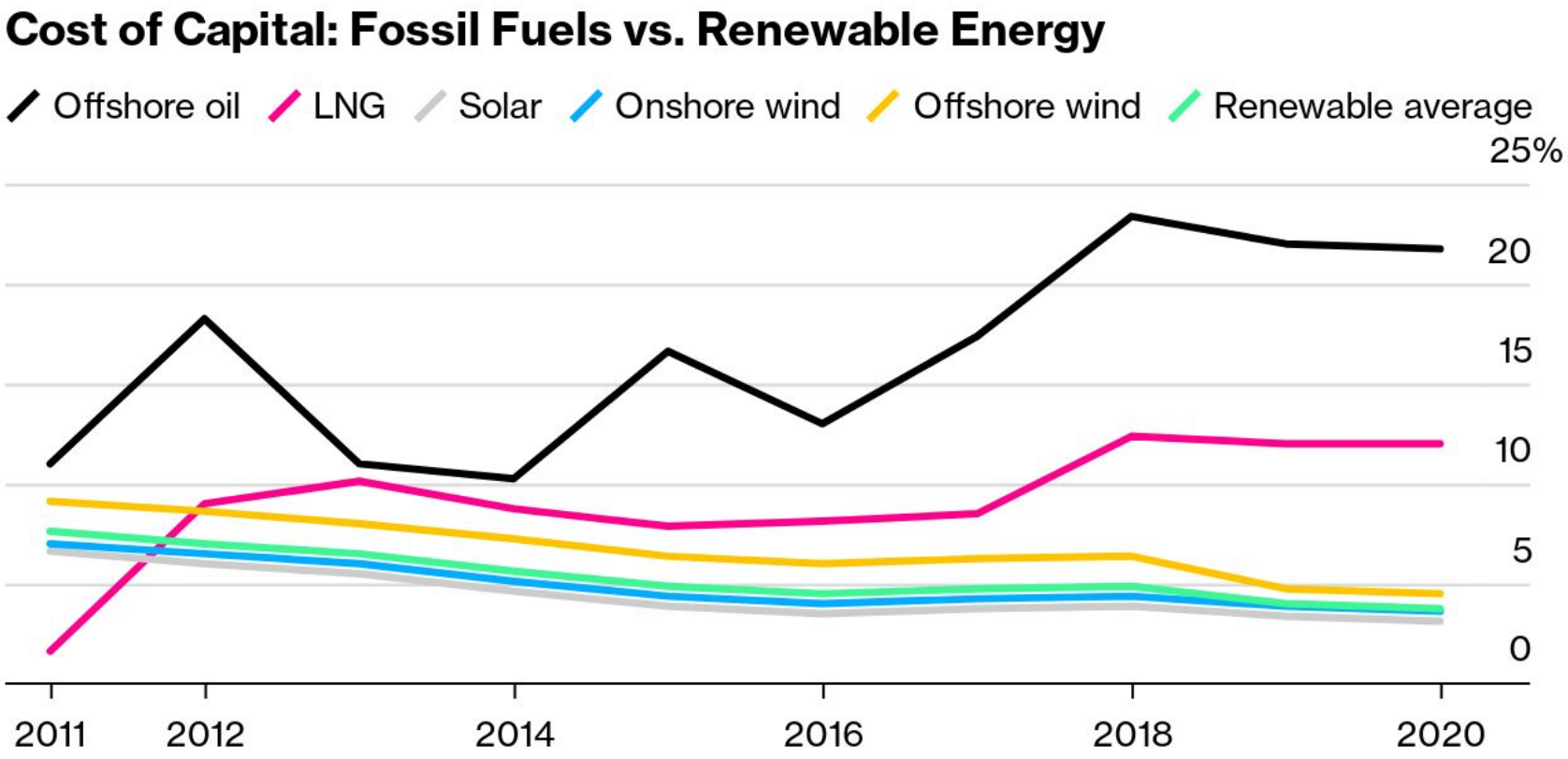
The Russian factor

- Russia sees its gas exports growing in the future but mostly to Asia in the form of LNG – about 150mtpa is being planned. Not planning any new pipelines, except to China
- Combined with Qatar's plans, new LNG from the two – the cheapest in the world – is likely to capture any new markets
- Gazprom said that it has met its contractual obligations in Europe in full, and that in fact from January to October supplies to its European partners actually increased by more than 13%
- It stressed that it prefers long-term gas contracts and warned against hub indexation and short-term trading. Not interested in record low or record high gas prices and prefers a balanced and predictable market that only long-term contracts can provide. It needs this to justify and support its long-term investment plans

Investment climate

- Financing new oil&gas is becoming increasingly difficult as climate change pressure on fossil fuels grows. The cost of capital is up
- Goldman Sachs says that this year will be the first time in history that renewable power will be the largest area of energy investment
- Natural gas has a role in energy transition, particularly in Asia, displacing coal and enabling renewables
- But price volatility, finance becoming more challenging and uncertainty about the future, make investment decisions that much more difficult, affecting longer-term investments in oil&gas
- Warning: prematurely choking off oil&gas investment can trigger future shocks. May lead to re-think
- Gas has a future, but the industry must develop a convincing narrative around its value in a decarbonizing energy system

Cost of capital



Source: Goldman Sachs
Note: Figures for 2020 are estimates.

Bloomberg

Impact on East Med

- New natural gas developments and exports to global markets have not progressed in the East Med mostly because of economic and market conditions
- East Med gas does not have the volumes needed to make a difference – only about 2% of global reserves. It is expensive to develop and cannot complete in global markets
- There are regional geopolitical challenges, disagreements on EEZs and historical enmities and rivalries. But in my experience, when a project is commercially viable and profitable, eventually ways are found to develop it
- Once the pandemic and the energy crisis are over, the well-known challenges that development of East Med gas has been facing will re-surface

East Med energy – a change of direction?

- Drilling for hydrocarbons offshore Cyprus is about to restart. ExxonMobil will start drilling an appraisal well in block 10 this month. But are we heading for another crisis?
- First, Cyprus must act according to its contractual obligations to the oil companies (IOCs) and vice-versa.
- But, as I explained, IOC interests have now changed and are even less likely to proceed with development of East Med gas, unless the global markets undergo a major change and prices stay high for the longer-term – which is not likely
- Completion of appraisal drilling by ExxonMobil end of year, and other contractual obligations, may be followed by a long period of inactivity
- Is it time for a change in direction?

New long-term strategy needed

- The IOCs are interested in immediate, easy and high returns - not long-term performance. Something that is a challenge for the East Med. And so are exports to global markets
- East Med must review the strategy for exploration and development of hydrocarbons, taking into account the latest global energy developments - in line with the outcome of COP26 and EU's Fit-for-55, but also net-zero by 2050 - including the inexorable and rapid shift from fossil fuels to clean energy, especially given the outcome of COP26
- The future is renewables, with natural gas discoveries made so far in the East Med to be used regionally as back-up to expanding renewables. The region should aim for 50% renewable electricity by 2030. Pressure to do just that will intensify at COP27 in Cairo next year