The Energy Security dimension in SE Europe and the role of gas

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I would like to start my argument using Italy's recently published Energy Strategy to 2030 and then link it to the East Med.

One of the key goals in Italy's Energy Strategy is to improve energy security.

Italy is the third largest gas consumer in the EU, consuming 64.5 bcm gas in 2016, and with further growth in demand expected in the future as coal plants are closed and power demand increases.

Long term gas supply contracts with Russia, Algeria, Netherlands and Norway are all considered to have limitations and security of supply risks. These are up for renewal between 2018 and 2026. Russia is the dominant supplier, Algeria has problems, Netherlands and Norway are expected to reduce future gas exports due to declining domestic production.

There is a need for sufficient diversification of supply in case some of these contracts are not

renewed or there is a shortfall. As a result, Italy is looking for alternative gas supplies.

One such new source is gas from Azerbaijan through the TAP pipeline, expected to be providing 8.8 bcm/yr by 2020, meeting 13% of Italian gas demand.

In addition, Eni has the option to import more gas from Libya, but also LNG from Egypt as the country resumes gas exports after 2020. Zohr has been granted a quota for export once the Egyptian domestic gas demand is satisfied. But neither is certain.

Eni and Edison are also in discussions with Gazprom about the possibility of importing gas from a southern route, as an extension of Turk Stream. But this still has a number of hurdles to overcome.

Another option is the EastMed pipeline, but this faces major commercial challenges.

Italy’s Economic Development Minister Calenda is also concerned that as a result of rising gas demand in Asia and Africa in the coming years, there could be a supply risk for Italy, where gas demand is forecast to increase.

In order to counteract these potential security of supply risks, Italy's Energy Strategy has identified the need to create a 'liquidity corridor' through Switzerland to facilitate more competitive gas supply from north European markets towards Italy. It also proposes installation of an additional FSRU to facilitate LNG imports to boost Italy's security of supply and flexibility, and in the process exploit the opportunity of low prices due to an oversupply in the global LNG market until mid-2020s.

But lets look at the East Med gas import options. In April Minister Calenda took part in the Isrsel-Cyprus-Greece meeting in Jerusalem to confirm Italy's interest in the EastMed pipeline project.

This is considered to be a strategic project for exporting East Med gas, and in particular Israeli gas. The aim is to create a direct gas export route from the region to Europe, through Greece and Italy, by 2025.

However, even though the project is feasible, the pipeline can become commercially viable only if the price of gas in Europe rises substantially above current levels, to $7-$8 per million BTU. Given that last year the average price was $4.7 per million BTU, and this year are

only just higher, and with long-term forecasts predicting $5.50 per million BTU in Europe, such prices cannot support this project. The long-term price forecast for SE Asia is $7.50 per million BTU. I will cover gas prices further in my presentation tomorrow.

In fact, gas exports from Israel and Cyprus to Europe are unlikely, challenged by these long-term low gas prices.

It is not surprising then that Italy's Energy Strategy makes strong commitments on renewables. Renewables now provide 17.5% of Italy's power, already exceeding its 2020 target of 17%.

Minister Calenda said that the new target is to achieve 27% of primary energy consumption from renewable sources by 2030. This is identical to the target set by the European Commission in its November 2016 Winter Package. Going further, the 2030 target requires 48% to 50% of electricity production to be provided through renewable sources. Italy is also committing to a 33% reduction is carbon emission levels in comparison to 2005.

If Italy achieves these targets its needs for gas will be substantially reduced. And this is also the

trend in the rest of Europe. Renewables penetration is relentless and is changing Europe's energy mix and markets, with gas finding it difficult to make an impact. Without a doubt it will never be 'business as usual' ever again.

And this is at a time when there is a deluge of LNG supplies globally and more are coming. In addition, with Qatar lifting its moratorium on new production and with the US approving many new LNG export projects, future LNG supplies will increase dramatically, keeping prices down. So far these low prices and the flexibility offered by FSRUs have helped attract new demand.

The US Energy Information Administration (EIA) forecasts that US LNG exports could increase to over 100 bcm/yr by 2025 and further after that, based on committed projects.

But there is more to come. President Trump has just announced his new American energy dominance policy. As a part of that many new LNG projects are receiving approval for exports, which so far total 220 bcm/yr.

The driver behind these is the need to find markets for associated shale gas so as not to slow down shale oil production. The North

American gas market, domestic electricity production and industrial use are not expected to grow fast enough to absorb this gas. As a result the focus is shifting towards LNG exports. Given that production costs are mostly recovered from oil, associated gas prices could go down very low, making US LNG exports quite competitive.

But unleashing large quantities of cheap US LNG on the rest of the world could have a dramatic impact on re-shaping markets and keeping prices low. They are leading to a shift towards more flexible trading, shorter and smaller contracts and increased spot trading.

Increasingly, US LNG has the potential to have a similar effect on global gas supplies and prices as US shale is doing to oil.

Those in the East Med aspiring to export LNG to Asia will need to be able to compete on price in these new markets. It is becoming very challenging.

Dr Charles Ellinas, @CharlesEllinas
CEO eCNHC
Nonresident Senior Fellow
Eurasian Energy Futures Initiative
Atlantic Council

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