Insight

LNG Exports and the Trade Deal

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Executive Summary

- The "Phase One" U.S.-China trade deal requires China to purchase over $50 billion in U.S. energy resources, including liquid natural gas (LNG).
- Despite this trade deal with China, U.S. LNG exports continue to be subject to Chinese tariffs, depressing demand and making it unlikely that China will purchase the agreed-upon amount of U.S. energy.
- The administration's lack of follow-on negotiations suggests that U.S. LNG will continue to be at a disadvantage, despite China's potential as a market for U.S. LNG.

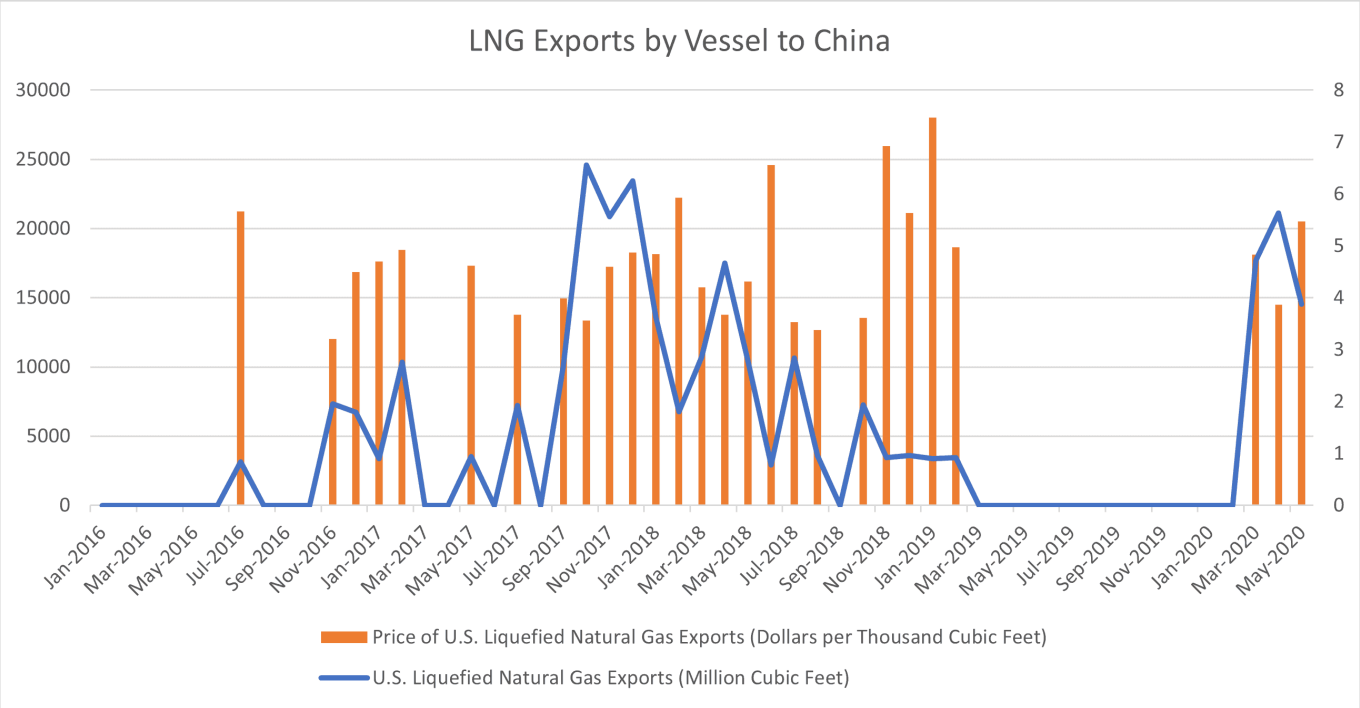
Introduction

Throughout the past five years, six liquefied natural gas (LNG) export terminals—facilities located along coastlines capable of condensing natural gas into a liquid that can be shipped—have gone into service in the United States and another 15 have been approved by regulators.[1] These companies arose in response to the cheap and plentiful supply of natural gas produced domestically that could be sold abroad.

In 2018, following President Trump's decision to impose tariffs on goods imported from China, China retaliated by placing tariffs on U.S. products, including LNG.[2] This LNG tariff increased from 10 percent to 25 percent in 2019 as the trade war continued. Since then, the two sides came to a "Phase One" trade deal and China has agreed to buy an additional $52.4 billion worth of energy resources, including LNG. The LNG tariff, however, remains in place and has increased the price of U.S. gas, restricting Chinese purchases.[3] The tariff, in combination with the deal's terms and market conditions, suggests that the trade deal won't result in the promised large-scale increase in Chinese consumption of LNG.

LNG Trade

The first U.S. export of LNG to China was in May 2011.[4] After that month, however, several years passed with no more exports, but in 2016 shipments resumed. In 2017, U.S. producers delivered 103,410 million cubic feet (Mcf) to China, representing 14.6 percent of U.S. LNG exports. In 2018, exports to China declined, totaling 90,473 Mcf, 8.5 percent[4] of total U.S. LNG exports. This drop was followed by only a couple months of shipments in 2019, as the chart below shows. [5]



Source: Energy Information Administration

Meanwhile, exports to Europe and Asia increased. Japan imported 11,137 Mcf in 2015 and 201,085 Mcf in 2019, a 1,706 percent increase. In the same period, South Korea (now the largest importer of U.S. LNG) saw similar increases. Consequently, U.S. LNG exports have steadily increased, despite major fluctuations in trade with China from 2016 to 2019,[6] and the United States saw a nearly 65 increase in 2019 when compared to the previous year.[7]

In 2019, Chinese LNG import growth continued but at a slower rate than in[8] According to the International Group of Liquefied Natural Gas Importers, China is the world's second largest importer of LNG. China predominantly relies on Australia and Qatar for imports.

The declining U.S. exports to China despite growing demand can, in part, be explained by the retaliatory tariffs placed on U.S. goods such as LNG. Chinese tariffs on U.S. LNG increase prices for Chinese buyers and as a result, give other sellers an advantage. In

September 2018, China imposed a 10 percent tariff, which reduced exports to nearly zero for two months before the market rebounded. In 2019, China raised the tariff to 25 percent, leading shipments to cease for about a year from March 2019 through February 2020, as depicted above. In short, the Chinese market has not been the driving force behind the expansion of LNG, but as the second highest consumer of LNG, it does serve as a growth opportunity.

Phase One Trade Deal

The trade deal was signed in January 2020 and includes a two-year term, characterized as "Phase One." The deal includes annual goals for the purchase of energy resources, including LNG, crude oil, coal, and refined products, with the goals defined by total spend rather than the quantity of each resource purchased. Within the first year of the deal, China is to spend $18.5 billion on a combination of these resources. In the second year, China is to spend $33.9 billion, totaling $52.4 billion of energy resources throughout the term of the deal.[9]

Despite a forecasted increase in Chinese demand over the next two years of about 15 to 25 million tons a year, the Chinese are unlikely to meet the terms of Phase One. In 2018, prior to entering into the deal, China bought a total of $8.2 billion[10] of these specific goods from the United States, of which $400 million was used to purchase LNG. As a result, the deal's terms were ambitious from the outset, requiring China to increase its purchases by 413 percent over two years.[11] During the first half of 2020, China purchased $1.29 billion of energy resources under the trade deal, or 5 percent of the agreed value,[12] with $246 million comprised of LNG. In the third quarter, China made additional purchases and has since fulfilled only 14.5 percent of the quota for year one.

A key issue with the Phase One deal is China's continued imposition of tariffs. President Trump declared that the tariffs would be removed under Phase Two, but further negotiations are unlikely at this point. [13][14] With the tariffs still in place, U.S. LNG producers continue to face loss of direct sales to China because of loopholes in the form of portfolio buyers and the spot market. A sizeable portion of U.S. LNG is purchased by portfolio buyers, [15] companies with multiple sources of supply and multiple customers, who act as intermediaries. These portfolio buyers can swap out U.S.-origin cargoes for non-U.S. cargoes when selling to Chinese buyers. Then there is the spot market, which allows for purchase and immediate delivery through a short-term contract that reflects commodity values in real time, unlike long-term contracts with a U.S. LNG producer.[16] China's largest private importer, ENN Energy Holdings Ltd., indicated that it intends to increase spot purchases for the remainder of 2020 rather than entering into long-term supply contracts.[17]

These transactions allow for the continued purchase of U.S. LNG by non-Chinese firms and the continued purchase of LNG by Chinese firms without incurring the tariff. Thus, the trade deal appears to do little in the way of securing purchases of U.S. LNG.[18]

Conclusion

In response to U.S. tariffs, China imposed tariffs of its own on U.S. products, including LNG. These tariffs appear to have depressed demand for LNG within one of the largest growing markets for LNG in the world. While the U.S.-China Phase One trade deal mandates purchases of U.S. energy resources, it is unlikely that China will reach the agreed level of imports, indicating that the trade deal has not been effective at securing purchases of U.S. LNG.

[1] https://www.energy.gov/fe/downloads/lng-monthly-2020, https://www.ferc.gov/sites/default/files/2020-06/lng-approved-export-new-052920.pdf

[2] Reuters

[3] Reuters

[4] EIA

[5] https://www.forbes.com/sites/judeclemente/2020/01/26/us-lng-exports-reach-third-place-in-2019-with-much-more-coming/#8bea82b5049e

[6] EIA Total LNG Exports

[7] https://www.forbes.com/sites/judeclemente/2020/01/26/us-lng-exports-reach-third-place-in-2019-with-much-more-coming/#8bea82b5049e

[8] https://www.naturalgasintel.com/as-chinese-lng-imports-increase-u-s-gains-market-share/

[9] Phase One Trade Deal

[10] EIA and OEC combined with spot market pricing for crude oil estimates

[11] Reuters

[12] Reuters

[13] WSJ

[14] AAF Insight on Phase One deal

[15] IGU LNG Report

[16] https://blogs.platts.com/2019/09/17/lng-sector-transformation-long-term-contracts/

[17] https://www.naturalgasintel.com/as-chinese-lng-imports-increase-u-s-gains-market-share/

[18]Platts Insight