Slugcatcher hears the first shots in a gas war

THE fighting in Ukraine might have died down, for now, but Slugcatcher has just heard the first shots fired in an energy war which started with threats from Russia to cut off the flow of gas to Europe, followed by signs of collapsing LNG demand in Asia.

Those events, Ukraine, Russia, and Asian LNG, have a common bond which regular readers of this column written by an unapologetic advocate for the oil and gas industry has been banging on about for years, a lack of exploration and project investment which can now be seen as a massive mistake.

Renewable energy, mainly wind and solar, might one day power the world, along with nuclear, but the switchover from fossil fuels is years away, decades perhaps.

Oil company managers, frightened by environmental protestors, activist investors, and spineless bankers, have fallen for the "horse in midstream" blunder, trying to develop a renewables business while forgetting where the real money is made.

In Europe, epicentre of these events, there is a whiff of panic in the air as household power costs explode and industry threatens factory closures.

Governments which once tried to ban oil and gas are now desperately trying to encourage exploration and project development.

Examples of this re-discovery include Britain moving to lift a ban on fraccing, Germany scouring the world for non-Russian gas, Bulgaria rushing to boost gas storage before next winter, while the US government response is to release oil from its strategic reserves and plead for more drilling.

All of those events are important but they are also just previews of what's to come in the next few weeks as Russia weaponises its gas assets and prepares to attack Europe, turning off the tap as punishment for supporting Ukraine.

"It won't happen", is a common reaction to Russia's gas export threat, but that's coming from the same people who said Russia would never invade Ukraine. It made no sense, but Russia did it anyway and is now bleeding cash, men, and equipment at the same rate as its target.

Gas is the next chapter in this ludicrous situation and while it might make no sense to an outsider, and will be as damaging to Russia as Europe, it cannot be dismissed as impossible because the groundwork has been done with demands that European gas buyers settle their accounts in roubles.

Mid-April is the deadline for payment in US dollars and Euros to be substituted with Russia's debased currency and while no-one seems to understand why it should be seen as a political manoeuvre rather than anything that makes business sense - a currency version of the Ukraine invasion.

As one European diplomat told London's Financial Times newspaper over the weekend there are three possible reasons for the pay-in-roubles edict from the Russian president, Vladimir Putin.

The Russians could be trying to use gas as a tool to split European solidarity and possibly circumvent sanctions, or it could be an attempt to boost the value of the rouble, or it could be an attempt to scare the market and drive gas prices even higher.

And then there's the pure political play of trying to force customers in western Europe to deal with the Russian central bank, which is under sanction, forcing gas buyers to break the sanctions of their own governments.

But, on top of that was the most interesting observation of all: "It seems very likely that even people inside the Russian administration don't know about the objectives."

The next two weeks might reveal more but given what happened with the invasion which made no sense it might be wise to assume that turning off the gas to western Europe will happen even if it also makes no sense.

For Australian investors, what's happening in Europe is a fabulous opportunity but one which comes with a warning about demand destruction as much as it is about restricted supply.

On the positive side of the ledger there is the unmistakable evidence of sky-high prices for oil and gas delivering windfall profits which will continue even if the oil price slips back below US$100 a barrel.

Gas, however, is what's driving Australian producers which Credit Suisse analyst Saul Kavonic last week described as "the most structurally bullish event in LNG history".

Kavonic told the Australian Financial Review newspaper that a supply/demand gap of 70 million tonnes of LNG a year was expanding to 100MMt, a shift in the market which is about 10-times the impact of Japan's Fukushima nuclear accident of a decade ago.

A lack of projects in the development pipeline means that "prices will have to rise materially to incentivise such a large wave of supply".

But as that happens another economic force swims into view, demand destruction of the sort being witnessed in Asia where high LNG prices are crushing demand.

According to the resources sector consultancy, Wood Mackenzie, Asia Pacific LNG imports are down 10% in the March quarter compared to a year earlier thanks to a four-fold price increase.

The gas price increase, and the potential for an ongoing shortfall, means that energy customers are falling back on the most reliable of fossil fuels, coal.

With Russia's trigger finger poised over its European gas pipelines, and with prices close to record levels, the scene is set for an energy market showdown in which everyone in Europe is a loser while gas producers elsewhere, including Australia, emerge as winners.