



How Russia Could Be the Energy Patch's New Worst Enemy

Description

Over the last few months, Russia hasn't exactly done a good job with its foreign relations.

Sure, the Sochi Olympics went off without any major issues, but the main thing I remember from the Games is the tales from the international media about substandard hotel rooms and the many stray dogs that roamed the streets.

And then, shortly after the Olympics were over, the whole Ukraine situation started to escalate. Crimea announced it no longer wanted to be part of the Ukraine, and a vote quickly made it official. Now tensions are high in the eastern part of the country, as Russian-backed Ukrainian rebels have seized this opportunity to fight for their independence.

In response to all this, sanctions have been placed on Russian interests abroad. Many pundits view these sanctions as a mere slap on the wrist, more for show than to actually punish Russian interests. There's one simple reason for this. Europe needs Russian gas — 40% of the continent's natural gas is supplied by Russia, via pipelines through the Ukraine.

Like Canadian producers, Russia realizes that China is a huge market for its energy. The two countries share a common border, are often allies during international situations, and China is Russia's largest trading partner.

Currently, the two nations are in high level negotiations regarding a \$400 billion multi-decade deal to ship Russian gas to China. Vladimir Putin and Chinese leader Xi Jinping are expected to sign the deal in Shanghai very soon. The main stumbling block was price, but it appears the two nations have come to an agreement.

How will this affect Canadian producers?

Unfortunately for Canadian natural gas producers, Russia has one key advantage over us — location.

Russia's huge energy giant **Gazprom** plans to extent its current pipeline network to accommodate this new deal, with construction starting soon and being completed sometime in 2019 or 2020. This new

pipeline is expected to cost the company somewhere around \$22 billion.

For the Chinese, getting energy from Russia represents a better alternative than liquified natural gas (LNG) exported from Canada. Shipping always has risks, and delays are a possibility too. Russian gas will likely be cheaper than imported LNG. And from China's perspective, it can't like seeing delays on Canada's attempt to build the infrastructure needed to export LNG. Russia is ready to go ahead on a deal. Canada is still trying to figure out whether it'll allow a pipeline to be built.

Many of Canada's largest natural gas producers are counting on Asian exports to be a huge market for energy going forward. **EnCana** (TSX: ECA)(NYSE: ECA) and **Canadian Natural Resources** (TSX: CNQ)(NYSE: CNQ) are two of Canada's largest natural gas producers, with investors that are really counting on LNG exports as growth areas for the two companies going forward. And, of course, **Enbridge** (TSX: ENB)(NYSE: ENB) is just waiting on approval to build the pipeline that will carry natural gas to be exported out of Kitimat, in British Columbia.

This new deal between Russia and China represents about 25% of China's current natural gas needs. China expects to double its thirst for natural gas by 2020, but this still represents a huge chunk of Chinese demand going forward. But what happens if growth starts to slow in China? Suddenly this huge market for Canada's energy doesn't look so lucrative.

There are plenty of other markets that are hungry for Canadian natural gas. Japan is the world's largest importer of LNG, and South Korea is a rapidly growing market. Plans to export LNG from various other places, like the United States and Australia, are also moving forward. If Russia can get its gas to accessible ports, it also becomes an attractive trading partner for Asian markets.

The bottom line is sobering for Canadian natural gas producers. Investors often forget that there are other energy exporting nations that are also desperate to sell energy to Asian markets. Canada has to start construction on its own LNG exporting infrastructure soon, or else our producers might miss out on this huge opportunity.

CATEGORY

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