Santos' expensive birthday gift

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ABSTRACT (ABSTRACT)

Santos turns 60 on Tuesday, an Australian-made success story of survival in a world of global giants in the oil and gas industry. But it's still true that all politics is local. And right now, no politics is more local than Santos' ambitions in coal seam gas development in NSW.

As Santos' NSW experience demonstrates, getting new projects approved can be a protracted and difficult affair. Companies should have seen this coming and been far more focused and forward-looking on the need to build community trust and compromises to counter the emotional intensity of the opposition. Now it's almost too late to prevent a semi-crisis of supply and public confidence. So in the short term at least, the impact of new supplies and new gas markets is, in Australia, exactly the opposite of what has happened in the United States. There gas prices have plummeted to around $4.50 a gigajoule due to a new shale gas industry, leading to a resurgence of manufacturing domestically and an obvious and broadly shared national benefit. Opposition to shale gas development and fracking in particular is still significant in many American states. But the US industry can at least point to the rationale that carbon dioxide emissions have fallen more sharply in the US than in any other country - and are now at the levels of 20 years ago. Australia is still figuring out all the moving parts.

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FULL TEXT

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The level of community antagonism to CSG - leading to the O'Farrell government's severe case of nerves - has overwhelmed all that carefully fostered advertising about gas being a nice "clean" fuel, particularly compared to coal. Many farmers are loudly proclaiming a version of Not-In-My-Paddock. CSG has become almost a term of abuse.

Add in the need to deal with a few examples of earlier shoddy environmental practices by Eastern Star Gas, a company that Santos took over, and it's not surprising that an aggressive green movement finds the company an appealing target.

But Santos is also fighting what may be an even tougher political battle. That is the inevitable sharp rise in domestic gas prices due to the growing demand - and higher prices available - for exporting gas as liquefied natural gas out of Gladstone, Queensland. That is enraging many manufacturers who, of course, have their own survival issues. Nowhere is that more obvious than in NSW which imports 95 per cent of its gas - much of which has been traditionally used by manufacturing. These companies argue that exporting Australia's advantage in relatively low-cost energy production is totally counterproductive for the economy.Contradictory forces sweep the economy

So that makes Santos' potential - as well as its various political problems - emblematic of the contradictory forces sweeping through the Australian economy. These include the trade-offs between environmental protections and commercial needs, between protecting local industry and chasing higher export prices and between balancing surging job demand and costs in the construction phase of resources projects and the big let-down in the production phase.

Santos, for example, is a partner in one of the three huge and separate LNG projects now being built simultaneously at Gladstone at a cost of $70 billion. At the moment around 20,000 people are employed in highly paid jobs in construction and Gladstone is booming. Within a couple of years, the number of employees will be down to a maximum of 5000 running those same operations. There are no big new resources projects in the pipeline to soak up that construction workforce.

It's not just that Australia has priced itself out of the market. Resources companies worldwide are also focused on cutting costs, returning capital and reducing risks rather than expanding. The impact of that has already flowed into the jobs market in Western Australia and Queensland and will not change direction. But just as with jobs in the car industry, it's taking a while for reality to register.

The other catch is that, starting next year, all three LNG projects at Gladstone are going to be initially short of gas from Queensland to fulfil their massive export contracts. That's even though the industry in that state is much more developed and accepted in rural areas, where many see the "rent" paid for wells and drilling as a way to revitalise communities.Supply crunch ahead

The obvious alternative is to take more gas from existing supplies in the Cooper Basin and Bass Strait. But that demand - and the higher prices available in the export market - ensures that there will be a supply crunch in states like NSW from around 2016 unless customers are willing to pay much higher prices.

That is even though the wholesale demand for power in Australia is declining as manufacturing businesses have closed or become far more energy efficient and renewables have become a bigger part of the mix.

Already gas prices have risen from a low $3 a gigajoule to $8-$9 a gigajoule in recent contracts. Citi predicts that wholesale price spike could go as high as $10-$12 a gigajoule for at least 12 months from late next year before receding to today's (still relatively elevated) prices. It also believes that the three big Gladstone LNG exporters will remain in the domestic market for longer-term supply contracts.

The loud complaints about the effect on prices won't make any politician happy. Those trade-offs are a lot more complicated than the promise to abolish the carbon tax. And the problem of guaranteeing supply is particularly acute in NSW.

The industry's response is to argue that the days of cheap gas were coming to an end anyway and the best means to get prices down over time is to increase supply.

But as Santos' NSW experience demonstrates, getting new projects approved can be a protracted and difficult affair. Companies should have seen this coming and been far more focused and forward-looking on the need to build community trust and compromises to counter the emotional intensity of the opposition. Now it's almost too late to prevent a semi-crisis of supply and public confidence. So in the short term at least, the impact of new supplies and new gas markets is, in Australia, exactly the opposite of what has happened in the United States. There gas prices have plummeted to around $4.50 a gigajoule due to a new shale gas industry, leading to a resurgence of manufacturing domestically and an obvious and broadly shared national benefit. Opposition to shale gas development and fracking in particular is still significant in many American states. But the US industry can at least point to the rationale that carbon dioxide emissions have fallen more sharply in the US than in any other country - and are now at the levels of 20 years ago. Australia is still figuring out all the moving parts.

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