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U.S. Gas Sales to China Dry Up as Ukraine War Disrupts Energy Trade

In a redirection of flows, America sells more to Europe, while Russia becomes more dependent on sales to Beijing

By Brian Spegele Follow *and Sha Hua* Follow

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BEIJING—This time last year, China was racing to buy as much natural gas from the U.S. as it could get. After Russia invaded Ukraine, those purchases all but dried up, and China is now buying more from Russia.

The U.S.-China energy trade had until recently been one area of deepening ties in an otherwise fractious relationship. Large energy sales were a central part of the Trump administration's trade deal with China. China's imports of liquefied natural gas, or LNG, in particular offered a concrete example for Beijing to show how the country's growing economy helped create U.S. jobs.

The invasion of Ukraine has halted that for now. After Russia attacked, Europe pledged to cut Russian gas imports in response. LNG from the U.S. was one of the few alternatives available to European countries as they scrambled to fill the gap, causing prices to surge to record highs.

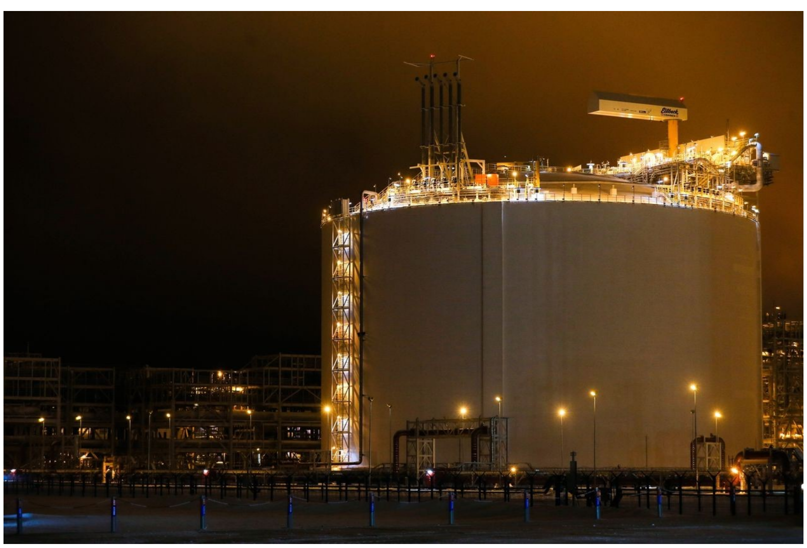
At the same time, a slowing economy damped China's energy demands, one reason it needed less LNG from the U.S. Another reason was the cheaper gas it could get from Russia, with Chinese buyers scooping up Russian LNG at discounts to market prices in the weeks after the invasion.

Between February and April, China's imports of LNG from the U.S. dwindled by 95% from the same time a year earlier, Chinese customs data showed, while its buying of Russian LNG grew by 50%. Data for May indicated a moderate rebound in China's demand for America's LNG, but it was still far below last year's levels.

The changes haven't been limited to gas markets. China's imports of Russian oil surged 55% in May compared with a year earlier, with Russia overtaking Saudi Arabia as China's top supplier. Russian oil has been selling at a steep discount as some countries have cut imports because of the war.

Of all the ways that the Ukraine war is reshaping global energy flows, perhaps the most significant is that it is forcing Russia to lean more on China for economic support as it grows isolated from the West.

"It's clearly pushing Putin to reorient more toward the East," said Erica Downs, a senior research scholar at Columbia University's Center on Global Energy Policy.



In April, Russian President Vladimir Putin instructed Russian energy companies "to redirect our exports gradually to the rapidly growing market of the South and East." Last week, Russia slashed natural-gas deliveries through the Nord Stream pipeline to Germany, potentially leaving factories and households across the continent in peril ahead of winter.

For now, U.S. LNG exporters are protected from the Chinese shortfall by the plentiful demand from Europe. Down the line, competition from Russia for China's market poses potentially big complications for billions of dollars of planned LNG infrastructure on the U.S. Gulf Coast, investments that assume China will be a huge buyer of America's gas for many years to come.

China won't completely stop buying LNG from the U.S. Most of its purchases of U.S. LNG have until now come from the spot market. Going forward, more will come from fixed contracts that are just starting to kick in. Even as fighting rages in Ukraine, some Chinese firms have continued negotiating such deals with U.S. producers.

China reinforced its partnership with Russia during a phone call between Chinese President Xi Jinping and Mr. Putin in mid-June. China has used careful language about the Ukraine conflict, neither criticizing nor endorsing the Russian invasion.

Russia's natural-gas strategy had long focused on Gazprom PJSC's delivery of fuel by pipeline into Europe. A pivot to Asia has gained speed over the past decade and is on display at two large-scale LNG projects, one in the Arctic and the other in Russia's Far East.

Above the Arctic Circle, the Yamal LNG project is majority-owned by PAO Novatek, Russia's second-largest gas company, while China's Silk Road Fund and China National Petroleum Corp. also hold stakes. When Novatek was barred from raising dollar financing in 2014 after Russia annexed Crimea, it managed to secure the equivalent of $12 billion in loans from Chinese banks.

Another part of the Asia effort is Sakhalin-2, an oil and gas project that includes LNG production in Russia's Far East. Shortly after the invasion, Shell PLC said it would sell its 27.5% stake in the project, part of plans to leave Russia altogether.

Within weeks, China's imports from Russia began ticking up, which an analyst at S&P Global Commodity Insights attributed to two large shipments from Sakhalin-2. Chinese buyers were getting substantial discounts on spot prices, according to an analysis of customs data by the Chinese energy consulting firm Jinlianchuang.

Representatives for Yamal and Sakhalin Energy, which operates the Sakhalin-2 project, didn't respond to requests for comment.

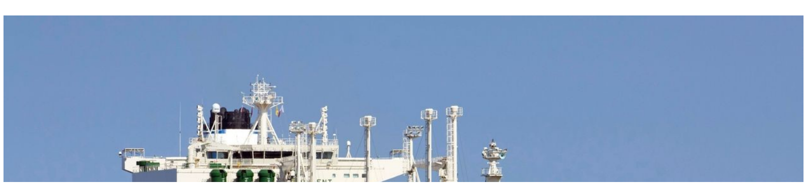
Ties between China and Russia have ebbed and flowed. A 2,700-mile land border between the two countries was a source of conflict going back centuries. The mistrust continued during the Soviet era.

Relations have warmed under President Xi. While China carries far greater economic weight—and has even made strides into Russia's traditional sphere of influence in Central Asia—the countries have pursued common ground as a counterweight to the U.S.-led international order.

At the same time, China is leery of relying too heavily on Russia, or any single country, for its energy supply. "Europe stumbled into a big pit," said a Chinese government adviser. "China will definitely try to avoid that."

As the Oxford Institute for Energy Studies put it in a research note earlier this year, "For China, happiness is multiple supply sources."

In 2014, Russia and China deepened their energy ties, reaching a long-awaited agreement to build a pipeline linking eastern Russian gas fields with China. Gazprom said at the time that the agreement to sell China 38 billion cubic meters of gas annually was worth $400 billion over 30 years.



During Mr. Putin's visit to China this year, China agreed to buy another 10 billion cubic meters of gas annually from Russia.

Even so, those numbers are dwarfed by the 155 billion cubic meters of gas that the European Union bought from Russia in 2021—representing 40% of its gas consumption.

Moscow envisions sending up to an additional 50 billion cubic meters annually to China through a second pipeline that is being negotiated. Russia's need to pivot to Asia is likely to give it a weaker hand in those negotiations.

One risk for U.S. producers is that while Europe is willing to pay top dollar now to secure all the LNG supply it can, its gas needs will dwindle over time as it transitions more quickly than China to using nonfossil energy. Some industry analysts are asking whether high prices today could end up hurting Chinese demand over the longer term.

"I don't think U.S. producers can shift completely to Europe even though that is where the money is right now," said Michal Meidan of the Oxford Institute for Energy Studies. "Asia is where the future growth is."

Robust demand from China is crucial for places such as Lake Charles, La., where Dallas-based Energy Transfer LP is far along in developing a new, large-scale LNG export terminal.

Since Russia invaded Ukraine, Energy Transfer has announced two deals with Chinese buyers for 3.4 million metric tons of LNG a year. China represents roughly 60% of the total amount of LNG contracted by the Lake Charles project to date.

The company declined to make executives available for an interview. It said in a written response that the recent events in Europe highlighted the importance of U.S. LNG and that it was committed to the Chinese market.

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