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Getting the formula right for LNG terminal

EDITORIAL

SINGAPORE is in the midst of working out a fair, practical formula on the future use of the liquefied natural gas (LNG) terminal here, in the context of its long-standing ambitions to grow into a regional LNG hub. This comes as the issue of energy security has been largely nailed down, thanks to the recent start-up of the Jurong Island facility where incoming LNG shipments from various locations worldwide is helping the Republic diversify its gas supplies beyond those piped in from neighbouring Indonesia and Malaysia.

Last month, the regulator of Singapore's energy industry, the Energy Market Authority (EMA), launched two follow-up consultations with industry players on what they would like to see as the LNG terminal's modus operandi, having earlier obtained valuable inputs from its first consultation on future procurement of liquefied natural gas beyond that by initial appointed buyer BG Group.

While that earlier exercise was about 14 months ago, the time has been fruitfully spent, as is evident from the revised proposals set out in EMA's latest consultation. Additional industry feedback by the consultation's close this month-end will help put the finishing touches to this. Tied to it is a parallel consultation by the regulator to hammer out a Terminal Access Code which will govern the facility's use.

But there are still vital questions that await answers. Primarily, with so many interested parties, how should space be allocated at the still ramping-up SLNG terminal which can at best accommodate three or four importers in the coming years?

A proposed solution is for Singapore to have a flexible LNG import framework aligned with fast-changing gas markets. That is, on top of the BG Group's current three million tonnes per annum (tpa) of franchised supplies, the near-term, incremental LNG demand here of just 1-1.5 million tpa to 2018 is small, so EMA is suggesting a tranche-by-tranche approach for the Republic to enter the market and procure LNG at regular intervals.

It is, therefore, proposing the appointment of just one new LNG importer for this next tranche, with the learning and discovery process from this initial exercise helping Singapore to prepare for future supply opportunities such as LNG from US shale gas developments, among others.

Also on the table is possible spot LNG imports, as well as additional new piped gas imports, especially if the latter is competitively priced. Supplementing the baseload LNG supplies obtained through the usual established players, such spot supplies by others, as well as opportunities for pooled, group purchases should hopefully lead to an LNG market here which not only offers more dynamic trading opportunities, but which ultimately results in more-competitive pricing for the end-consumer and less dependence on just one or two suppliers.

Too big to fail: *Citigroup may lose US$7 billion in FX derivatives markets if the dollar appreciates as capital flies back to the United States.* PHOTO: AFP

The US as a global risk generator

World can't afford to create major loopholes that could threaten financial system yet again

By **KEVIN P GALLAGHER**

THE US economy continues to have a hard time recovering from the biggest financial crisis since the Great Depression. So the last thing one would expect the US government to do is to engage in policies that open the floodgates to severe risks in financial markets once again. Yet, that is precisely what's going on.

For all the attention that is paid to the Federal Reserve's "tapering", what Washington has in its crosshairs is something quite different. It is putting massive pressure on the Commodity Futures Trading Commission (CFTC) and the Security and Exchange Commission (SEC). Unless concerned policymakers and the public at large act quickly to counter that pressure, the disastrous past – a financial industry running amok – may well be in the future of not just the United States but also the world.

How is this even possible?

Even though the US Congress passed the Dodd-Frank financial reform law a few years ago as a bulwark against reoccurring financial crises, the legislation actually left most of the key decisions – the actual detailed rule-making to rein in the financial industry – for later.

At the centre of this entire issue is Gary Gensler, a former Goldman Sachs partner, who is now the CFTC chairman. Mr Gensler is one of the few officials who can credibly say that, having worked in the lion's den for many years, he is committed to rectifying what he knows is truly troublesome in the boiler rooms of the US financial industry.

Yet, the deck is stacked against him. The fundamental imbalance at the heart of this issue is not just very irritating but also profoundly undemocratic.

Just look at the numbers. The Sunlight Foundation found in a study released last year that Wall Street has met government officials 1,298 times to influence the new rules. By sharp contrast, public interest groups have been able to get only 242 such meetings. They have been outgunned five to one.

But this unsettling imbalance in the US political process has consequences way beyond US borders as the US financial industry is still in a dominant position globally, setting many of the standards and practices for "what goes". The Group of 20 and the Financial Stability Board have pledged that powerful nations such as the US will ensure that the global impact of their national rule-making will be taken into account.

But now the US may blow a hole in the Dodd-Frank law by allowing many of the key global operations of US banks to be entirely exempted from regulation. The first blow came late last year. Very quietly, when the US Congress was on its Thanksgiving holiday, the US Treasury Department exempted foreign exchange (FX) swaps and forwards from the regulations.

Why should the American and global public care about this? After all, when US banks operating offshore, and in places such as South Korea, sell FX derivatives to exporters, it allows them to hedge against foreign-exchange risk. That sounds innocuous enough.

But when the last financial crisis hit, there was such a flight of capital out of emerging markets and back to the US that many of those positions were rapidly unwound – to the great detriment of those economies. Such are the massive – and global – transmission effects of today's tightly integrated financial markets. Never relenting, these same FX derivatives market operators got very busy again right in the wake of the global financial crisis.

Asset bubbles

Hedge funds and big banks engaged in the carry trade. They borrowed in dollars at very low interest rates and then invested in foreign currencies in a broad range of countries – from South Korea, Brazil, Chile, Colombia, Mexico, South Africa, Indonesia, to Thailand. They then built FX derivatives that shorted the US dollar and went long on those currencies.

This fuelled exchange rate appreciation and asset bubbles that are part of the reason for the slowdown in emerging markets. Now that the Fed is looking to wind down its easing policies, capital is fleeing emerging markets, causing exchange rates to depreciate and debt burdens to rise.

By now it is a familiar story. Financial engineers, largely by US-owned firms, generate serious blowback in the real economy, and get hurt themselves. Citigroup, a too-big-to-fail bank, may lose US$7 billion in FX derivatives markets if the US dollar appreciates as capital flies back to the US.

The next regulatory blow may hit any day. The CFTC and the SEC are now considering exempting those same foreign subsidiaries and branches of hedge funds and big banks headquartered or with stakes in the US that have been packaging derivatives overseas.

This would be disastrous for emerging markets and developing countries attempting to maintain financial stability for development. To their credit, South Korea and Brazil both have put in place their own regulations on FX derivatives, but emerging markets alone cannot carry the burden of regulating a US$4 trillion per day market.

Mr Gensler has said that, if these regulations are swapped out of the rule-making, hedge funds can evade the rules "by setting up shop in an offshore locale, even if it's not much more than a tropical island PO Box". Mr Gensler needs a majority of commissioners to help him close this loophole by tomorrow.

Time is running out. The world cannot afford to create major loopholes that could threaten the global financial system yet again. While there have been reports that Mr Gensler is wavering with regard to the timeline and the substance of his position, now is not the time to shift from hero to being on the verge of "capture". He ought to hold strong.

The writer is co-director of Boston University's Global Economic Governance Initiative and a regular contributor to 'The Globalist', where this article first appeared

THE BOTTOM LINE

Pain lies ahead as fund flows adjust to BRIC realities

ANTHONY ROWLEY
Tokyo Correspondent

THE relative ease with which China and other emerging economies were able to take up much of the slack after advanced economies slumped into recession in the wake of the global financial shock in 2008 always seemed to be too good to be true. Now it appears that it was.

Emerging economies – not least China's – are slowing to the point where they are becoming a drag on overall growth of the world economy, according to the latest update of the International Monetary Fund's regular World Economic Outlook (WEO) report.

The relevant part of the WEO deserves close reading, not least by financial market practitioners who often seem to inhabit a kind of parallel universe, from where the view of economic and investment prospects is different from that in the "real world".

"Growth continued to disappoint in major emerging market economies" during the second quarter of this year, says the IMF report.

This reflects "to varying degrees infrastructure bottlenecks and other capacity constraints, slower external demand growth, lower commodity prices, financial stability concerns, and, in some cases, weaker policy support".

For equity and bond investors, it seems there always has to be a "growth story" somewhere and if there isn't one to hand, then analysts in the pay of major investment houses can be relied upon to invent one.

This is not to say that the emerging markets growth story was a myth right from the start. The story has been a very real one, not least in the case of China but also in the other big BRICs – India, Brazil and Russia.

But after the great financial crisis and ensuing global recession some five years ago, investors and their advisors were over-eager to climb on the emerging markets bandwagon to counter to the advanced economy slump.

The fact that trillions of dollars of liquidity were going to be pumped into markets was obvious from the US Fed's quantitative easing splurge and the flood of money created by the European Central Bank and others.

It was equally obvious that bond yields would plummet as central banks pumped money – and that investment funds from advanced economies would rush offshore like an ebbing tidal wave in search of higher returns.

What should have been examined far more closely by investment analysts and economists alike was the "capacity" of leading emerging economies to absorb these mega funds without collateral damage being done.

Emerging market equity and bond prices leapt in the wake of the funds ingress and that appeared to bolster the emerging markets growth case. But few seemed interested in what would happen once these flows reversed.

That has begun to happen now that the Fed has indicated that it is likely to begin "tapering" (a euphemism if ever here was one) its monetary stimulus as early as September of this year.

It's a case of "rush for the exit and the devil take the hindmost" as investors fight to get out of emerging markets and back to the putative and supposed comfort of advanced economy markets. This process has only just begun and is likely to accelerate in coming months as the US moves toward tightening – and that is ignoring the fact that massive monetary easing in Europe and Japan must be reversed eventually.

As the IMF says (in customary oblique-speak): "If underlying vulnerabilities lead to additional portfolio shifts, further yield increases, and continued higher volatility, the result could be sustained capital flow reversals and lower growth in emerging economies."

So there we have it. On the ground only of an inevitable and entirely predictable correction of capital flows, emerging economy growth will slow. But what of the more fundamental growth constraints facing these economies?

How many investors intent on grabbing quick returns in emerging markets thought seriously about the strain put on physical infrastructure – not to mention human capital resources – by arguably over-rapid investment in manufacturing?

Now, some of these problems are coming home to roost, as the WEO observes. If China has so far managed to handle the infrastructure issue rather well, the same cannot be said of India and other BRICs.

"Financial market strains" that the IMF sees developing in emerging economies were also eminently predictable. Stock and bond markets, not to mention banking systems, that have suddenly to absorb huge financial inflows and then outflows are highly vulnerable in this regard.

Some slowdown in what has really been the frenetic growth rate of emerging markets in recent years (egged on by avaricious external investors) may be salutary. But there will be pain all round as they seek to adjust.