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PM looks in wrong places for answers

Malcolm Turnbull likely hasn't heard of Central Petroleum. But Macquarie Bank sure has.

The millionaire factory liked lending money to Central so much that it wants to buy the company. And, as of Friday, the driller quite likes the idea, with Macquarie's $87 million takeover pitch being recommended to shareholders by the Central board.

So why should this cash-strapped, opportunity-rich Macquarie-targeted Northern Territory gas driller also be on the PM's radar?

Well, because Central, like so many others not on the prime ministerial gas crisis guest list, should have been invited to the executive gathering later this week that will see Turnbull and his Energy Minister, Josh Frydenberg, attempt to find answers to the nation's present and future gas "crisis".

Of course, finding answers might not necessarily be the ambition of that meeting. The decision to limit the gathering to a cohort of the most senior international and domestic gas drillers and sellers risks reducing it to an exercise in buck-passing.

But having called the crisis at The Australian Financial Review Business Summit last Thursday morning, the PM took the risk of owning the problem in revealing that big gas was to be called in to be quizzed on how they intend to deal with the problem.

Australia's energy crisis has two distinct wings. There are the issues that have destabilised the electricity business, and a different set of issues that mean the Australians are paying unprecedented high prices for gas.

There is an understandable focus on the problems of the power sector, given that we all like the lights to come on when we flick the switch. But, for a variety of reasons, including the unavoidable fact of greenhouse emissions targets, you can't fix the national power failure without first making sure there is enough gas.

The executives who will front the PM this week run the big three gas exporters whose new demand has so altered gas supply patterns on the east coast. The big suppliers are now driving gas to export plants that were supposed to be sustained by their owners' own resources to fill the original east coast gap.

Central Petroleum's Richard Cottee has a potential gas solution. PHOTO: JIM RICE

Neither the LNG project managers, GLNG, APLNG and QCLNG, or their local owners and gas suppliers, Santos and Origin Energy, can solve the PM's problems. The projects have spent $70 billion on their machines and they simply cannot afford not to fill them with gas to chill and export. And the demands of those machines have already outstripped the capacity of at least one local operator, Santos, to supply the apparatus it helped build.

Santos has not been able to deliver the volume of gas it expected to when its project was sanctioned by board and government back in 2010. As a result the two trains at GLNG rely on others for gas. So it has hoovered up loose gas from a variety of sources including drillers like Origin and traders like AGL Energy.

Once upon a time, AGL had aspirations to be a gas producer like Origin, but one freed from the capital and market risk of owning the export gateways. But the strategy to tap coal seam gas wealth in NSW did not survive executive succession. Current CEO Andy Vesey had no appetite for the public affairs challenges of an unconventional gas life.

In February last year, Vesey walked away from natural gas production and exploration, adding $640 million to the $435 million impairment taken on the upstream business in 2015.

Looked at through one lens, Vesey got that decision right. A NSW Liberal government has, in all but one case, utterly shirked its responsibility to lead debate on unconventional gas. It has reacquired the licences of coal seam gas explorers in preference to embracing and marketing its own chief scientist's sensibly qualified endorsement of the extraction technologies.

But studied through a more commercial lens, Vesey seems to have robbed his shareholders of considerable upside while exposing AGL to equally considerable downside risk. Vesey has been left to complain at the lack of contractable gas while being unable to supply gas into a price-inflated market.

But, just to take one step back here, we need to recall that as recently as 2014 a review of coal seam gas by the NSW chief scientist, Mary O'Kane, found that unconventional gas posed a conventional, limited and manageable set of risks.

NSW is not alone in apparently ignoring O'Kane's report. Neither side of the Victorian parliament seems to have read the thing. Both have endorsed a forever ban on hydraulic fracturing and a moratorium on more traditional extraction technologies.

Why this hysteria?

Well, because Labor is fearful of the Greens and the anti-carbon causes they so successfully promote, while the conservative Coalition is even more petrified of pastoralists who don't like what they don't understand and will not actively benefit from.

No state outside of Queensland has been prepared to promote the environmental integrity or the economic necessity of unconventional gas. Instead a collection of regional fleas are wagging the national dog. And there, folks, is the rub.

Everyone but the folk from battery-land at Tesla reckon the fix for our power problems lies in a complex of interwoven initiatives. But gas is a very different story. Sure, there are a wealth of little things that need to be done. But thematically the answer is simple. It is all about supply. Gladstone's LNG plants consume annually the equivalent of three times the national domestic gas market. And, so far at least, the supply-side response to their introduction has been managed essentially by those who aim to fill those machines.

Energy Australia managing director Catherine Tanna hit the nail on the head at Thursday's Summit. The gas problem will not go away until there is more onshore supply. End of story.

Turnbull cannot be criticised for calling the gas producers to some sort of account. But if he wants all the answers, he needs to broaden his eyeballing. He needs to call in, too, the pipeliners, the big gas users and the premiers of the no-fracking states.

And he needs to find himself a wrangler to force them to make informed, targeted commitments. My suggestion would be competition regulator Rod Sims. Few people are as across the industry.

Oh, and Macquarie Bank's move to take ownership of Central Petroleum says that it too might be a welcome guest at a prime ministerial gas showdown.

Macquarie has played a hand that says it is a true believer in the remunerative potential of this gas shortage. It is plainly now looking to play a role in creating a more liquid spot and forward market and, in a market structurally under-supplied, the only way to do with any level of acceptable risk is to own gas.

Central's potential is obvious. It has legacy gas fields that once supplied 30 petajoules daily of gas but now only have customers enough for 10pj. The demand side of that will change when Jemena completes a new pipeline that will link the NT infrastructure to the east coast market through Mt Isa.

Central has the resources but nothing like the capital to make that gas available by the time the pipeline is ready in late 2018. Given the public markets currently do not know how to value stranded gas like Central's, access to new equity was going to be hideously expensive. So it has been obvious for sometime that private equity was where Central's fate would eventually lie.

There are many who now claim to be lone voices in predicting the gas crisis that is now upon us. We have been channelling warnings of market disequilibrium by 2016-17 for five years. Our original informants were ex-Origin boss Grant King, ex-Santos east coast gas boss James Baulderstone, ex-BHP Billiton boss Marius Kloppers and the man who sold BG Group the coal seam gas territories that inspired the first of Gladstone's three liquid natural gas projects, Richard Cottee.

These days Cottee steers Central Petroleum. And, while those who know him might wonder how it will work, it seems Cottee might well stick around once the Macquarie deal is done.

"Macquarie certainly said they would love me in the morning," Cottee said on Friday with very typical irreverence. "So, let's just say we are still dating."

Cottee is classic petroleum industry maverick. And Macquarie is, well, Macquarie. So the potential of cultural difference lies very real. But Cottee appears as driven to stay should Macquarie secure the business.

"I have a missionary zeal about this one," he told me on Friday. "I am keen to bring this gas to market, I am keen to see a solution to the problem [the supply crisis] and I am arrogant enough to think I could be relevant to the solution."

This could be an awful lot of fun to watch.

Karen Maley

Market fears 'three steps and a stumble'

Investors are about to find out whether the old market adage "three steps and a stumble" still holds sway over equity markets as the US Federal Reserve prepares to raise interest rates at its meeting this week.

Fed officials have spent the past few weeks laying the groundwork for the third post-financial crisis hike in US interest rates. And any lingering doubts that they might postpone their move were blown away by Friday's surprisingly robust February jobs report.

The figures showed a sturdy 235,000 jump in US non-farm payrolls in February from the previous month, well above the consensus forecast of 190,000, and a dip in the US unemployment rate to 4.7 per cent. Average hourly earnings in the private sector rose by 2.8 per cent from a year earlier, marginally faster than US consumer prices, which increased at an annual pace of 2.5 per cent in January.

Investors decided that the February jobs figures mean the Fed will almost certainly proceed with a 25 basis point hike at its meeting on Wednesday, the third since the US central bank began the excruciatingly slow process of raising interest rates back in December 2015.

What's more, investors believe the strong jobs figures have boosted the likelihood that the US central bank will fulfil its own forecast of three rate hikes this year. Futures markets, which are pricing in a 96 per cent probability of a US rate hike this week, now see a more than 55 per cent likelihood of a second rate hike in June and a close to 60 per cent chance of a third rate hike in December.

But although US Fed chief Janet Yellen has moved very slowly in raising rates, and has gone out of her way to prepare markets for the inevitability of higher rates, some analysts are warn that the old market adage of "three steps and a stumble" – which predicts a US share market selloff after three Fed rate hikes – is likely to hold sway.

And this could have extremely important consequences for the behaviour of US consumers, who have been comforted by the rise in value of their homes and share portfolios, and have continued to spend briskly even though they have yet to to enjoy a strong lift in real (inflation-adjusted) wages.

Higher asset prices mean US households ... have seen their net worth soar.

There's little doubt that the Fed's decision to keep interest rates extremely low in the wake of the financial crisis has caused asset prices to balloon. The Fed last week reported that the net worth of US households climbed to a record $US92.8 trillion ($122 trillion) in the fourth quarter, following an eight-year bull market in US equities and rising US house prices.

Higher asset prices mean US households, which lost nearly $US13 trillion during the financial crisis, have seen their net worth soar by $US38 trillion since early 2009. Indeed, the surge in the net wealth of US households has more than outstripped their very modest income gains. As a result, household net worth is now 6.5 times higher than personal income, eclipsing the previous record set at the height of the US housing market frenzy.

But while US share market investors appear to be sanguine about rising US interest rates, investors in commodity and junk bond markets appear to be getting edgy.

US crude oil prices slumped by more than 9 per cent last week, dropping below $US50 a barrel, as investors worried that the OPEC-backed deal to cut global oil supplies could fail due to rising US shale oil production. At the same time, fears of slowing Chinese economic activity pushed the copper price to tumble to a two-month low.

The prospect of an imminent US rate rise has also curbed investor appetite for risky US high-yield corporate bonds. An estimated $US2.8 billion was pulled out of high-yield bond funds last week as investors worried that US interest rates are rising at a time when energy and metal prices are under pressure. Many high-yield bonds have been issued by energy and mining companies.