

ASIAN LNG COMPANIES LOOK TO NBP, TTF FOR PRICE REFERENCE



Friday, Feb 19, 2016
SET
Open: 1,295.01
High: 1,320.23
Low: 1,270.48
Close: 1,319.19
Volume: 5,729,430
Open Interest: 92,8258
Settlement: 293.5537
Dividend: 1,332.7269
Yield: 5.3502
ROE: 3.5601
EPS: 1.7901
Dividend Yield: 62.6032

By Alex Thackrah

MARKET INSIGHT

ASIAN LNG COMPANIES LOOK TO NBP, TTF FOR PRICE REFERENCE

BY ALEX THACKRAH JUNE 2018

So far this year, just 5% of US LNG exports have ended up in Europe, with two cargoes received by the UK, one into Portugal, one to the Netherlands and two to Turkey.

Global markets have been tighter than expected and this is primarily due to high demand from Asia sucking up flexible supply, as well as strong US deliveries to markets closer to the Americas.

But this situation could change in the years ahead as more production capacity comes online in the Atlantic Basin and, with it, the behaviour of some of the new US LNG offtakers.

The majority of new US LNG production to come to the market in the current phase should arrive in 2019 and 2020.

Activity appears to be picking up, with US exporter Cheniere taking a final investment decision on the 4.5mtpa Train 3 at Corpus Christi on 22 May.

In the coming years, a raft of contracts between Asian end users and US LNG exporters will come into effect, and this could provide a greater incentive for east Asian buyers to trade at European gas hubs.

This is in addition to the increasingly global stance that many east Asian buyers will need to take to balance LNG portfolios, and could involve physical or derivative trade at European hubs.

Some companies already take an active interest. However, the number of Asian companies licensed to trade directly at the Dutch TTF and British NBP remains limited, and as yet, there has been no clear tipping point steering them towards these hubs.

“Many Asian buyers have been looking at the NBP and TTF for a while,” said one source at a Japanese trading company.

“They are looking for cargoes with flexible destinations, so if the Asian market spikes, then they will take cargoes there. But if the market is not strong, then they will take the cargoes to Europe,” he added.

Japanese buyers have a history with the NBP and tend to be familiar with the European markets.

Sumitomo Group has long been involved in oil and gas

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EUROPEAN GAS HUB LIQUIDITY, CHURN

Greater liquidity at the TTF and NBP make them reliable price benchmarks and provide a strong case for hedging LNG, with a mixture of sophisticated derivative trading options available.

Companies are easily able to move in and out of the market, and many major LNG companies frequently trade the TTF, albeit more for domestic gas purposes than for LNG-specific reasons.

In general, liquidity at the TTF and NBP has been steadily growing in recent years, with the TTF recently overtaking its British counterpart to become the most liquid gas hub in Europe.

6,574TWh of over-the-counter and exchange trade was recorded at the TTF in the first quarter of 2018, a record high.

Two major cold snaps, as well as rulings over future production limits from the Groningen gas field, were key to driving up liquidity 28% year on year.

LNG buyers in the less liquid markets in Europe often use the TTF as a price reference, rather than their own domestic hubs.

In recent weeks, traders looking to bring LNG into the Iberian Peninsula, France and Italy have been quoting prices at a basis to the TTF, rather than as a spread to the PVB, PSV or PEG Nord hubs.

Another indicator of greater liquidity at the TTF is its churn ratio, a measure of the number of times a parcel of gas has been traded at a hub.

The churn ratio at the TTF jumped from 6.75 in 2011 to 26.27 in 2016, according to a report by the Centre on Global Energy Policy's Mike Fulwood.

The churn for the NBP is also high, but it has not grown to the same extent as the TTF, totalling around 20 between 2011 and 2016.

Put into context, none of the other hubs in Europe has recorded a churn ratio of above five.

That said, the TTF and NBP continue to lag well behind the churn seen at the US Henry Hub, which regularly registers a ratio in the 60s and above.

NBP OR TTF?

Whether companies use the Dutch or British hubs as their principal price reference will depend on numerous factors and the particular company's assets in LNG and gas storage infrastructure.

"There's not too much difference between NBP and TTF," said Gregor Pett, executive vice president of Market Analytics at Germany's Uniper.

He said that the recent closure of Britain's largest storage site, Rough, was not necessarily a major disincentive for traders to bring LNG cargoes into the UK.

This highlights the difference between using the European hubs as a venue to physically deliver cargoes or as a place to hedge and manage risk.

The closure of Rough has resulted in greater price volatility at the NBP, which can provide opportunities for traders.

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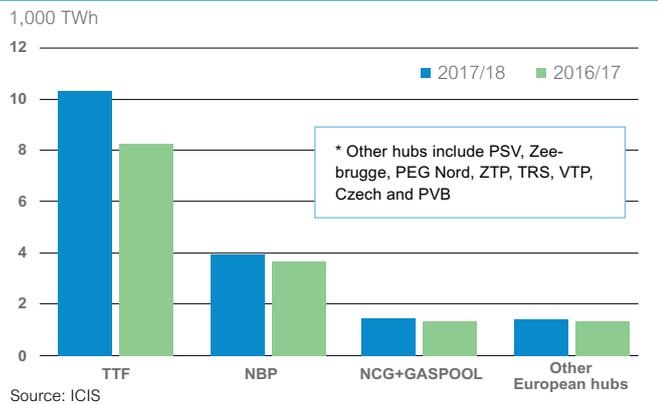
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EUROPEAN GAS HUB OVER-THE-COUNTER TRADED VOLUME(1 OCTOBER-30 APRIL)



At times, this has made the NBP more of a favourite for sellers.

Nevertheless, the euro-denominated TTF remains the preferred hub for managing risk on the far curve, as it is the only venue in Europe where there is regular trade of the Calendar Year +2 contract and beyond.

This is evidenced by the TTF scoring a full 20 points in the ICIS tradability index, four points above the NBP.

In addition, those companies wanting to take positions in other European markets may favour the euro-denominated hub to reduce currency trade.

TTF BACKWARDATION LINKS TO LNG

The backwardation in the TTF far curve can in part be attributed to backwardation in the oil market, but is also indicative of LNG companies managing their risk at the hub.

The expectation that additional US LNG volumes will arrive on European shores in the years ahead is a key reason pressuring TTF far curve prices.

This remained the case even after the decision to fast track the closure of the Groningen gas field in February.

At the market close on 23 May, the TTF Calendar 2019 contract was assessed at \$7.627/MMBtu, \$0.468/MMBtu above the Calendar 2021 and \$0.649/MMBtu higher than Calendar 2022.

But it is not just the European gas hubs that are seeing trading patterns shifted by LNG companies' activities.

Over the past 18 months, the Henry Hub has seen a dramatic change in the share of activity taking place during Asian working hours, according to CME Group, the derivatives marketplace.

"Around 7% of total Henry Hub volumes, equivalent to almost 45,000 lots, are now traded during the Asian day compared with an average of 2% just a few years ago," CME said.

As the LNG industry becomes even more commoditised and interconnected - and as the cargo churn increases - this trend will become even more apparent.

PRICE CONVERGENCE

The increasing interconnectedness of the global LNG and European gas markets may also drive greater global price convergence, especially if US exports to Europe and Asia increase.

Since early 2015, European gas hub prices and global LNG markers have traded in a much narrower range than the previous few years, in line with lower oil prices.

Asian prices have risen to significant premiums during the winter months, but not to the same extent as was seen previously.

In recent months, a rise in oil prices has dragged up global LNG and European gas prices more or less in unison. But US Henry Hub prices have remained resistant.

As more export capacity comes online, it is possible that Henry Hub prices may be more influenced by global LNG market dynamics than purely domestic supply/demand fundamentals.

In any event, the role of the European gas hubs as pricing benchmarks for Asian LNG companies, and for the global LNG business as a whole, should become ever more entrenched.



ABOUT THE AUTHOR

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