# LT-ST Markets in Gas

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# Introduction

**Project objective**

- To assess the impact of an increase in short-term contracts on competition and security of supply in the EU gas market, based on a holistic view of the EU gas sector

**Three elements concerned**

- Overall contract duration
- Flexibility: ToP, levels, Re-openers, re-negotiations
- Pricing formulas

**General trend towards more short-term oriented contracts**

- Shorter durations the more downstream the value chain
- Driven by EU and global market dynamics
- Is expected to gain momentum
- Exceptions for Member States with limited supply option

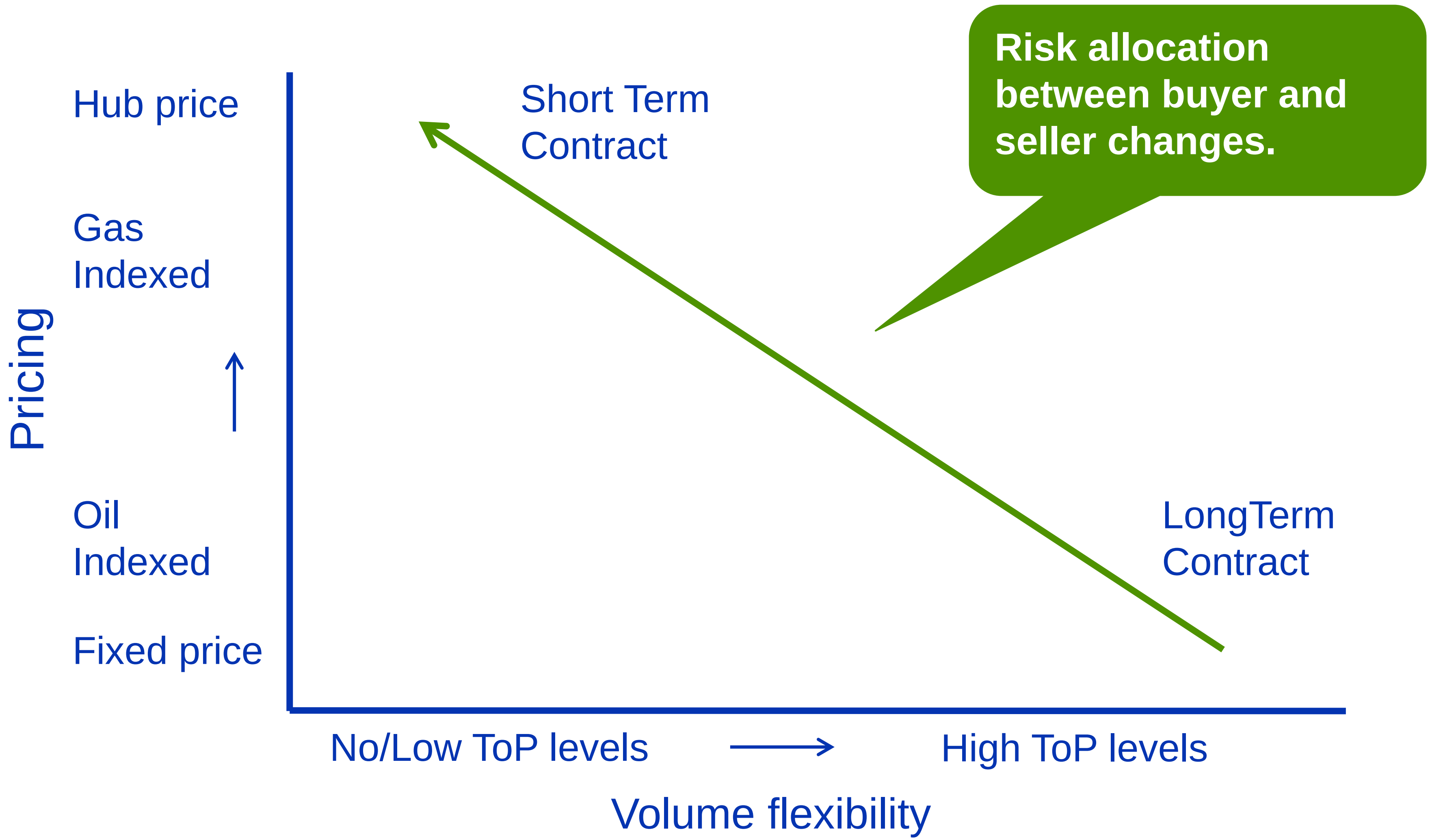
**Project Approach**

**EU Gas Sector**

**Other Gas Sectors**
(USA, Japan, China, Australia)

**Other Commodities**
(Power, Oil, Coal)

# Contract Structures in the EU – General Development



# Conclusions

## Future of LT Contracts

- In the long-run, **traditional long-term, oil-indexed contracts** will very likely **not prevail**
- In particular on the level between importers and re-distributors, smaller wholesalers and large customers, **short-term contracts will become increasingly dominant**
- On the one hand side, **contract durations are likely to become shorter**, with a strong role of spot trading
- On the other hand side, **pricing is likely to change towards more short-term, gas market related elements**, i.e. hub-based pricing
- **If pricing** becomes **more short-term** oriented, overall contract **duration loses significance**

# Conclusions

## Liquidity and Competition

- **Existence of** mature, i.e. **liquid and competitive markets**, is the **key divider for the assessment** of an impact of an increase in ST contracts
- Where competitive markets already exist or are emerging, and where physical conditions such as diverse supply sources and adequate interconnection capacities will allow, **ST contracts will foster market entry**, thereby strengthening competition and increasing liquidity
- **New entrants** will typically join the ranks of so-called **second-tier players**, i.e. at a level below the traditional incumbent importers and large wholesalers
- More ST contracts **provide additional room for traded volumes, hedging and paper trade**, further strengthening competitiveness of markets

# Conclusions

## Liquidity and Competition (cont'd)

- In liquid markets, role of transport and storage **capacity** is expected to change to **being a hedge against** regional or intertemporal **price spreads**
- The **expected spreads** will increasingly **shape the willingness** of market parties **to pay** for transport and storage capacity
- Where **liquid and competitive markets** will provide the fundament, market parties are thus facing **rather a price risk than a physical risk of supply interruptions**
- **Forward markets** will likely be **strengthened by increased ST transaction volumes**, providing effective signals to all market parties

# Conclusions

## Prices and Market Signals

- Under ST contracts, **prices will better reflect short term supply and demand situations**
- **Price volatility could** therefore **increase**, as recent examples show
- **More volumes** will be traded **subject to** those **ST prices** which likely **strengthen consumer reactions** on price signals
- To the extent consumption will respond to price signals, **consumption will become more efficient**
- **Market ability to absorb price movements** as well as changes in supply-demand situation **is improved** (higher resilience)

# Conclusions

## Prices and Market Signals (cont'd)

- Where market **prices become more volatile**, **investors** tend to **adapt their behaviour**, investing when the market outlook is rather positive
- Due to considerable lead times of gas production and transport investments ahead of the liquid end of the forward markets, the result could be a **more cyclical pattern of gas markets**
- Interim price movements could lead to **negative side-effects**
- Increased **efficiency and resilience** of gas markets **could absorb** (part of) the tendency to a **more cyclical market development**
- More **liquid forward markets** will **shorten time gap** between price signals for investors and the time investments will become effective

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