Trading in the wholesale gas market – an attempt to summarize the complexity

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Types of Traders

- Generally the term ‘trader’ in the first instance stands for ‘market participant’

- To name some types and categories of market participants: producers, retailers, aggregators/portfolio managers, utilities, midstreamers, traders, financial institutions/Hedge Funds (…and there are many more different names and types possible)

- Ultimately the nature of the market participant’s business defines to which category a market participant belongs as ‘trader’, and accordingly this defines his activity on the market place

- Examples of purposes/drivers of market participants activities:
  - Producers: needs a market place to sell his production
  - Retailers: needs a market place to buy the commodity for his end customers
  - Utilities: often both a producer and a retailer, need a place to buy and sell
  - Portfolio Managers: in order to balance his long and short he needs to buy and sell
  - Traders/Financial Institutions: usually no up- or downstream position/commitment, opportunistic

- In reality the different roles/drivers may sit in one company or group, structured into several companies fulfilling different roles

- All of the above types are important to create a balanced mix of market participants

- Moreover the above activities are distributed across the trading tenor (time), some market participants are more active on the very short term market, other rather on the longer term market
Trading strategy

- What means ‘strategy’?
  - A plan...
  - ...to achieve a goal...
  - ...under conditions of uncertainty
- In other words based on the variety of different drivers of the market participants we experience a huge variety of trading strategies
- The trading strategy is driven by the purpose each market participant intends to reach on the market:
  - *Hedging future production*: producers intend to fix (secure) the future income by selling forward contracts for the production plan
  - *Hedging future purchase prices*: retailers intend to fix (secure) the future purchase cost by buying forward contracts for the retail sales plan
  - *Fixing future production/sales*: utilities often have both production (gas, oil, coal, power) and retail exposure, so need to be hedged on both sides and are effectively active on buy and sell side (often even multi commodity)
  - *Fully flexible on taking a position opportunistically*: either outright, or as time spread, or location spread: this a what pure traders / hedge funds pursue on the market; generally they have the role as risk takers
  - *The ultimate goal of all strategies of all market participants* is to create value within the value chain, i.e. to generate profits for their own organisations

- The sum of all of different activities and drivers of all market participants create in sum what we call liquidity
Trading & Compliance

- All aspects of life are governed by rules, and so are the commodity wholesale markets.

- Compliance is one element of the variety of rule sets we have (next to Energy Markets regulation, Financial Markets regulation, internal rules set be Risk and Credit teams, etc.)

- The compliance rule set for correct trading behaviour is globally developed and introduced, and supervised not only by independent authorities but also strictly followed by the Compliance officers of the market participants.

- Market participants spent a lot of resources internally to supervise and also to train the employees.

- We all appreciate and deserve to have an orderly organised and well functioning market place, so we need common rules – that’s it!
Information availability

- see above the definition of strategy: “... under conditions of uncertainty...”

- Information is the key to reduce the level of uncertainty, and to enable and/or improve the success of the activity; let’s be clear: commercial activity always bears a risk / uncertainty, and we strive to reduce the level of uncertainty as much as possible

- In today’s energy world the availability of information is vast, and accessible to all market participants at low hurdles; it is rather the challenge to collect, digest, analyse and convert the mass of information and implement it into the trading strategy

- Compared to the early days of energy trading today’s amount of information is enormous and the access to information is easy, introduced by transparency initiatives from Regulators. Technically any relevant information is available to the market participants

- So it is up to the market participants to collect the relevant data for their type of business and their region of activity

- Analysis of available information spans from a very regional view (e.g. single country) up to a fully global picture, even including a multi commodity approach (gas, power, oil, coal, EUAs etc), and the general macro picture to be added
Liquid vs illiquid gas markets

- broadly we see a drop of liquidity going from North West Europe to South East Europe
- This is clearly historically driven, as market liberalisation started in the UK and dribbled into Continental Europe in the years after, step by step reaching the regions further south and east
- Today the Dutch TTF has taken the role of the anchor market for Europe, sending the general price signal to all other markets, which trade at a location spread to TTF
- The location spreads to TTF are volatile, and change based on fundamental drivers, e.g. availability of transport capacity, Supply & demand in the specific markets, storage situation, regional weather patterns etc.
- Technically most of all EU market places have the potential to become a very liquid trading location; question is do we need it, or is one anchor market with liquid spread trading to other markets sufficient?
- We observe a very liquid market for products from Day Ahead up to 5 years out at the TTF, whereas liquidity at the other markets is much more concentrated in the shorter term products
- This is a sign that TTF is the market place for financial hedges for Europe, whereas the other markets fulfil the role of physical balancing markets (which is concentrated in the shorter term trading tenors)
- So as long as the liquidity on the location spread products is high the industry can cope with one liquid anchor market
Excursus: about capacity contracts

- Latest since the introduction of CAM and easy access for shippers to booking platforms (Prisma, RBP, GSA) the commercial behaviour of the market participants has changed drastically.

- Whereas in the past multiyear bookings were the common tool to run a gas portfolio, today the prevailing capacity products used by shippers are from DA up to maximum front GY, i.e. decisions and contractual obligations are concentrated in the short term.

- This development seems to be fully market rational, as access to book via platforms is easy, very standardised and non-discriminatory.

- Not to forget the transformation from point-to-point transport to entry-exit systems is providing so much more opportunities for market participants, which are better to capture with shorter term capacity portfolio.

- The current booking behaviour also reflects the anticipation by all market players of higher uncertainties in a highly competitive environment, to remain flexible in steering and optimising their commercial activity/portfolio.

- The shorter the duration of a capacity booking the lower the risk of stranded (out-of-the-money) capacity contract, i.e. reducing the financial risk for shippers.