

New Report Looks at Fundamentals of Natural Gas Trading and Exchanges

A new EPRI report describes the latest trends and changes taking place in the principal natural gas trading venues and the implications of these changes for electric utilities.

This very timely report, entitled *Characteristics of Natural Gas Trading and Exchanges* (1016790), tracks trends in trading levels, the degree to which different types of traders are long or short in the market, the use of trading activity information in hedging market risks, and a variety of problems with the data that impede interpretation.

Qualified funders may view or download a copy of the report by clicking on the link below.

How to Apply the Results

Interest in energy trading grew exponentially during 2008 with numerous U.S. Congressional hearings on the influence of speculation on oil prices. Natural gas is an extremely important fuel in the electric industry, accounting for 54% of annual fuel expenses and frequently driving power prices.

The boom in trading activity and the controversies surrounding energy trading (and natural gas trading in particular due to its great importance to the power industry) call for detailed, dispassionate analysis of natural gas trading as a phenomenon unto itself. By drawing on the skills of an insider to trading and compiling information in innovative ways, this study provides a uniquely comprehensive analysis of trends in gas trading and the emergence of new markets/exchanges. At the same time, the report is self-critical, pointing out the very real limitations that plague interpretations using these data.

For individuals involved in day-to-day trading, the report provides an integrated perspective. For others, the report helps to demystify the variety and usefulness of data reported by the various exchanges.

Background

This is a very dynamic time in the trading markets, not simply because of tight fundamental market conditions but also because new and more transparent information will likely continue to emerge from improving Commodities Futures Trading Commission (CFTC) datasets and tighter trading regulations.

In November 2007, at the EPRI-EEI Annual Power & Fuel Supply Seminar, EPRI hosted a presentation on the trading dimensions of natural gas markets. The talk garnered great interest and pointed to the need for greater understanding of the changes taking place in natural gas trading venues and the use of information derived from the exchanges. The first step is to simply better understand what is going on and where. This report tries to provide that understanding.

Areas Covered

The report addresses the following seven topics:

- **Commodities as an Asset Class.** Provides an overview of the size of the exploding derivative markets and the participants with focus on the speculative traders and investors.
- **Fundamentals and Beyond.** Briefly reviews international crude oil and domestic natural gas fundamentals, and discusses the nature and impact of market psychology.
- **Natural Gas Markets.** Reviews trading volumes and participants in the three principal markets: the Exchange Traded Markets, the Bilateral Over-the-Counter (OTC) Markets, and the Exempt Commercial Markets.
- **Volume and Open Interest.** Discusses traditional concepts of interpreting changes in volume and open interest against price movements.
- **CFTC Commitment of Traders Report.** Introduces CFTC information about the levels of trading, types of trading, and participants (e.g., commercial versus non-commercial).
- **Market Oversight.** Reviews the actions taken to date by the U.S. Congress and the CFTC to strengthen market oversight and curb excessive speculation. Also includes a critique of the recent CFTC analyses of speculators' roles in the energy markets.
- **European Gas Markets.** Offers a high-level overview of the National Balancing Point and continental gas markets.

Highlights of Findings

Some highlights of the report's findings are as follows:

- Trading in natural gas has increased rapidly as part of the global commodities supercycle in which an increasing number of financial entities have shifted assets into commodities as an asset class.
- While energy and agricultural trading shot up from \$1 trillion to \$8 trillion in just three years, this is surprisingly only 1.5% of total trading in financial and other derivatives. The author concludes that speculation has provided some uplift to prices, although estimation of magnitudes may be impossible.
- Trends in trading activity are summarized for the principal exchange traded market (NYMEX), the principal exempt commercial market (ICE Futures), and for bilateral Over-the-Counter markets. Evidence from levels of open interest suggests NYMEX is the premier trading venue for U.S. natural gas traders.
- Data from weekly Commitment of Traders reports, issued by the CFTC, are examined in detail. These provide a window into activity by commercial and non-commercial or speculative traders and their relationship to prices. Traditional relationships have broken down over the past several years with more trading occurring off NYMEX.

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