What's Hot: Have we hit peak-bearishness on Natural Gas yet?

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US natural gas prices (Henry Hub Futures) have declined 51% in the past month, marking the worst 30-day performance we have on record1. US natural gas prices are now 26% below the levels seen on the eve of the Ukrainian war (19 February 2022). US natural gas prices are not necessarily a representation of global natural gas prices and the Ukrainian war shock had affected European natural gas prices more (with European prices more than tripling at one point in 2022). But even European natural gas prices are now 28% below the levels seen on the eve of the Ukrainian war2. To be clear, there is no typo in the date of this publication (13/01/2023) and the Ukrainian war is still ongoing. So why have natural gas prices fallen so much? The answer lies largely in the weather. Both the US and Europe have had unseasonably warm winters. Although there have been some sharp dips in temperature in some regions, they have been short-lived. Natural gas is largely used for heating purposes and also for power production (electricity).

Europe averts crisis, with a little help from policy and good weather

Europe has made a conscious effort to fill its natural gas storage capacity going into winter and reduce its demand for energy, with a European Union (EU) agreed target to reduce gas demand by 15% from August 2022 to March 2023. Bruegel3 estimate that in 2022 natural gas demand in Europe was 12% lower than the 2019 – 2021 average. Demand in October 2022 was 27%, in November 24%, and December 13% lower for the selection of EU countries with available data (versus the averages for 2019 - 2021). According to Gas Infrastructure Europe4, natural gas storage in Europe was 80% filled in Europe on 13 January 2023, that compares to 47% on 13 January 2022 and 63% on 13 January 2021.

As a result, Europe doesn't need as much US natural gas imports to replace Russian supplies as many had feared in 2022. That is true even though Russian supplies to the North West Europe have fallen to zero and are negligible elsewhere in EU.

Source: WisdomTree, Bloomberg. Data from January 2020 to January 2023

Historical performance is not an indication of future performance and any investments may go down in value.

US LNG export capacity hamstrung, but for how long?

Added to US's woes is that its largest Liquified Natural Gas (LNG) terminal – responsible at its peak for close to 20% of the US's natural gas exports – has been offline since June 2022. Freeport LNG shut after a fire and its reopening has been constantly delayed. Because Freeport is exporting gas, natural gas

inventory is building up in the US, keeping supply there flush. Freeport's latest guidance (sent in December 2022) is for a reopening this month (January). Given constant delays, its unsurprising the market doesn't believe this announcement as we head into the final stretch of the month. However, there are reports that there has been a surge in gas flow to the Freeport's LNG terminal over the over the long U.S. Martin Luther King Jr holiday weekend (14-16th January)5. That indicates it is readying to start operations.

US gas looks cheap to Europeans

EU natural gas prices currently trade at 6 times the price of US prices (and in 2022 it was sometimes more than 8 times). Although liquifying and regasing adds cost, US natural gas prices are still attractive to import. While storage facilities are 80% filled in Europe, the scarring stress of worrying about insufficient supplies in 2022, should motivate the EU to opportunistically fill storage to 100% whenever possible. The EU was lucky that weather was on its side this winter. The same cannot be guaranteed for future seasons.

Source: WisdomTree, Bloomberg. 09/09/2018 to 18/01/2023. TTF price using Dutch TTF Gas 1st Line Financial Futures (USD/MMBTU) as published by ICE Endex who convert megawatt hour to Metric Million British Thermal Unit (MMBTU) and USD using the WM/Refinitiv Closing EURUSD Spot Rates as published by Refinitiv at 4 pm UK time. Note 1st Generic Futures Prices do not incorporate roll yields.

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Europe is building more storage capacity and will be able to import more US gas

The EU is frantically building new storage capacity as well. Liquefied natural gas (LNG) import capacity in the European Union (EU) and the United Kingdom (UK) will expand by 34%, or 6.8 billion cubic feet per day (Bcf/d), by 2024 compared with 20216. Based on Gas Infrastructure Europe database7, we see that that the EU a large number of these projects should complete in 2023 and the EU intends to continue to build capacity beyond 2024. So, while storage may be 80% filled today, capacity will continue widen, giving US exports further room to grow.

Cold spell maybe favourable for US demand

The National Oceanic and Atmospheric Administration (NOAA) is predicting temperatures to be below normal for the coming 8-14 days8 across the US. We know weather can change abruptly and forecasts are hard to rely on (we were caught out on this in December 2022, when NOAA predicted a cold month, but temperatures surprised to the upside overall). However, if NOAA are correct, we could see higher domestic natural gas consumption.

Is bearishness overdone?

Positioning in natural gas futures is net short 176k9 (more than 1 standard deviation below the 5 year average), marking a bearish signal. That is the most negative since March 2020, i.e. the peak of COVID 19 market stress in the energy markets.

Source: WisdomTree, Bloomberg. 02/01/2018 to 10/01/2023.

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Conclusions

Good weather has reduced natural gas demand in US and Europe. In Europe thrifting has reduced its demand for US gas imports. But have prices fallen too much in response? The Ukrainian war is certainly not over and gas supplied from Russia have slowed to a trickle. As Europe builds more capacity it will need more US gas and US should be able to export it as Freeport opens. With shorts so stretched, we could see a potent reversal in US natural gas prices.

1 As of 13/01/2023, Source: Bloomberg. We have front month Henry Hub Futures data to 03/04/1990.

2 As of 13/01/2023, Source: Bloomberg. Using Front Month

3 https://www.bruegel.org/dataset/european-natural-gas-demand-tracker#:~:text=The%20primary%20solution%20is%20to,and%20household%20sectors%20wherever%20possible.

4 https://agsi.gie.eu/

5 https://www.reuters.com/business/energy/gas-starts-flow-freeport-lng-export-plant-texas-data-shows-2023-01-17/

6 https://www.eia.gov/todayinenergy/detail.php?id=54780

7 https://www.gie.eu/transparency/databases/lng-database/

8 https://www.cpc.ncep.noaa.gov/products/predictions/814day/

9 10/01/2023, Source: CTFC

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