

Friday 14 February 2025

Politics and financial (gas) markets are not a happy marriage

The past few weeks have been dominated by falling gas supplies and, by extension, rising gas prices. As a result of this growing tension in gas markets, politicians are experiencing increasing pressure to intervene in the markets. This manifests itself in several ways. Firstly, calls for a new price cap on gas are increasing. In addition, there is increasing talk of the need for an extension of the filling task of gas stocks from the government and the holding of strategic gas reserves. Insurances cost money, and this clashes at a time when politicians are simultaneously calling for lower gas prices for households.

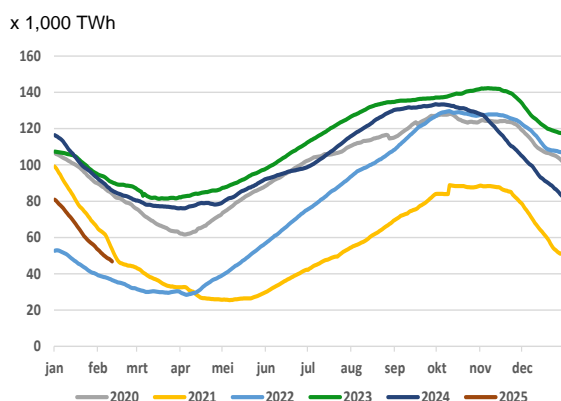
Several conclusions can be drawn from this mix of market developments and the pressure felt by politicians to intervene here:

- Intervention in the market is market-distorting and can be counterproductive for filling stocks and gas prices;
- Focusing only on gas reserves ignores the other options (such as imports and demand reduction) to meet gas demand;
- Ensuring security of supply (obligation to fill gas stocks) costs money and thus clashes with the political desire for lower gas prices;
- A strategic stock may be useful, but it does not necessarily help against price fluctuations;
- Protecting against unnecessary price volatility can only be countered with (politically unpopular) long-term solutions;
- Decoupling of the themes physical and financial gas markets is necessary;

Gas stocks falling rapidly

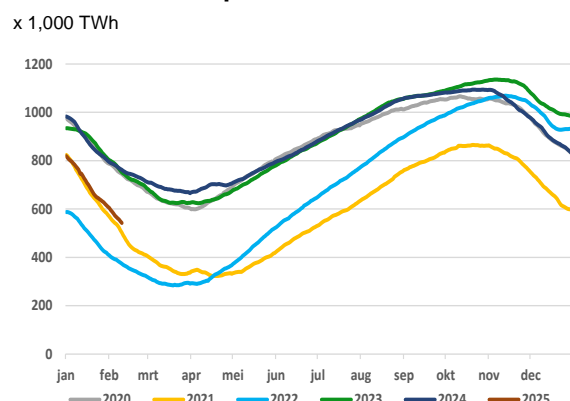
Gas stocks fell significantly faster this year than in the past two years. One reason was that this winter is slightly colder than in past years. But another, more important, reason is that gas prices give reason to use gas from (Dutch) stocks rather than imports or gas from neighbouring countries. This has mainly to do with the price of gas in stocks in the Netherlands compared to the price in surrounding countries and (liquefied) natural gas on the spot markets.

Gas stocks Netherlands



Source: GIE

Gas stocks Europe



Source: GIE

Now, we will get through this winter and there will be no physical gas shortages, even if it gets extra cold in the coming weeks. What is more interesting is whether, and if so to what extent, gas supplies are going to be filled in the coming summer months in preparation for next winter.

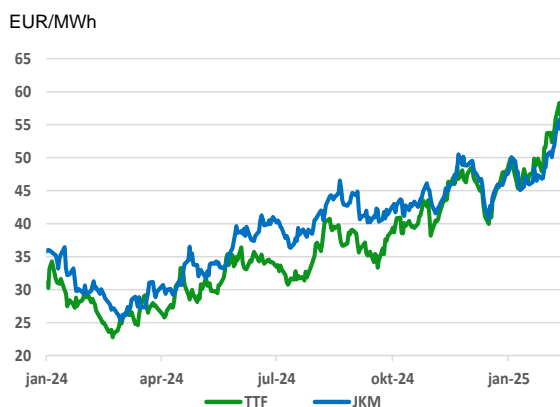
Gas prices ahead of expected purchases

Gas markets have accelerated from a regional market (Europe) to a global market since the energy crisis, with liquefied natural gas (LNG) playing an important role. Because gas is now no longer tied up in pipeline transport routes but can be moved flexibly in an LNG tanker, the market has become a lot more liquid, but also more volatile. Gas trading takes place through long-term and short-term contracts. Those buying in for the long term now have guaranteed delivery. If you are not yet guaranteed to buy, you have to turn to the short-term (or spot) market. The still-uncontracted gas ends up with the highest bidder.

Over the past year - from February 2024 - the *Title Transfer Facility* (TTF) gas price has been on an upward trend. Due to increased industrial activity, tighter markets due to the further loss of Russian (pipeline) gas and market speculation, the gas price has increased by more than 150% compared to a year ago.

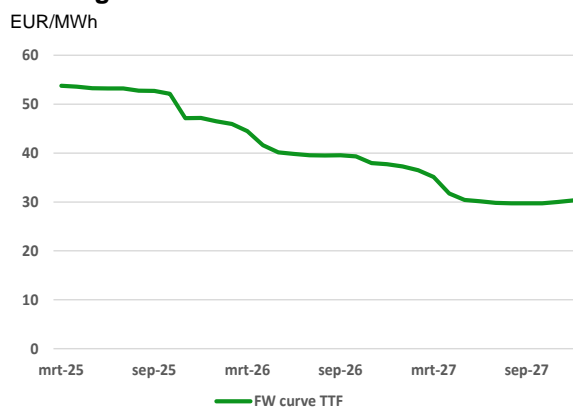
In recent days, there has been a downward price correction of around 15% due to rumours surrounding a possible 'peace deal' between Russia and Ukraine. In addition, rumours are buzzing that the European Commission may start to loosen the filling obligations for gas stocks slightly. The possible impact on the gas market creates such uncertainty that market speculators cashing out on their long positions because of this.¹

TTF gas price in upward trend



Source: LSEG Refinitiv

TTF forward curve: commercial incentive missing



Source: LSEG Refinitiv

The right-hand chart above shows the forward curve of TTF gas. This is a representation of current prices for gas deliveries in the future. Where normally a clear seasonal pattern is visible in this forward curve, we now see an almost linear downwards trend. This means that the market currently expects gas to get cheaper and cheaper in the future.

Normally, we see in seasonal patterns that gas prices are cheaper in summer than in the following winter. This leads to a buying incentive in summer (low prices) to fill gas stocks in preparation for higher gas demand in winter (higher prices). With current market expectations, there is currently no commercial incentive to fill gas stocks as gas prices are cheaper at a later date.

The price chart above clearly shows the difference between the TTF gas price and the *Japan Korea Marker* (JKM) price. The principle is simple: LNG generally ends up in the port of the highest bidder. So last summer, that mostly went to Asia, while currently more goes to Europe. That imported gas is now fed directly into the gas grid, or - in the case of the Netherlands - goes to the nitrogen plant in

¹ Long positions: market positions that speculate on future price increases.

Zuidwende. There, it is diluted with nitrogen, giving it the quality used by Dutch households. This is the so-called low-caloric gas, similar to the gas from the Groningen gas field.

As markets wait, pressure on politics increases

So gas stocks are currently at lower levels than in the previous two years. And although winter is not yet over and the 'filling season' has yet to begin, the commercial incentives to actually do so seem to be lacking. In addition, gas prices ticked up to their highest point in two years.

PVV leader Geert Wilders posted a message on 'X' earlier this week that negotiations for the Spring Budget will start soon and that the PVV mainly wants a lower gas bill for households (read voters). Now this seems fairly easy to achieve, since the gas bill for households consists of about 50% taxes. And that is precisely an instrument where the cabinet turns the knobs. The tricky thing, of course, is that a cut here leads to an increase elsewhere. The other important factor for the gas bill is the raw material, the gas itself.

Political pressure is twofold: access to sufficient physical gas and preventing high/rising gas prices. During the 2021/2022 energy crisis, the government, in consultation with the EU or following European decision-making, took several measures in an attempt to calm gas markets. These measures consisted of setting a filling task for EBN (20 TWh, or 18% of the total storage capacity) in case commercial parties failed to do so, joint purchasing of gas by European parties to prevent mutual competition, introducing a price cap, and compensation for high energy costs.

Whereas in the past year it was regularly stated that the energy crisis was behind us, we see the pressure on politicians rapidly increasing again now that gas stocks are relatively low and gas prices are rising. Once again, there are calls for a price cap, a minimum filling obligation of gas stocks and strategic gas reserves. All solutions that are suboptimal and all serve different - and often opposite - purposes.

Gas stocks are an important aspect of the market, but not the only one

The focus on gas stocks makes sense, especially now that the filling pattern is different than in recent years. The Netherlands has three major underground gas storage facilities: Norg, Grijpskerk and Bergermeer. Norg and Grijpskerk are managed by NAM, Bergermeer by Taqa. All three fields currently have a fill rate of around 30%. Nonetheless, Minister Hermans recently indicated that the situation is not worrying, as we also had a similar decline in reserves in 2017 and 2018 and this did not lead to shortages at the time either. In doing so, the minister ignores three crucial changes since then:

- 1) There are no more European imports of cheap Russian pipeline gas;
- 2) The Groningen gas field is no longer available as a production field or backup;
- 3) The gas market has become global. With that, we are now competing with consumers in other continents, especially in Asia.

So, although this winter's gas supply trends are similar to those of 2017 and 2018, market conditions have changed dramatically. Market concerns are therefore more well-founded than the government seems to think or wants to admit.

Nevertheless, we should also keep an eye on the other aspects of the market and again not overestimate the value of the level of gas reserves. Europe, and the Netherlands, has invested heavily in expanding LNG's onshore capacity in recent years. This ensures that there is sufficient import capacity to actually feed gas purchased on the market into the gas grid. In addition, a single member state's supplies cannot be considered in isolation from surrounding countries. For instance, if gas stocks in the UK, Belgium or Germany are filled at a higher price, it pays to use the cheaper gas from the Dutch storages first. Market forces are also at work here.

A third aspect is *demand side response*, or demand management. The moment there would actually be too little gas available, gas prices would rise and the market would react accordingly. This response could consist of shifts in supply (less gas, more coal/oil), or on the demand side. With rising prices, households and businesses will start to temper their consumption or look for alternatives. This is something we have also seen in recent years. Households started insulating and/or making their energy consumption more sustainable and companies changed their production process or scaled down.

So the gas market is part of a large and complex energy system in which you cannot separate storage, imports and demand-side management. The moment the government intervenes in one aspect of this complex energy system, it will have an effect elsewhere in the system.

A filling obligation from the government distorts the market

The European Commission has imposed a filling obligation on member states through the EU gas supply security regulation. This regulation predates the Russian invasion of Ukraine and aims to secure gas supplies from third countries towards the EU. However, this mainly concerned guarantees of gas transit to other member states. In light of the energy crisis and the need to secure the EU's gas reserves, Amendment Regulation (EU) 2022/1032 required underground gas storage on the territory of member states to be filled to at least 80% of capacity before the winter of 2022/2023 and to 90% for winter periods in subsequent years.

With this obligation, not only has it become a lot clearer when to buy gas, but also how much. This is fodder for market speculation and drives up prices further than would have been necessary at the time when gas procurement (as efficiently as possible) was left entirely to the market. The large price spike in 2022 is mainly explained by the resulting tightness in the market due to the largely elimination of gas imports from Russia. But the price rise is also partly explained by EU commission president Von Der Leyen's announcement to 'fill gas reserves at any cost'. A signal that was received as a buying signal by market speculators, thus causing an additional price boost.

By mandating part of the purchase of gas in a set period, gas buyers can no longer do so at the most economically efficient time. Commercial interests of the buyers may clash with the political interest to fill stocks in a timely manner. From a commercial perspective, a strategy may be to buy earlier or later, or focus entirely on spot markets (or imports rather than storage). Mandatory filling of gas stocks ignores price signals from the market and will lead to inefficiencies. This kind of filling obligation drives up prices because it does not remove the underlying problem, a skewed supply-demand balance.

A strategic reserve can be useful, but does not necessarily help against price fluctuations

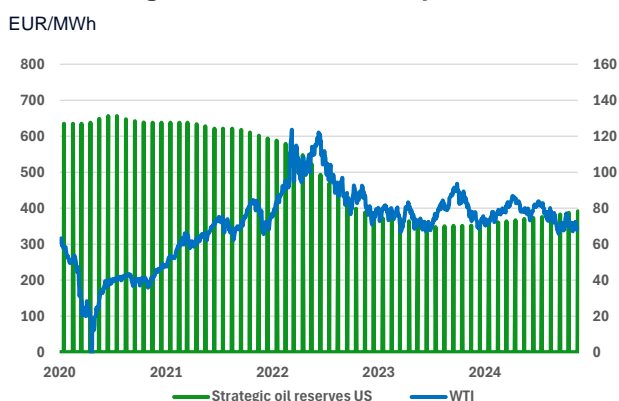
Following previous recommendations by the Court of Auditors, Gasunie Transport Services (GTS) and the Council of Mines, among others, but also from Europe, the advice to hold strategic gas reserves is once again growing. The idea behind this is - as with oil - to build up strategic reserves and deploy them when 'markets' are disrupted. Here, a clear distinction should be made between a gas reserve that can serve as a guarantee for times when the Netherlands, or (Northwestern) Europe, is denied access to physical markets and a reserve that serves to prevent gas price increases.

Continuing that parallel with oil markets, we have seen in recent years that using strategic stocks to counter price movements has worked optically (see chart below). President Biden sold a large portion of US strategic oil stocks in an attempt to drive down petrol prices ahead of elections. Yet the effect on the price was limited. After all, we saw the price correction in the second half of 2022 not only in oil markets, but in all financial markets, including the gas market. So it is reasonable to argue that oil prices also would have shown a sharp downward price correction without the release of oil from

strategic reserves. It was an expensive tool (selling some 300 million barrels of oil), to achieve an effect that would have been achieved just as well without the measure.

The important lesson to learn from this is that using strategic stocks to influence prices is limited and market-distorting. Especially in a global market where physical supply is only one of many factors determining the price of, in this case, gas.

US strategic oil stocks and oil price



Source: LSEG Eikon

Yet strategic reserves can be useful. Strategic oil reserves were created after the oil embargo in the 1970s. Major Middle East oil suppliers (OPEC) boycotted oil exports to the US and the Netherlands, among others. In response, the West decided to build up strategic oil reserves in case problems arose again in the supply chain of oil towards Western refineries.

No strategic reserves are held for gas. Until now, there was no need to do so. The Netherlands had the Groningen gas field that served as a buffer at times when demand was unexpectedly high and existing buffers were not sufficient. In addition, we could always ask the Russians to supply a bit more and we had a landing site for LNG with the Gate terminal. This situation has changed and, as Northwest Europe, we now mainly rely on LNG imports. Strategic reserves can be wise if you want to hedge again against unexpected problems in gas supply. Think of the unavailability of gas pipelines between Norway and Europe, or the inability to unload LNG at terminals.

Price protection is possible, but only long term

So can't the government do anything to stop rising gas prices? Certainly they can. Only these measures have not proved very popular in recent years. The various options consist of depending less on that global market: in short, less consumption and producing more ourselves. Another option is to reduce consumption. Only, phasing out gas has been given a lower priority than reducing coal and, in some countries, nuclear power. We will therefore continue to rely on gas in our energy mix for many years to come.

Producing more ourselves is controversial and therefore unlikely for several reasons. Powerful arguments such as the lower carbon footprint that North Sea gas, for example, has compared to imported gas, and the simple fact that indigenous gas generates money rather than that it costs money, have so far not led to an increased share of national, or European, gas production.

Another option to counter price risks is hedging. Buying gas now for the longer term provides 1) security of supply, and 2) avoids price risks. Normally, forward contracts are concluded by the parties that actually have to deliver gas and are part of the total range of instruments that commercial parties

can choose between to fulfil their obligations. If, as a government, you want to combat price fluctuations, you can choose to hedge these price risks yourself.

A state-owned company such as, for example, GasTerra or EBN would be perfectly capable of buying gas for the longer term as a buying party. They could then act as a 'compulsory intermediary' towards the commercial parties that need the gas. But insurance costs money. In addition, such a solution again distorts the market and would therefore probably make the gas price slightly higher than the long-term average price. However, you do thereby avoid large price fluctuations and it thus provides security.

Decouple physical and financial goals

The conclusions of the current market developments are wry: the energy crisis is really not over yet and there is no miracle cure. In the current tight market conditions it is impossible to guarantee security of supply while promising lower gas prices to consumers as long as you are not willing to reduce energy taxes.

The key lesson is that the physical market has very different dynamics from the financial market. In policy-making therefore, these markets should be seen as two separate components of a larger system. This is not sufficiently recognised by our policymakers.

For both physical and financial markets there are solutions that can contribute to the desired outcome. However, the measures often have contradictory effects. A strategic gas reserve may be useful in case of physical shortages, but will not do much to dampen price increases. At the same time, a price cap acts as a market distortion, and lower gas bills for households should mainly come from lower taxes. In short, greater security of supply goes hand in hand with higher prices, and lower prices go hand in hand with relying more on market forces than many a politician would like. Politics and financial markets are not a happy marriage.

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