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Will Russia Shut Off the Taps? Traders Bet on Gas Prices as Winter Nears

By The Moscow Times

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MILAN/LONDON — As the conflict in Ukraine heads toward the winter, Europe's politicians are braced for supply disruptions from its biggest provider, Russia, yet some energy traders sense an opportunity if peace prevails and the gas keeps flowing.

Russia is Europe's biggest supplier of natural gas, and its pipelines through Ukraine are subject to political maneuvering as Europe and Moscow clash over the crisis in eastern Ukraine.

State-controlled Russian gas giant Gazprom meets about one third of Europe's gas demand, worth some $80 billion a year, and it sends almost half of these supplies through Ukraine.

Some traders have steadily bid up winter gas prices on fears of a sudden halt in Russian gas deliveries, which would trigger price spikes and in southeast Europe most likely power and heating outages.

The sense of urgency is so great that authorities across the region are preparing contingency plans that include forcing industry to stop using gas in order to protect households.

Gas prices for delivery during the winter at European trading hubs such as Britain's National Balancing Point, or NBP, have rallied over 8 percent since July, while consultancy Energy Aspects predicts a doubling of gas prices if Ukrainian transit flows are cut.

With markets and governments preparing for the worst, some traders are betting on the opposite, expecting Russian gas to continue to flow, resulting in a market that could be oversupplied especially because stored reserves are so high.

"That risk premium [in prices] will go away immediately if the Ukraine situation is resolved or gradually if there is no disruption of Russian supplies this winter," said Bart Riemens, head of gas trading at Swiss energy firm Axpo.

"If it is going to be a normal winter I don't expect problems even in the case of a short Ukrainian transit cut, the system should be able to cope with it from a physical [supply] perspective," he said.

Mild weather and low demand this year have allowed utilities to stock more gas than previously, with storage facilities filled to almost 90 percent and holding 74 billion cubic meters, equivalent to more than 15 percent of Europe's annual demand.

"The biggest risk for us is that there is no disruption through Ukraine, and if we get a mild winter at the same time we wouldn't know what to do with all the gas currently in storage and the impact for next summer prices could be awful," a manager at a major Western European utility said.

Can Europe Cope?

Some analysts argue that Europe could cope even if Russian gas stops flowing due to falling demand as well as new import capacity of liquefied natural gas, or LNG, via tankers and improved infrastructure that allows for a better distribution of gas to the regions where it is needed most.

"European natural gas supply is secure in the short term despite the current political crisis between Russia and Ukraine [and] Europe can largely cope with a supply disruption by Russia via Ukraine," the German Institute for Economic Research, or DIW, said in a report on gas supplies in August.

Indeed, Europe's gas prices are already relatively low despite recent rallies due to the Ukraine conflict, with contracts for delivery in winter down more than 15 percent since the beginning of the year.

The slump also translated into a sharp fall in trading volatility and the commonly used volatility index, which offers a good rule of thumb for potential trading profits, has slumped more than 40 percent this year to its lowest level this decade.

New gas storages sites developed by Abu Dhabi's Taqa in the Netherlands, which is well placed to send gas across western Europe, should be partly operational for this winter and help guarantee supply needs.

"Everybody is fully geared toward disruption, so if that doesn't happen, there'll be a huge price adjustment as the market will be left totally oversupplied," one gas trader said.

"Personally, my bet is on peace, so I'm shorting the gas market," he added.

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