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Deal to Create Futures Contract Seen Bolstering Market for US LNG

CME Group has reached an agreement with Cheniere Energy to develop the first-ever physically deliverable LNG futures contract, which will be tied to the Sabine Pass terminal on the US Gulf Coast.

Market players in the LNG space have been anticipating the development of liquid trading hubs that can provide gas-on-gas price signals -- undoing the dominance of oil-indexed LNG pricing that is unrepresentative of gas market fundamentals.

US LNG volumes, sans traditional destination clauses, have already brought significant liquidity into the market through increasing numbers of spot cargoes, and those volumes may now have put the US in the race for the first LNG trading hub (NGW Jul.9'18).

"The fundamental problem is that there is no reliable, sufficiently liquid global price benchmark for LNG at the moment," Akos Losz, a senior research associate at Columbia University's Center on Global Energy Policy, told *Natural Gas Week*.

"This can be a meaningful step toward the development of a sufficiently liquid global LNG price benchmark over time," Losz said of the CME-Cheniere deal. "But first we will need to see the details of the contract, and whether a large number of market participants (including some speculative traders) will be willing to embrace it."

Losz added that "liquidity is absolutely key to the success of a reliable price benchmark and hedging tool in any commodity market."

Peter Keavey, CME Group's global head of energy, said the agreement with Cheniere "is significant because it will be the foundation for developing a new LNG risk management tool for producers, consumers and traders around the globe, while further cementing the role of Henry Hub natural gas futures as the global gas pricing benchmark."

Chicago-based CME added that "as US Gulf Coast LNG is increasingly exported to Asia, South America and Europe, there will be an increased need for producers, processors and end users to hedge their price risk."

Abhi Rajendran, director of Research & Advisory at Energy Intelligence, believes that the agreement is good for liquidity, transparency and allows "better use of Henry Hub gas price futures as it pertains to LNG. ... However, it's not some sort of game-changer, but an enabler of US LNG."

In 2015, CME was working with Japan to develop an LNG index. And in March of last year, Intercontinental Exchange announced that it would begin trading the first-ever US LNG futures contract, to be cash-settled against the Platts LNG Gulf Coast Marker (NGW Mar.27'17).

Then in December, the Singapore stock exchange cleared the world's first LNG derivative pegged to a price index for physical cargoes headed to the Middle East and India. Last month, commodities pricing agency S&P Global Platts expanded its markets-on-close (MOC) assessment process to include LNG. The first deal was executed in connection with the MOC last week.

"The most advanced such LNG hub initiatives are in Singapore, Japan and China, but each of these initiatives face substantial challenges, and creating the conditions for a well-functioning LNG hub is a painstaking process that can take a decade or more," Losz said.

But a US LNG hub can develop independently from Asian benchmarks. "The first would be reflective of the value of US LNG in the global market ... while the second would reflect the value of LNG in Asia," he said. "When US LNG is the marginal source of LNG supply and Asia is the highest-priced market for LNG, these two prices will be connected ... at other times they might disconnect."

Meanwhile, with more precise hedging mechanisms still in development, several buyers of US LNG hedged those volumes by buying US upstream assets. This month, those LNG buyers included Japan's Sumitomo and Osaka Gas.

Cheniere's Sabine Pass LNG terminal started exports in February 2016, and currently operates four trains capable of producing 18 million metric tons of LNG per year (2.6 billion cubic feet per day). A fifth train is under construction and a sixth is fully permitted but stalled commercially. If the sixth liquefaction train were to become a reality, the site would be capable of exporting a total of up to 27 million tons of LNG per year (3.8 Bcf/d).

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