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Unintended consequences: Have LNG spot markets become dysfunctional?

[1]

The stratospheric LNG spot prices of recent months have taken the market by surprise and had a number of knock-on effects, including political ones in Europe, where natural gas is now linked to the LNG spot price. Price spikes are a common phenomenon, driven by temporary supply/demand imbalances caused by weather events or infrastructure outages, but as these short-term effects resolve, prices normally come back down again. They can also be argued to be self-correcting, as a high price environment will lead to demand destruction – another bearish driver.

But while the high prices of the last few months persist, the LNG market has not yet seen much demand destruction. Arguably, they do not fall into the normal category of gas price spikes, but are caused by a market structure that amplifies supply/demand effects. The potential for such price excursions is now ‘baked into’ the LNG spot market, whose progress to fuller commoditisation may be slowed or reversed. Meanwhile, in Europe, policy makers are facing some unintended – and unpalatable – consequences of gas market liberalisation.

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