Understanding the Natural Gas Commodity Market

Transparent natural gas commodity market reflects supply and demand; effect of shale gas

Natural Gas Supply Association

The transparent natural gas commodity market provides a clear view of the stabilizing effect of shale gas. The chart below tracks price changes in the commodity futures market for six different commodities, including natural gas. The chart chronicles the transformation of U.S. natural gas supply that began in 2008, the year that natural gas produced from abundant shale formations first arrived on the market in large volumes.

As supply has grown, natural gas prices in both the physical and the financial markets have steadied and dropped. In comparison, the other commodities that are traded on the futures market continue to show significant upward and downward price swings.

The U.S. natural gas market offers an exceptional amount of timely and widely available information about physical and financial transactions and underlying market fundamentals. This transparency strengthens competition and provides natural gas market participants with more facts than any other commodity market, contributing to informed decisions that benefit consumers.

There are two distinct markets for natural gas: the physical market and the financial market. They are separate but linked.

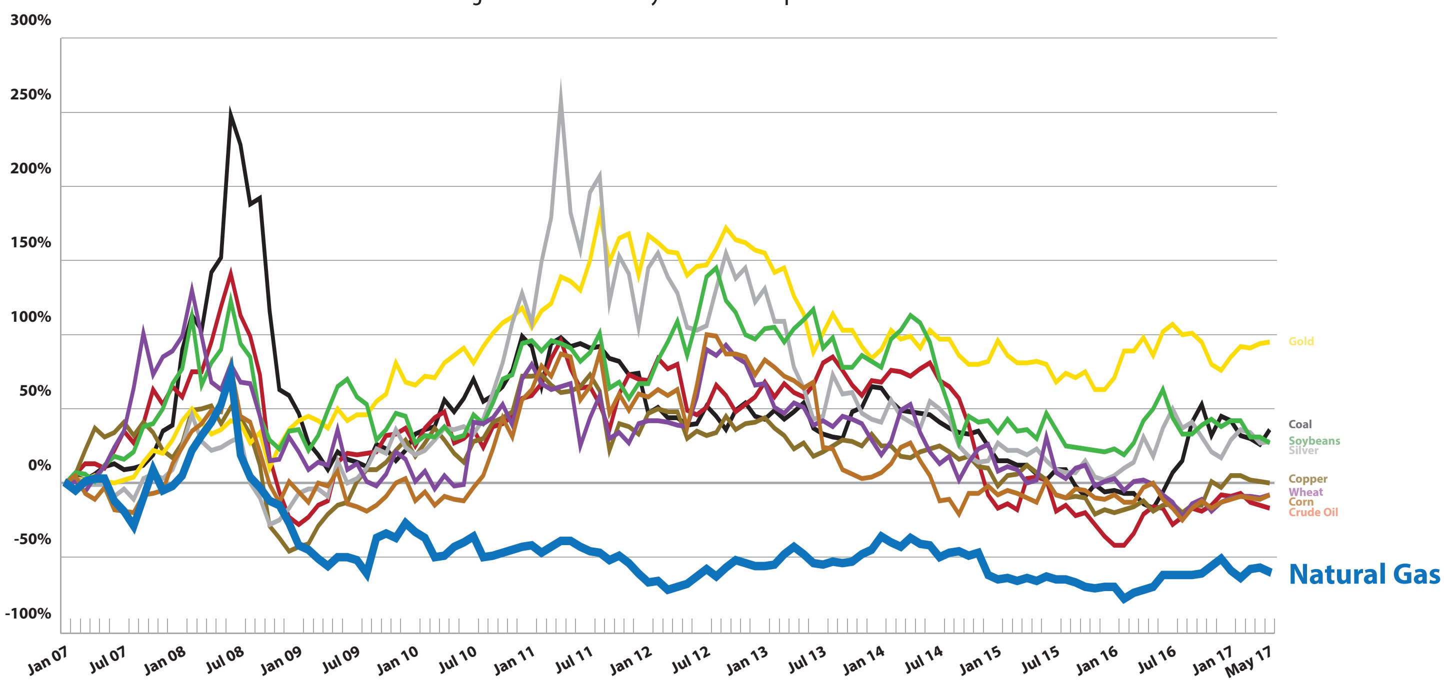
Financial Market: In addition to physical transactions, natural gas is traded for future delivery between one and 36 months from the present. These "futures" contracts are traded on regulated futures exchanges and are used by both buyers and sellers as risk management tools to manage exposure to potential changes in the future price of the commodity.

Natural gas futures contracts may occasionally involve the actual physical delivery of natural gas, but more frequently futures contracts are traded for a different contract or the obligation is settled through a cash payment. As the date of the futures contract gets closer, the financial and physical markets converge. To facilitate convergence, the futures exchanges have rules that govern contract trading, including rules surrounding trading around the time of settlement.

Physical Market: Natural gas is bought and sold for physical delivery the next day at different hub locations around the U.S. These transactions take place on the "spot market," sometimes also called the daily market or the cash market. In addition, natural gas is commonly bought and sold for physical delivery in monthly packages. The daily and monthly natural gas markets consist of thousands of participants making transactions at numerous locations, with many of those transactions negotiated at a fixed-price and reported to natural gas price publishers. Using these reported transactions, price publishers are able to calculate a benchmark "index" price for natural gas at a specific location. This system of index price discovery in the physical market is unique to the U.S. natural gas market and contributes substantially to its unparalleled market transparency. (Albrecht, *Price Transparency in the U.S. Natural Gas Market*)

Comparison of Commodities Shows Stability of Natural Gas

Changes in CME monthy settlement prices Jan 2007–Present



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