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Oil groups and utilities grab bigger share of airline hedging

By Ajay Makan in London

Oil companies and power and gas utilities are increasing their share of the airline hedging market according to participants, as physical operators extend their reach into a business long dominated by investment banks.

The development reflects a shift in power in commodity markets, as expertise in derivatives spreads beyond banks to energy companies and trading houses. The growing prominence of non-banks in the hedging business also shows how physical operators are increasingly taking on financial market exposures, as well as physical contracts.

Airlines often enter derivative contracts with banks to manage their exposure to changes in the price of crude oil and jet fuel.

During the financial crisis some airlines actively sought alternatives to banks and the trend has gathered pace in the past year, as some banks have scaled back their commitment to commodities and those that remain have tended to price credit risk more conservatively.

Three bankers active in the industry estimate energy companies' share of the European airline hedging market has grown from 5 per cent in 2008 to between a quarter and a third.

The trend is also present in the US, although less advanced as many US airlines opt for complex hedging deals, in which banks are still the preferred counterparty, according to market participants.

BP, Royal Dutch Shell and Total, which trade crude oil and jet fuel as part of their business, have long offered hedges to airlines. But their market share has increased significantly, according to market participants. European power and gas utilities with trading arms, including RWE, EDF and GDF Suez, have also expanded into oil derivatives in recent years.

GDF Suez confirmed that its hedging activity with airlines is growing, but said it was a natural extension of the business: "We trade gas and power first and foremost, but a lot of the gas we buy is indexed to oil prices so this requires us to be active in other commodities." RWE and EDF declined to comment.

Bankers said they felt energy companies paid less attention to the credit risk involved in providing a long-term hedging contract, allowing them to price aggressively.

"We often hear on the floor that we've lost a trade with an airline by a few cents, and it will be exactly the same as our credit charge," said the head of energy sales at one bank.