Energy Market Update

Quarterly Update | ISSUE 110

Welcome to our Summer Energy Market Update.

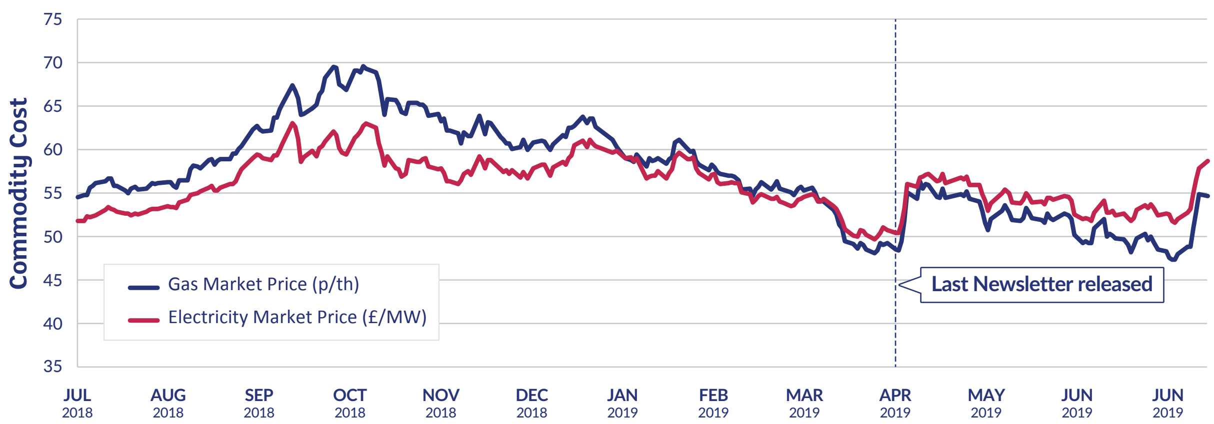
MARKET UPDATE

Price volatility is still a key factor in the UK's wholesale energy markets. Following the sharp increase seen in April of over 15%, the market fell away to come back to the lows seen before that event. However, recently a similar event has occurred causing another 10% rapid increase. The below are key factors driving the market over the last quarter:

- **LNG Arrivals:** LNG Imports remained strong in April and May with record levels arriving on British shores. However, June saw only a third of the average monthly arrivals this year caused by low UK gas prices failing to attract spot cargoes.
- **Oil:** The second quarter of 2019 saw a volatile oil price with a range of $14 a barrel (20%). Volatility has been driven by a combination of rapidly changing optimism/pessimism of the US-China trade talks, ongoing global economic concerns, maintaining of OPEC+ led supply cuts, healthy US-shale production and more recently, increasing tensions with Iran over a key oil tanker route through the Strait of Hormuz.
- **North Sea Gas:** As with the last newsletter, news from the North Sea gas production fields owned by Norway caused the significant increase recently seen. An unexpected outage at one of these fields has been confirmed to be in place until the end of August, much longer than initially expected. Great Britain imports nearly a half of its gas requirement from pipelines from Europe.
- **Coal and Carbon:** Coal prices continually declined over the second quarter of 2019 to levels not seen since 2016 caused by healthy European stocks. Whilst Britain now uses minimal coal towards its power generation requirement, there is still heavy use within Europe which in turn impacts UK prices. Carbon, the cost of permits in the EU to release carbon in to the atmosphere, has continued an ever increasing rise to record highs not seen since 2008. In fact prices remained below €10/tonne from 2012 to 2017. Since the beginning of 2018 there has been a sustained increase to the level now of €29/tonne. These elements influence electricity prices significantly due to the requirement of polluting power stations to buy these.

Energy Commodity Market Prices (2018/19)

Source: Bloomberg



Market Outlook

BULLISH FACTORS

WHAT COULD PUSH PRICES UP?

- **Carbon:** the trend in increasing Carbon prices has been forecast to reach at least €30/tonne. Recent news out of Germany where they want to restrict permits in advance of winding down their heavy coal reliance has caused ongoing upside risk.
- **North Sea Maintenance:** alongside the unplanned outage mentioned, there is significant planned outages over the coming weeks through to the end of the Summer. Therefore any change elsewhere in the gas supply picture is likely to have a much larger impact.
- **Geopolitical:** escalating tensions with Iran is a significant risk factor for oil prices, which in turn influences gas and electricity prices. A lot of aggressive rhetoric has been spoken by the US and Iran which, if acted upon, would directly impact oil transit in the region.
- **Forex:** due to uncertainty around Brexit and the Conservative party leadership race, the Pound's value against the Euro has dropped in the second quarter of 2019. With the deadline at the end of October to exit the European Union, the value of the Pound is definitely a risk factor. The UK buys electricity and gas from Europe; if the value of the Pound is low, then the cost increases.

NEUTRAL FACTORS

WHAT FACTORS ARE CURRENTLY HANGING IN THE BALANCE?

- **Coal:** whilst coal has been on the end of a long decrease in price, a recent, sudden reversal to this has been seen. This has halted the previous downtrend but lower demand for coal globally may mean the demand is not there to sustain a bullish run.
- **Gas Storage:** UK gas storage levels have decreased to average levels for this time of year, previously being in a strong position, and therefore becoming a neutral factor. A key concern is that the North Sea Maintenance schedule and the ever present risk of a cold start in winter could mean we may not have the flexibility in our storage facilities to cope with demand and prevent price spikes to attract gas to Great Britain. However, counter to this, European gas stock levels are above the previous five year range for this time of year, meaning there is plentiful gas available elsewhere.

BEARISH FACTORS

WHAT COULD PULL PRICES DOWN?

- **Gas Supply:** globally there is a significant volume of gas available from new LNG projects and increased US production. This has a knock on effect throughout the world's gas prices.
- **Weather:** we have had a very warm summer which is looking to continue. This helps keep gas demand low helping flexibility within the system, especially when demand for gas for power burn is high when renewables (e.g. wind) output is low.