Energy Market Update

Quarterly Update | ISSUE 112

Welcome to our Winter Energy Market Update.

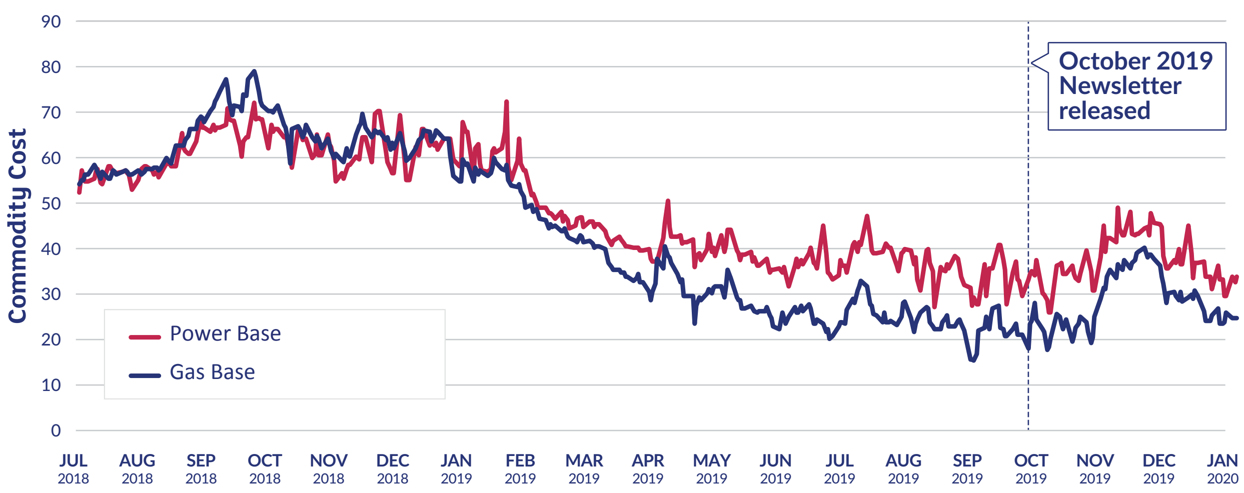
MARKET UPDATE

Overall the quarter has followed a largely bearish trend, with both gas and power prices falling off significantly throughout the period. We have seen an oversupplied gas system, healthy renewable generation and above average temperatures helping to support this movement. The wider commodity mix has seen continued volatility into Q4, as geopolitical events shook the markets. The major impacting fundamentals are listed below:

- **LNG:** The UK has seen a record number of LNG deliveries throughout both November and December. LNG continues to grow as it becomes increasingly important to the domestic supply mix. We are seeing US exports rocket, with a further 60% growth expected for 2020, which has resulted in reduced tankers from our previous main supplier in the Middle East, Qatar.
- **Oil:** The long running factor heavily influencing oil markets over the past few months, has been the US/China trade war. When scepticism surrounding a potential deal arises, the oil price pushed lower, however, with the recent news of a 'Phase One' deal due to be signed on January 13th, the price has begun to rise. Moreover, on the 6th December OPEC agreed to increase global production cuts by 400,000b/day, as they try to tighten the market and bring prices back higher.
- **Geopolitical:** Recent tensions in the Middle East hit breaking point with the US assassination of Qasem Soleimani, prompting a retaliation airstrike on two US military bases in the region by the Iranian regime. It now looks as if military de-escalation is in progress, with likely further Iranian sanctions to be placed in the coming weeks. This caused an oil price spike up to $72/bbl, however, quickly settling back to around $65/bbl shortly after. Furthermore, Brexit and the General Election which took place in early December solidified our exit from the EU, we now have around 11 months to agree a trade deal and begin the leaving process.
- **Gas Storage:** The UK and European gas storage positions have remained in a positive position throughout the first half of winter. The wider EU has maintained levels above 90% for the large majority of Q4, now currently sat slightly lower at 85%, which is still a very positive position. The UK's storage has been slightly more volatile, seeing LNG fall down to around 30% in December. However, currently we see MRS (Mid-Range) at 94.5% and LNG recovering to levels near 64.2%.

Gas and Power Day Ahead Prices

Source: Bloomberg



Market Outlook

BULLISH FACTORS

WHAT COULD PUSH PRICES UP?

- **Brexit:** With our imminent exit from the EU, the next concern is whether a successful trade agreement with Europe can be drafted before the end of 2020. As time goes by this year, we are likely to gather a greater idea of whether this agreement can be reached in the time frame. This uncertainty will be relayed to the markets throughout.
- **Geopolitical:** The major events likely to impact the markets in the coming months are, the ongoing US/China trade disputes, which look set to be slowly rectified and tariffs reduced, US/Iran tensions and whether any military escalation occurs, and US-led disruption to the completion of the Nord Stream 2 pipeline between Russia and Germany.
- **Carbon:** The continuation of reduced carbon allowances being auctioned into the market in an effort to combat climate change will likely continue to push prices up over the long-term.

NEUTRAL FACTORS

WHAT FACTORS ARE CURRENTLY HANGING IN THE BALANCE?

- **Oil:** We are likely to see oil prices rise artificially through OPEC production cuts along with future agreements to reduce tariffs between the US and China, however, the forecasted falling demand for oil will likely hold resistance to significant rises.

BEARISH FACTORS

WHAT COULD PULL PRICES DOWN?

- **Renewables:** The capacity for renewables will continue to grow into 2020, additionally, the costs of installation, running and maintenance will continue to fall due to tech advancement, which will inevitably reduce demand for gas fired power generation. Reduced demand will likely result in falling gas and power prices.
- **Coal:** The demand for coal has fallen significantly throughout the year and will continue to do so as end users, companies and generators move away from the fossil fuels towards greener means of production. Cheap gas and low demand are pricing the commodity out of the market.
- **LNG:** Low spot prices and increasing exporting countries and sites will help the continued growth of LNG throughout Europe. 2019 saw record delivery levels and the market shows little signs of slowing.
- **Gas Storage:** The current high levels of storage pave the way for a secure remainder of the winter season and a strong position moving into the summer. Both the EU and UK are likely to maintain their positive positions well into 2020.
- **Nuclear:** Forecasted to see Dungeness B and Hunterston B's reactors come back online in Q1/2 2020 (February-May), which will significantly improve nuclear availability, providing greater supply security on the domestic power market.
- **Nord Stream 2:** Russia to Germany gas pipeline scheduled to be completed in Q2 (depending on impending US sanctions), this will double the quantity of gas piped into NW Europe.
- **In summary:** We are likely to see the continued trend of an oversupplied gas system moving into the summer season. Furthermore, the re-introduction of multiple UK nuclear reactors will help support the power network and ensure security of supply moving forward. With the assumption the UK does not have any significant cold spells over the remainder of winter, both the gas and power markets are likely to remain bearish.