1 August 2017

WHOLESALE ENERGY PRICES: MAY – JUNE 2017:

In this series of articles, Dominic Whittome covers recent changes to wholesale energy prices.

Crude Oil

Brent crude fell $51.75 to $48.85/bbl amid concern that OPEC and OPEC Alliance states have still been struggling to remove the slack from the oil market, also rising exports from Libya (adding over 1 mbd) and from Nigeria (over 1.7 mbd) to world supplies. Neither oil producer is covered by the production accord.

Oil prices fell by just over 5% which seems a comparatively modest fall put in perspective and against recent newswires and headlines on the subject. Looking at the price upside, markets will be concerned at growing global oil consumption, notably in the automotive sector, the prospect of faltering supplies and the possibility of deeper OPEC Alliance cuts, which may well happen if it is now clear that the existing cuts do not go far enough.

On the downside, the market will be looking at future output increases in Libya, Iraq and North America. Shale exports are clearly having an impact, although longer-term questions about the sustainability and commercial viability of sub $80/bbl production projects outside Africa and the Middle East are likely to remain. Ongoing political troubles in South America and the South China Sea may also rattle petroleum markets in the weeks ahead. Furthermore, with derivatives now accounting for most of the open positions in the forward markets, physical prices may be very sensitive indeed to general shifts in perception, even if the market looks calm at the moment with the 15 Day Brent contract seemingly stuck between the same £45/bbl 'floor price' and £55/bbl resistance level mentioned in the last edition of this update.

Natural Gas

Gas prices barely moved over the period, up just 2%. The main news last month was the announcement that Centrica will permanently shut its Rough facility. This is a converted North Sea gas field which, as most articles reported, accounts for 75% of the UK's storage capacity. While that percentage is perfectly accurate, in terms of the 'high-space/low-deliverability' storage (i.e. the type the market needs to balance on a seasonal basis and to provide cover for prolonged emergencies) the true percentage cover which is provided by Rough is even higher, possibly over 90%.

The closure of such a strategic asset should be a concern therefore. The last 15 years have seen new investment in onshore salt-caverns, although these are generally 'low-space/high-deliverability' assets. Although they are more flexible, the emergency cover they can provide is limited. They are also likely to be more expensive, certainly once competition hitherto provided by Rough is withdrawn. The closure of Rough may therefore expose the UK gas balancing market to technical and market developments relating to these smaller storage facilities, the LNG market and inter-connectors.

Consequently the risk-premiums in I&C contracts may rise (due to higher balancing risks), as will valuations of swing flexibility in North Sea gas sales agreements. From a North European perspective, the gas market does look well enough supplied for now. However, the Russian-Ukraine corridor, South East Asian LNG supply, demand and geo-political developments all need watching in the weeks ahead, as well as the oil market itself.

Electricity:

The forward baseload contract finished the period unchanged at £43.00/MWh. New delays were announced for the proposed 3,200 MW Hinkley Point C nuclear power station and the plant now looks unlikely to generate at full capacity until 2027, by which time all of the UK's remaining reactors, bar Sellafield, may have closed.

Progress on the next new-build site, the 3,600 MW Moorside plant, looks to be in jeopardy altogether, with primary shareholder Toshiba facing possible insolvency and minor partner Engie (formerly Gaz de France) pulling out of the project altogether. Power prices are being held down by low oil and gas prices for the time being but the long term outlook is less clear. To ensure the system has adequate volume, National Grid and central government have embarked on quite an extensive portfolio of new inter-connector projects to import from grids on Continental, Scandinavian countries and potentially Iceland, which has a 1,500 MW wire hoping to get the go-ahead soon.

There are already eleven major inter-connectors, rated between 1,000 MW and 2,000 MW, planned under construction or already live. But whilst the system may have the capacity spare, this is no guarantee that sensibly-priced electricity itself will be available to fill any short-fall. The UK's price-dependence on European and Nordic power exchanges looks set to increase. The landscape will be different with the current inflation-adjusted Strike Price for the first new-build reactor at Hinkley Point C already weighing in at £110/MWh, much higher than the existing baseload market prices.

Barring a renaissance in gas-fired or other indigenous generation, forward power prices look poised to shift higher. Significant increases in trend are perhaps most likely in the balancing market prices rather than baseload, with the latter fast becoming 'the residual' commodity by comparison. As we go to wire, there are reports that half of France's nuclear power plants are in shut down. It is not clear why or when plants will re-start. Twenty units offline cannot be explained by maintenance although there is a host of possible reasons to explain what has happened and no report yet of any sharp movement in European power prices.

Prospect Law Ltd
23 Berkeley Square, London W1J 6HE
T +44 (0)20 7947 5354

Regus House, Pegasus Business Park, Castle Donington, Derbyshire DE74 2TZ
T +44 (0)1332 818 785

@prospectupdate
E info@prospectlaw.co.uk
www.prospectlaw.co.uk

1 August 2017

Prospect Law and Prospect Advisory provide legal and business consultancy services for clients involved in the infrastructure, energy and financial sectors.

Prices quoted are indicative and may be based on approximate or readjusted prices, indices or mean levels discussed in the market. No warranty is given to the accuracy of any view, statement or price information made here which readers must verify.

Dominic Whittome is an economist with 25 years of commercial experience in oil & gas exploration, power generation, business development and supply & trading. Dominic has served as an analyst, contract negotiator and Head of Trading with four energy majors (Statoil, Mobil, ENI and EDF). As a consultant, Dominic has also advised government clients (including the UK Treasury, Met Office and Consumer Focus) and various private entities on a range of energy origination, strategy and trading issues.

For more information please contact us on 020 7947 5354 or by email on: info@prospectlaw.co.uk.

Prospect Law Ltd
23 Berkeley Square, London W1J 6HE
T +44 (0)20 7947 5354

Regus House, Pegasus Business Park, Castle Donington, Derbyshire DE74 2TZ
T +44 (0)1332 818 785

@prospectupdate
E info@prospectlaw.co.uk
www.prospectlaw.co.uk