6 March 2018

WHOLESALE ENERGY PRICES: JANUARY - MARCH 2018:

In this article, Dominic Whittome covers recent changes to wholesale energy prices.

Crude Oil

Crude prices paused for a breather amid confirmation of a surge in North American exports of shale.

US oil production broke through the symbolic 10 m/bd, the first double-digit figure since the early 1990s. However, this headline event did little to knock the crude market, with prices remaining flat over the period. Its impact was tempered by a rise in compliance levels across other oil producing countries in respect of Wider OPEC's November 2016 Accord with OPEC itself, exporting 32.25 mb/d which is a ten-month low. The oil market is also being underpinned by heightened geopolitical concerns which are now, if anything, more heightened then they were last year. The final success of the 'anti-dissident' crackdown and purge in Saudi Arabia remains far from clear. There seems to be no consensus among analysts and observers as to when or how the 'end game' (which is not clear either) will play out or how robust any favourable outcome will be.

Any flare-up or renewed uncertainty in this respect will immediately rekindle prices. Although, the medium-term oil supply outlook remains comparatively stable otherwise, at least for the time being.

Natural Gas

The gas market saw the curve rising just 1%. Although, spot prices charged above one pound a therm at one point amid a conflagration of adverse factors all coming together at once. These included import problems at the Nyhamna Gas Terminal Plant serving Langerled pipeline to the UK; technical issues with Dutch export Balgzand Bacton pipeline itself; a spike in energy demand throughout the North West European corridor amid freezing weather conditions and some market nerves heightened perhaps by enforced N Grid gas curtailments (if only temporary) and an appreciation that the UK finds itself in its first winter without any long-duration gas reserve facility of its own to fall back on.

This follows the closure of Centrica's Rough offshore storage platform, as discussed in January's edition of Energy Highlights. Overall, however, the forward gas market looks well-supplied in the medium-term, notably in respect of LNG supplies. That said, the UK's own long-term import dependency is set to rise, past 90% by 2040 according to the latest National Grid research. Forward gas demand may well be curbed by government legislation restricting domestic gas and space heating use into the next decade. Moreover, an early demand-call from the power generation sector also looks unlikely. Carbon prices meanwhile rose by over 80% over the past nine months, breaking €10/tonne CO_2 at one point.

The unfavourable regulatory outlook for new-build gas-fired power stations could keep a lid on prices. Although government policy could always change; indeed the treatment of specific gas-fired generation is known to be under review in Whitehall circles, even if the question is seldom aired very publicly.

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Electricity

Despite the cold snap, the electricity market slipped back. The annual base-load power contract fell by 7% on the back of improving plant availability and very few reported outages during a critical demand period.

That said, the current state of the wholesale electricity market perhaps belies the impacts pending on prices downstream. In particular, on smaller industrial and commercial customers who have no exemption from the new (somewhat paradoxically-named) 'Energy Intensive Industries Exemption Surcharge (or EII) that comes into effect in Q2.

The EII will not be introduced as a tax in name, although that is precisely what it is. The EII will instead be introduced as an 'uplift' to existing surcharges, namely the Renewables Obligation, absorbing circa 60% of the new levy; the Feed-in-Tariff and the Contract for Difference surcharges, absorbing circa ca. 20% a piece. Most of the energy intensive users' exemption surcharge will fall on the non-energy intensive users with no exemption from this (once conceived) 'carbon tax'. This, combined with other increases in transmission and distribution network charges, as already penned and indexed to inflation, will cause the median commercial electricity bill to rise by circa 25% in just three years from now, according to provisional calculations (my own - happy to compare notes with any reader on that question).

This expected rise in bills also assumes no rise at all in wholesale power prices between now and 2022, which is far from a given. Enhanced efficiency, optimised energy management, embedded generation and possibly electric storage may become more commercial as a consequence, as end users look for ways to side-step potentially significant future price rises.

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 private entities on a range of energy origination, strategy and trading issues.

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