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WHOLESALE ENERGY PRICES: MARCH – MAY 2018

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

Oil

Crude prices crept up a further 4% up amid renewed concern over OPEC exports, the possibility of new US oil sanctions on Iran and reports Houthi rebels starting to target Saudi exports of crude - a possible long-term campaign with the insurgency in Yemen showing no sign of abating. Exports from OPEC's second largest producer, Venezuela, were hit by a wave of national strikes and the market was buoyed further by the prospect that OPEC and non-OPEC countries agreeing to prolong their Accord and roll forward their production cuts well into next year. There are perhaps sound, if nefarious, incentives for Russia to take a lead in oil production sacrifices, possibly to 'rattle the inflation cage' of certain Western economies. Saudi Arabia will also be keen to keep oil prices as high as possible, in preparation for the partial sale of Aramco, whose stock market float is still believed to be on the cards. All in all, there have been few reasons to short crude over the past two months and oil prices could well strengthen further as we move into summer.

Gas

With oil prices re-visiting highs not seen in four years and heading for $70/bl, the effect of lagged oil price indexation in Trans-European take-or-pay gas contracts will be growing as the new gas year approaches on 1st October. Significantly, there are several major long-term contracts coming up for renewal. The starting Base Price in such deals will also be up rated and a 'ratchet effect' may be reflected to some degree in the Forward Market itself. Annual NBP gas prices rose a further 5% during the two month period. Despite the relative abundance of physical gas and the prospect of spot LNG cargoes being released by South East Asian buyers, gas prices could rise further if petroleum markets continue to climb as they have been.

Electricity

Prices rose 13% following the oil and gas higher (both more liquid and actively traded) although the market was spooked by the shutdown of the Hunterston B reactor. Although the plant was soon back online, the episode served as a reminder of the state of Britain's aging fleet of Advanced Gas-cooled Reactors. All AGRs are set to operate well beyond their original design lives and this design accounts for all still-functioning reactors bar Sellafield. EDF was confirmed in one report to have said "the findings [at Hunterston] will probably limit the lifetime for the current generation of AGRs" so some nuclear output may come off line sooner than expected and before new-build reactors can replenish it. This long-term outlook was dimmed further by reports of defects identified in rivets forged for the EDF's two European Pressurised-water Reactors (EFRs) under construction in France and Finland. The concern being that such design faults may extend delays at its third EPR under construction at Hinkley Point.

Wholesale market aside, business prices are set to rise anyway due to legislated increases in network capacity charges and higher tax levies. As of this April there are now seven separate taxes, on top of commodity and capacity costs. My research suggests that capacity and tax rises will have increased a typical commercial user's bill by 35% over the period Oct 2017 to Sept 2020, i.e. assuming as a baseline we see no rise in the wholesale prices (in Oct 2017 £45/MWh or 4½p/kWh, so already up 14% since) . Energy buyers will possibly be looking at a combination of competitive tendering and more active demand-side management, including the possible application of Demand Side Response hardware and DSR-related Battery Storage, a topic to feature in Energy Focus soon.

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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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