WHOLESALE ENERGY PRICES: JULY – SEPTEMBER 2019

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

Crude Oil

Brent prices soared in the aftermath of recent attacks on Saudi oil facilities. Spot prices saw their biggest one day increase since the start of the first Gulf War in 1991, only to give up all gains inside three days and close the quarter down 5% just below $60/bbl.

In such times, one might expect to see a higher risk-premium factored in prices, along the curve. However, this has not been the case. Indeed, the speed of the price reversal may reflect the market's main pre-occupation, the global economic outlook, or equally a continuing shift towards 'short-termism', perhaps as a consequence of AI/robot trading and the exit of 'liquidity providers' issues discussed in the last issue.

Meanwhile, the Saudi oil ministry has warned that further attacks that do succeed in halting production significantly would lead to "$300/bbl oil". That figure may look headlining grabbing, although the statement is perfectly serious.

Saudi Arabia may hold 18% of global oil reserves and provide just 12% in terms of consumption. However, its seven producing fields still make up circa 75% of the world's marginal supply. No other producer can make the numbers stack up. In fact, the world's reliance on this swing producer has not changed significantly, despite the emergence of shale and frontier oil production outside the Middle East, typically with much higher development costs. With no early rest-bite to troubles in the Persian Gulf in prospect, the oil market looks set to stay jumpy for the time being at least.

Natural Gas

The gas market held firm, falling back just one per cent over the last quarter. The Forward Market took in its stride news of the accelerated retirement of Groningen in the Netherlands, by far Europe's largest producing gas-field, as well as concerns that Russian exports will be cut amid the spat with Poland in the European Courts of Justice.

This ruled that exports through the OPAL pipeline must be halved, just as winter 2019/20 sets in. On the demand front, various meteo-office reports suggest that this winter could be a severe one for the UK and across Europe. Gas storage and heating oil inventories on the Continent are reported to be very high at the moment and this will explain the market's reaction. However, April Year 2020 gas prices could rise significantly above the 50 p/th mark once again if demand goes on to exceed expectations.

On the home front, it was confirmed that all remaining UK coal units will shut permanently by 2024. Theoretically, any shortfall here could be offset by gas-fired generators. There are several stalled projects in the pipeline. However, even if (and a big 'if' at that) a government policy shift were to see a limited renaissance in gas-fired generation, the timelines suggest that the power market could still come under stress, long before any gas cavalry arrives on the scene. The generation market looks unlikely to be the engine for any step increase in future gas prices therefore. However, the Forward Market could still creep higher for a variety of other supply questions over trans- European supplies and North Sea infrastructure.

Carbon prices, meanwhile, were fairly resilient, with the traded EUA contract heading back towards €25/tCO2. The nominal Spark Spread finished more or less unchanged at £17.50/MWh. This nominal profit margin may look promising. However, the spark spread reduces sharply once eco taxes, levies and limits are factored in.

Electricity

Forward base-load prices finished the quarter almost unchanged. However, the Prompt Market was jolted higher by concerns over output at five principal nuclear units in France. These were temporarily but very suddenly closed under orders of the National Safety Authority. No other EU countries have meaningful nuclear development plans of their own and many will remain reliant on French nuclear exports to balance their systems.

However, France's reactors are clearly showing their age now. Significantly, they are almost all of identical design and they were built fairly quickly after one another; part of a hitherto successful national security of supply programme initiated by President Giscard d'Estaing in the aftermath of the 1973/74 oil crisis and continued by President Mitterand. But the worry now is of safely or other technical shortcomings found in group of reactors which will manifest themselves at other plants before long. There is no obvious 'Plan B' if enough reactors do have to shut early because renewables alone will not make up the numbers.

Meanwhile, design and construction problems are dogging the introduction of the next-generation European Pressurised Reactor (EPR). Just three EPRs are being built at the moment. All have experienced delays. Hinkley Point C being the latest to mark-up construction costs last month. This plant may now be delayed further although this is not confirmed officially.

With all nuclear plants bar Sellafield due to close during the next decade, the UK's cushion of reliable peak-shaving capacity in the system might look precarious to some people. Wind power developments will continue and we saw some 'record low' strike prices in the last offshore auction, below £70/MWh in some cases. However, in volume terms the numbers are still small. The time horizons are also long and in other cases the final supply prices are somewhat higher than headline figures may suggest. Interconnectors with Iceland, Scandinavia and Continental Europe (albeit French nuclear or coal generation) may preclude part of any future 'imbalance' but possibly not all of this.

The 'Climate Change Emergency' environment may well be making it difficult for governments to sanction a general relaxation for gas-fired plant development. This may be needed to avoid repeats of the late summer incident when blackouts occurred after just one renewable project at Hornsea and a comparatively small, 650 MW gas station at Little Barford tripped at the same time, resulting in an intra-day price surge to £375/MWh at one point. The may or may no be an omen for the decade ahead of us. But in balance, the power market should still brace itself for bumpy times ahead.

About the Author

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.
Prospect Law is a multi-disciplinary practice with specialist expertise in the energy and environmental sectors with particular experience in the low carbon energy sector. The firm is made up of lawyers, engineers, surveyors and finance experts.

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For more information or assistance with a particular query, please in the first instance contact Adam Mikula on 020 7947 5354 or by email on adm@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

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