Energy Outlook – Qtr 4 2019

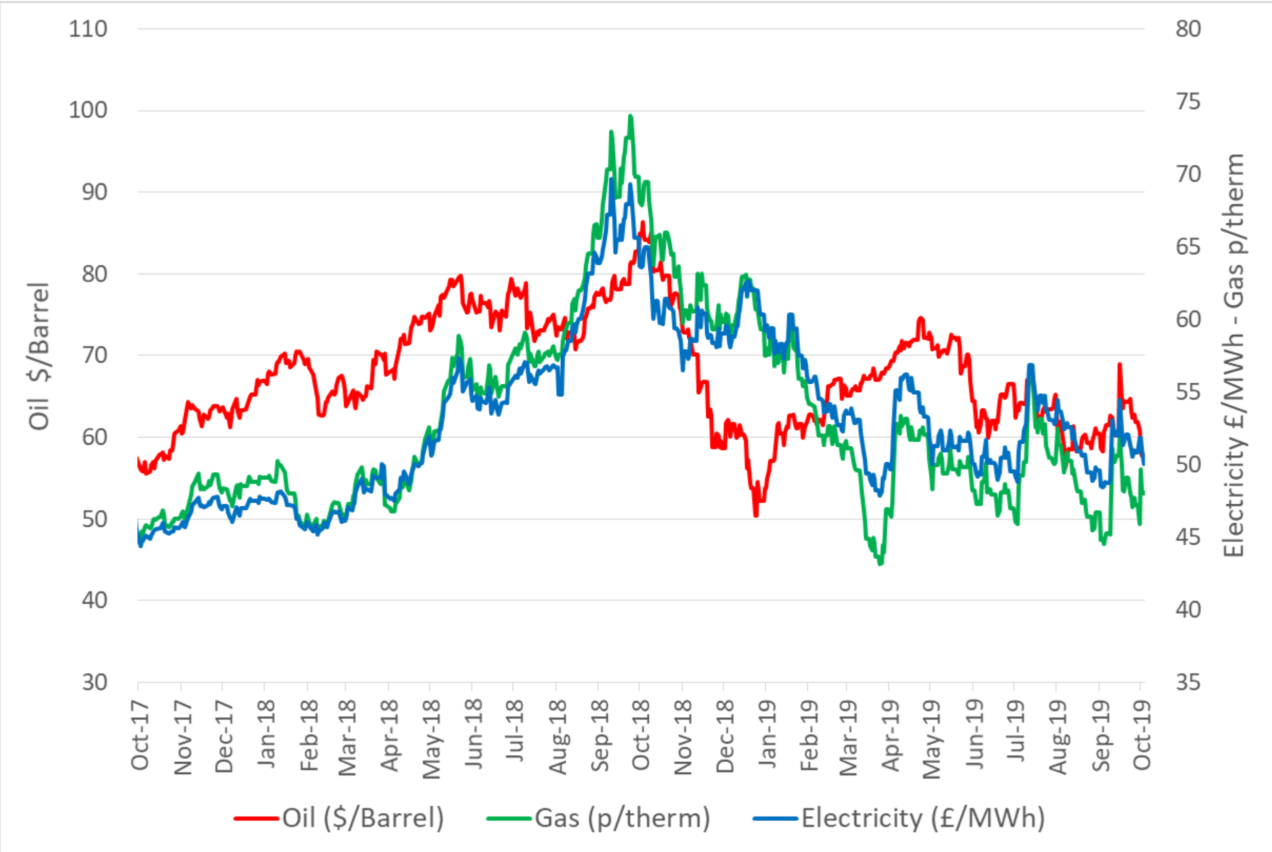
October 2019

The weather has started to turn colder and the clock change is coming. As the days draw in, it is a good time to take another look at the energy markets to reflect on what has happened over the summer and what the big knowns (and unknowns) are for the months ahead as we approach 2020.

How concerned are the markets about attacks on Saudi Arabian oil installations? What impact has the increasing mix of renewable generation had on electricity prices over the summer? Will the French nuclear fleet be taken offline again this winter? **Perhaps most importantly, what impact might the results of the General Election on December 12th, have on the energy price?**

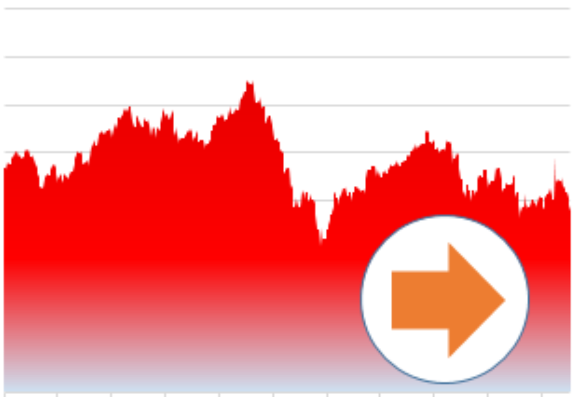
We explore these questions to help explain the factors which impact the price you pay for your energy.

Energy - Recent Price History



The chart above illustrates how energy prices have evolved over the past two years. UK gas and electricity prices largely follow oil's lead, albeit it with a few deviations along the way. This suggests that the correlation between the commodities may be weakening as renewable forms of generation gain an increasing foothold in the UK generation mix.

OIL



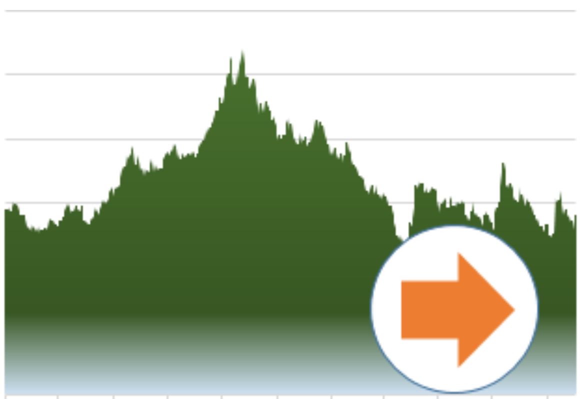
OPEC members agreed to extend production cuts into 2020 at their meeting held in July in an attempt to support prices. The markets seem unconvinced, mostly due to the restrictions not being applied to every member.

Nevertheless, continued instability in the Middle East did its own thing to push prices up mid-September when Yemen carried out a number of drone attacks on Saudi oil production facilities, resulting in the temporary suspension of 5.7m barrels a day of output.

After the initial shock of this subsided and output returned to normal levels, prices levelled out again, only to be supported briefly by reports of strengthened economic data in China.

GAS

The gas market continues to follow the lead provided by oil, with some notable market-specific impacts layered on to complicate the picture. Recent sentiment has been dominated by the short term market, with higher than average temperatures in September combining with a large import of Liquefied Natural Gas (LNG) from Qatar to push the within day price to below 19p/therm for the first time in 10 years.



To counter this, traders have cited concern for the longer term after the EU decided not to give Gazprom more capacity on the OPRAL pipeline, although this impact is currently limited by expected healthy LNG supplies over winter and high levels of medium-term storage.

Reports of severe wintery conditions to come in November appear to have been discounted by the market at this point, although if it does become unseasonably cold, it will push prices up for the remainder of the season.

ELECTRICITY

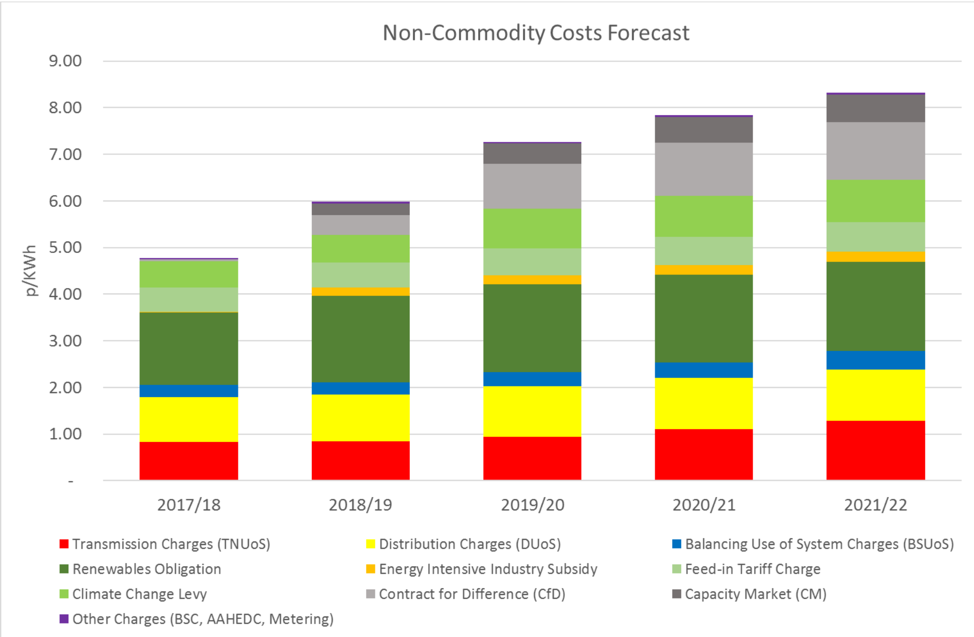
The impact of the increasing mix of renewables on the electricity mix in the UK over the summer was a tale of two halves, with greatly increased solar PV providing a significant boost while wind generation fell well below expectations on the back of relatively calm weather.

Since then, in line with the normal state of affairs, electricity has followed the overall direction of gas, although the drops in price have not manifested themselves quite so clearly.

NON-COMMODITY COSTS

Non-Commodity costs include the charges for delivering power through the national grid and local distribution systems to end users, as well as the costs of providing subsidies to renewable generation and capacity market payments to ensure there is sufficient generation at peak times. These costs are all regulated in some way – set by The Government or Ofgem, the Energy Regulator.

Some of the charges vary from region to region and they are typically rolled up together by suppliers when billing customers, meaning you won't always see the breakdown of charges in detail. **The charges represent a large proportion of everyone's bill and are expected to continue to rise above and beyond inflation levels for the next few years.**



Figures based on an average UK Half-Hourly portfolio

TARGETED CHARGING REVIEW (TCR)

Following the publication of its draft Impact Assessment for the TCR, Ofgem have subsequently consulted with interested suppliers and customers, with the latest round awaited after closure of the last consultation at the end of September. **The proposals have come under fire for both increasing costs of the system (expected to be reflected in Contract for Difference costs – an increasing element of the non-commodity price) and for potentially *discouraging* investment in some renewables due to increased risk.**

SMART EXPORT GUARANTEE

The Feed-In-Tariff scheme for small-scale generators finally came to an end for new plant at the end of March this year. Ofgem has since announced the introduction of the 'Smart Export Guarantee'. This is not a subsidy scheme (the theory being that the cost of small scale solar PV, micro CHP *etc.* has now dropped to a level which allows it to compete with market-priced power), but rather a mechanism to ensure that small scale generators - whether domestic of small business size - are compensated for any electricity they export.

The scheme doesn't guarantee a price; however, it is worth keeping an eye on this if you are considering small-scale investment or even if you already have FIT-subsidised installations, as these are eligible to change their export payment component into the new scheme.

Geo-Political Impacts

Brexit continues to drag on and in doing so, is dragging the £ Sterling with it on the exchange rate markets. The impact on energy prices is not lost, and until the impasse is resolved, this will in our opinion have negative impacts, industry wide. Similarly, post Brexit the UK government will start negotiations around the finer details of various trade agreements. The manner in which these negotiations are carried out, could have an impact on supply agreements, and as such, risks the relationship between the UK and its European trading partners. Typically, traders don't like risk and when risk appears prices usually head north to compensate.

Middle East tensions continue. The recent attack on Saudi Arabia could well be the first of many. Coupled with tensions in North Africa and Iran, uncertainty of supply and insecure supply routes could impact oil and gas availability going forward. Should supply issues become apparent, in particular in winter months, then expect prices to once again head north. It should be notes, that some of these increases could be off-set by LNG imports from other areas of the world.

USA and China/European trade war continue, with the latest round of tariffs being levied on a raft of European exports to the US. It would not be beyond the realms of expectation for the European Parliament to collectively impose counter tariffs on energy imports from the USA. Whilst demand would probably be unchanged prices would once again increase.

Our Opinion

The level of uncertainty, in various economies and governments across the globe, is high. Uncertainty brings with it an understandable degree of risk; the risk to both supply and the risk of price shocks. Whilst these risks are being managed by the markets, more significant geo-political events would more than likely have a direct impact on prices - negatively so.

For more information, please get in touch with your Utility Aid Account Manager or call us on

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