ECA Basket Update:

Date: August 2022

Market Update

The energy market has experienced unprecedented volatility in the last 12-months with many drivers behind the current extreme highs. As of the 4th August 2022, wholesale energy prices have risen by circa 450%+ vs the same time last year.

Initially causes included the global post-Covid surge in gas demand and, following a cold winter, depleted UK stock levels. Other factors such as lower gas supplies from Russia leaving European storage less than 60% full and maintenance restrictions on imports into Britain have further combined to create an imperfect storm, which has been compounded by a drop in renewable sources – most notably wind generation. As a result, the UK has been forced to use more gas for power production, which, in turn, has also had a detrimental effect on gas and electricity prices.

More recently, energy markets have seen increased volatility since Russia invaded Ukraine. Wholesale prices initially increased by 40% before pulling back to pre-war levels however have now spiked to record highs as the uncertainty of European gas supply plays a major role in volatility. We have seen a significant drop in market liquidity, this has affected energy trading and live prices are being inflated due to the size of the price swings and the speed at which they are moving. This volatility means that many energy suppliers are either not pricing or not able to hold open prices for long periods.

We have also seen Germany announce that Nord Stream 2 (gas pipeline) will now not happen and this would have doubled gas volume capacity into the European market. Germany has also announced that they are building 2 additional LNG terminals so they can reduce their dependency on Russian Natural gas longer term. A significant step as Russia currently supplies over half of the total volume needed by Germany.

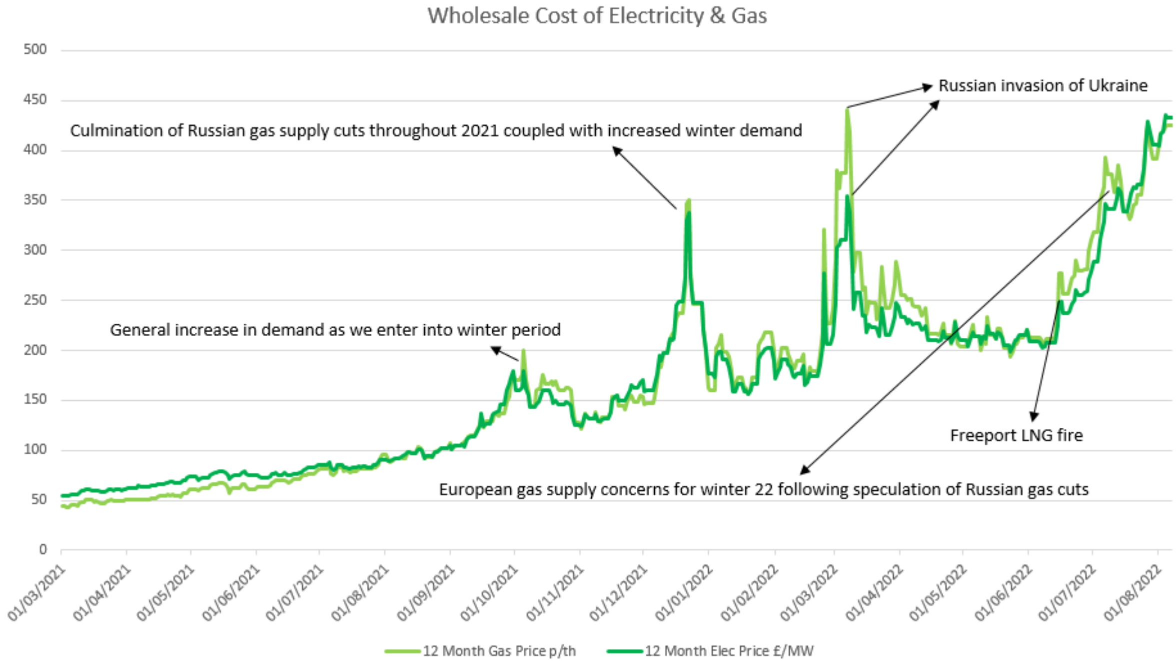
The latest spikes in the market has been caused by Nord Stream 1 (gas pipeline) be taken offline for unscheduled maintenance. This has seen extreme volatility as concerns over the future amount of gas transported and whilst the supply has come back online, it is now only operating at 20% capacity. This is putting pressure on the European gas storage levels that need to be fully ready for the winter period. The EU has already instructed all member states that they have to use 15% less gas this winter.

Throughout this period, there has been a huge impact on the supplier market and pricing mechanisms. For example, the markets previously used to see in day movement of circa £2-£5 mWh's, now we are seeing in day swings of £100's. There is also a lack of liquidity in the market, which is contributing to price volatility.

Wholesale costs market graph

Please refer to the below graph detailing the wholesale cost of electricity & gas since the start of last year:

We have highlighted several key events that have had significant impact on the movement of the wholesale price.



Non-commodity costs

In addition to the wholesale costs, there is another element included within your energy bills known as non-commodity costs.

These costs are added to the wholesale cost of energy by the government and third parties.

Essentially these costs are required to cover the cost of the system and network charges, which are incurred through the running of the distribution and transmission network.

New legislation has seen these prices increase over the last 18 months and will continue to do so.

What does the future hold for energy prices?

Looking forwards, markets are expected to remain highly volatile as we move towards winter 22.

Volatility will largely come from European gas supply concerns in terms of whether or not they are able to survive the over the colder months (Oct22 – Mar23) with potential cuts to Russian gas supply.

We have seen the markets reactive bullishly to this recently, firstly with the fire at Freeport LNG terminal in the U.S. taking offline approximately 10 cargoes per month until later this year. Coupled with this we have seen ongoing concerns surrounding Nord Steam 1 maintenances as a turbine required for the work was delayed and has been held in Canada for a number of weeks (as of the time of writing, the turbine is on route to Nord Steam 1 however concerns around further maintenance on the others turbines looms over the market).

In terms of post Winter 22, we expect markets to remain highly volatile. We are seeing lower Summer 23 prices (compared to winter 22) but these are still very high compared to previous years. Further out prices are lower but lack of liquidity for prices into 24/25 make securing the volume difficult.

While the war in Ukraine is still ongoing, there is likely to be little recovery to pre-war levels and high volatility and low liquidity is to remain. Bearish drivers are unfortunately rare – Nord Stream 2 continues to be on hold while the war is still ongoing, there is a return of the interconnector to Europe, which is currently offline, however the likelihood of these bringing prices much lower is unlikely.

Aside from this, a general end to conflict will be the significant bearish driver the market needs to see price recovery over the next few years along with a longer-term strategy to no longer have a reliance on European imports.

There is political pressure is mounting from many business sectors that these price levels are not sustainable and that the government must step in to provide business with support. At the moment the UK government have committed to helping domestic supplies but not commercial.