WEST MERCIA ENERGY

MONTHLY MARKET UPDATE: MAY

OVERVIEW

- Gas and electricity prices have risen sharply over the last month, gas by in excess of 8p per therm and electricity by in excess of £6 per MW
- One of the main drivers to these increases has been a rise in oil, coal and carbon prices which have all reached relative highs in recent days
- European gas storage levels remain at their lowest levels since 2013 which will require high levels of storage injections throughout the summer, supporting overall demand
- Oil prices have reached their highest levels since 2015, threatening to break through the $80 per barrel resistance level
- LNG stock levels remain relatively low with only one potential shipment currently en route to the UK

MONTHLY PRICE MOVES

ELECTRICITY PRICES (BASELOAD) £/MWh

	LAST NIGHT'S CLOSE	MONTHLY CHANGE	30 DAY MEAN	30 DAY HIGH	30 DAY LOW	Annual Change
Jun-18	54.60	6.70	50.79	55.00	46.10	
Jul-18	54.95	6.45	50.99	55.48	46.00	
Aug-18	54.65	6.65	50.17	54.65	46.00	
Winter 18-19	60.90	6.80	56.34	61.18	52.30	40.16%
Winter 19-20	56.65	6.90	51.77	56.75	48.53	37.75%

GAS PRICES p/therm

	LAST NIGHT'S CLOSE	MONTHLY CHANGE	30 DAY MEAN	30 DAY HIGH	30 DAY LOW	Annual Change
Jun-18	55.46	8.82	50.60	56.00	44.14	
Jul-18	55.84	8.85	50.79	56.47	44.69	
Aug-18	56.24	8.66	51.19	56.88	45.09	
Winter 18-19	63.50	8.33	58.16	64.14	53.00	38.62%
Winter 19-20	58.50	8.24	52.86	58.96	49.03	30.96%

	LAST NIGHT'S CLOSE	MONTHLY CHANGE	30 DAY MEAN	30 DAY HIGH	30 DAY LOW	Annual Change
Brent oil	$78.51	$6.31	$74.64	$79.30	$68.65	46.45%

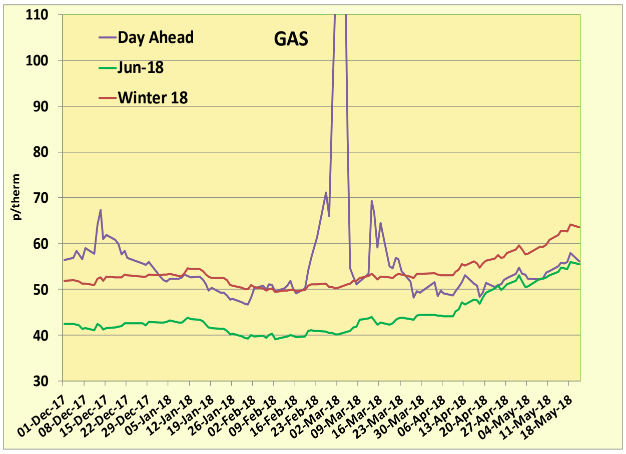
LOOKING AHEAD PRICES WILL BE INFLUENCED BY:

- European gas prices
- Day Ahead gas prices
- Gas export levels from the UK to Europe
- Carbon prices
- Coal prices
- Gas storage levels
- Oil prices
- The volume and frequency of LNG shipments into the UK
- Currency exchange rate fluctuations
- Domestic and global economic indicators
- Weather forecasts for summer

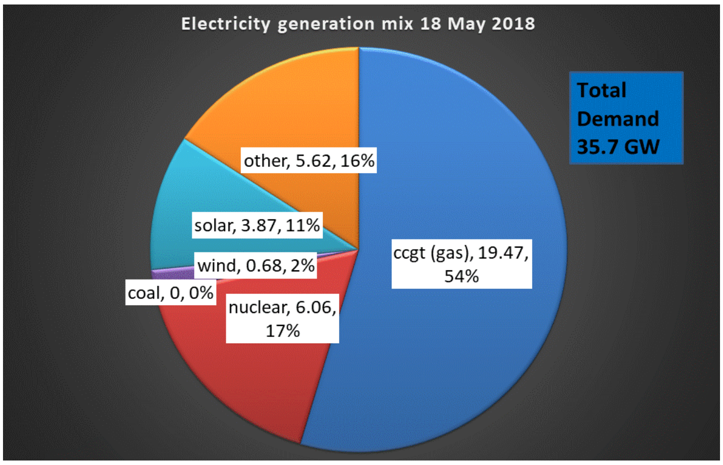
IN DETAIL

Due to a combination of factors gas and electricity prices have risen steadily over the last month, with increases remarkably consistent - gas prices up by approximately 8.5p per therm across the curve and electricity by £7.50 per MW.

This increase can be seen in the graph on the right which illustrates how Day Ahead, June 18 and winter 18 gas prices have all risen at a relatively uniform rate since mid-April. Day Ahead gas prices are currently trading at higher levels than we saw through most of January and February, whereas warmer weather and lower demand would have been expected to result in falls in prices as summer approaches. This can be partly explained by a number of outages affecting gas imports and higher European gas prices due to high storage demand required to replenish severely depleted stock levels.



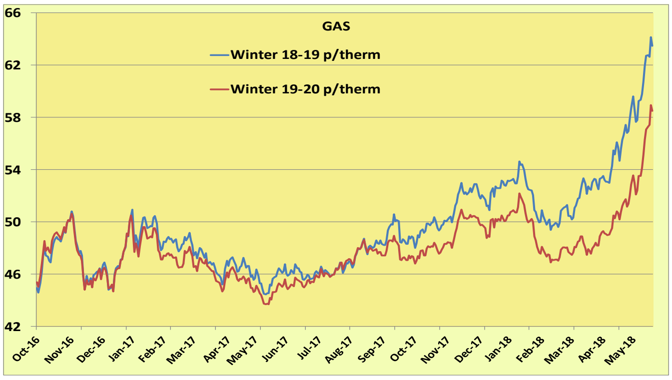
The main driver in the price increase that we have seen in winter 18 gas prices has been commensurate increases in oil prices. Whilst UK gas prices have always been influenced by oil prices due to the prevalence of index linked European gas contracts, the correlation between UK gas prices and oil prices has strengthened recently. When oil breached the $70 per barrel threshold, there was a correlation coefficient on UK gas curve contracts nearing 0.9, with 1 a perfect correlation and zero the opposite. Any continuation in the strength in oil prices is therefore likely to be reflected in higher gas prices.

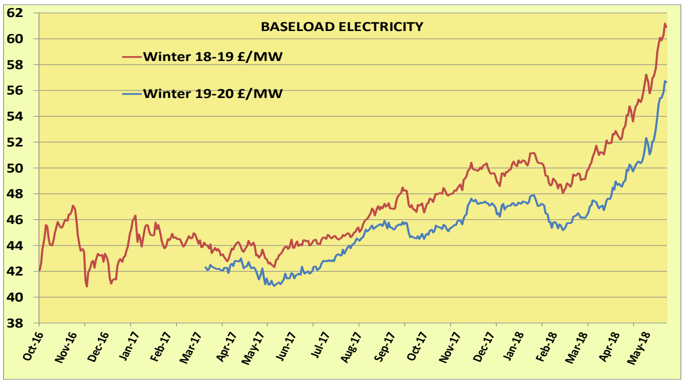


As mentioned above, it might have been anticipated that warmer weather would lead to lower demand for gas and electricity leading to a fall in the Day Ahead prices for both commodities. As we have seen the reverse has been true for gas. Electricity Day Ahead prices have also remained relatively high. One reason for this has been the high dependency on gas for electricity generation. The chart on the left illustrates the generation mix for last Friday where minimal wind generation required in excess of 50% of relatively expensive gas generation, something which is likely to continue in the short term with low wind generation forecast.

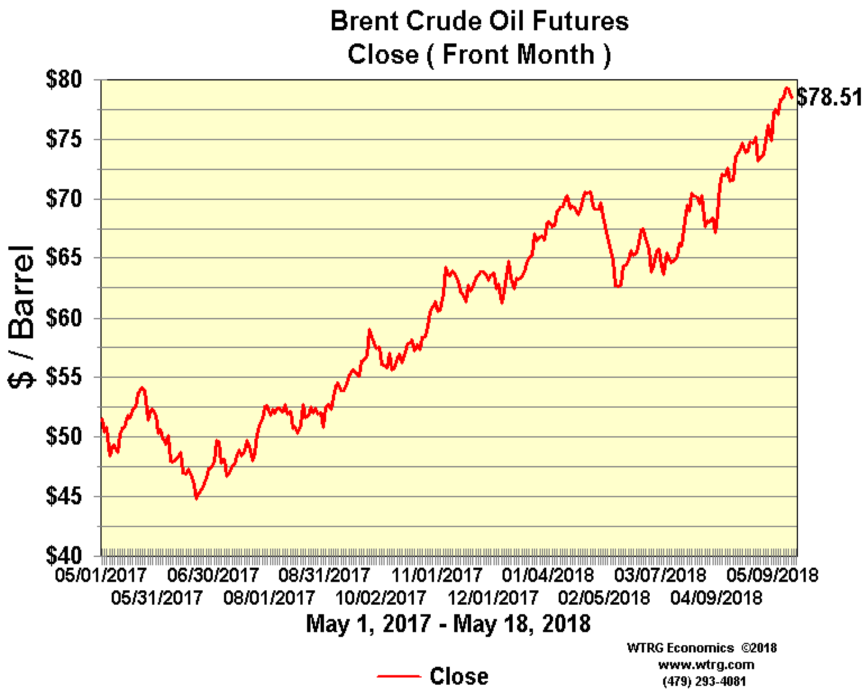
In addition to the increase in oil prices that we have seen over the last month, coal and carbon prices have also risen, with the latter at the highest level in more than five years. Although a high percentage of coal-fired power stations have closed in recent years, coal continues to play a part in electricity generation, particularly in winter. During the cold weather at the beginning of March coal was contributing in excess of 11GW or 25% of overall demand. Higher coal and carbon prices will therefore continue to impact on future generation costs.

As the graphs below demonstrate, the increase in gas and electricity prices that we have seen for the current year have applied equally to 2019/20. Again, the main driver to these increases has been the rise in oil, coal and carbon prices.





Having broken through the $70 per barrel resistance level, oil prices have risen, virtually unchecked, to test the next resistance level of $80. Having traded above this level at the end of last week prices have fallen back and currently trade around $78.50. Apart from a continuation in the OPEC/Russian production cuts, oils prices have found further support from the decision by the US to pull out of the Iran nuclear deal and threats to re-impose export sanctions.



SUMMARY

In the short term the markets are likely to continue to be heavily influenced by coal, carbon and particularly oil prices. In addition, relatively high European gas demand to support storage injections is likely to impact on UK gas prices with any falls in Day Ahead gas prices potentially resulting in an increase in gas exports through the pipeline connecting the UK with Belgium. This pipeline is scheduled to shut for maintenance from 13th to 28th June which could potentially leave the UK with a short term surplus of gas leading to lower prices, but it is likely that Norwegian imports will be diverted from the UK into Europe to meet their short fall, thereby restricting any UK gas surplus.