Digital Energy Element

June 2022

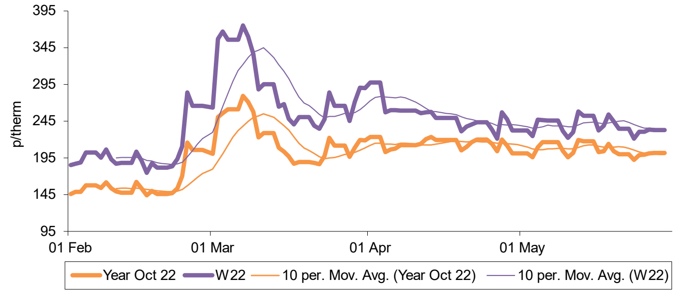
The Story of Two Halves as Energy Prices Take Direction

Untangle your energy spend management

Catalyst Digital Energy

Digital Energy Element / June 22

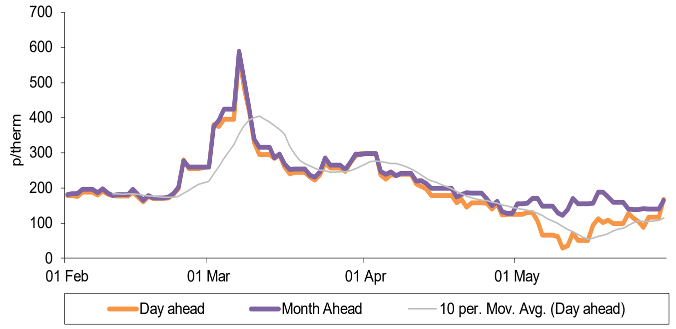
Annual gas prices



In May, near-term wholesale gas prices declined – most evident across the day-ahead and front-month contracts. However, further out on the forward curve we observed seasonal contracts from winter 23 to winter 24 increase, a likely response to the continuation of risk premiums being baked into future gas delivery, with on-going uncertainty surrounding the future of Russian gas supply.

On average, seasonal gas contracts from winter 22 to winter 24 were 3.7% higher in May than in the previous month. The majority of these seasonal contracts continued to climb as the month matured too.

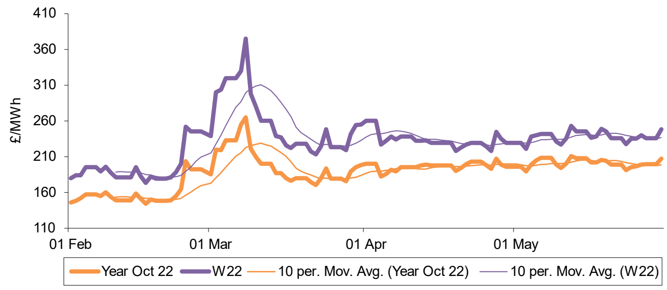
Spot gas prices



If we look closer at near-term gas prices across May, there were some evident bearish factors which brought down pricing levels. Firstly, warmer weather trends continued into May from what was already a warm April against seasonal averages, suppressing heating demand in-turn. Similarly, the UK saw an increased volume of LNG cargoes reach GB terminals in the month, subsequently raising domestic LNG send-out and softening the supply demand balance in the short-term.

In support of these bearish movements, the day-ahead gas contract fell 47.8% lower in May – to average 98.67p/th. Similarly, both front month contracts were down an average of 21.9% on the previous month, to sit at 155.31p/th and 178.82p/th respectively.

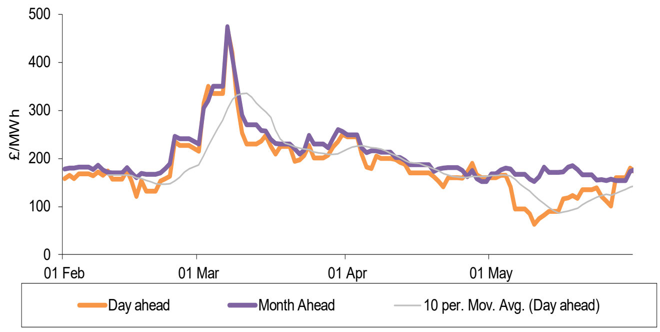
Annual power prices



Gas price losses also impacted the power market too, with most counterpart contracts mirroring gas price movements.

Elsewhere, day-ahead power prices eased 32.6% in May, to average £121.80/MWh, but remained 59.4% higher than the same period of 2021. Seasonal power contracts like their gas counterparts largely increased. Subsequently, seasonal power contracts from winter 22 to winter 24 lifted 8.1% on average compared with April.

Spot power prices



Primarily, the strong downward momentum on near-term domestic gas prices set a price direction for power prices to follow, coupled with periods of elevated wind outturn across parts of month softening supply margins slightly.

Front-month power contracts shared the descending price direction of their gas counterpart contracts and day-ahead power prices, subsequently falling 12.4% on average to sit at £168.35/MWh and £185.57/MWh, respectively.

International commodity markets enjoyed a bullish month of price direction in May. For carbon, both the UK and EU ETS schemes recorded growth, with UK ETS prices up 7.4% on the month prior to average £83.50/t, with the EU ETS up 7.8% to average €86.08/t. Elsewhere, Brent crude oil lifted 6.1% to average $111.95/bl – buoyed by globally tight supply markets and EU threats of Russian oil export bans.

 Catalyst Commercial Services' independent approach enables clients to manage their exposure to energy price risk, while at the same time benefiting from a first-class service from a range of major and independent suppliers. Catalyst Commercial Services' procurement solutions make it simple, so contact a member of the team to discuss requirements.

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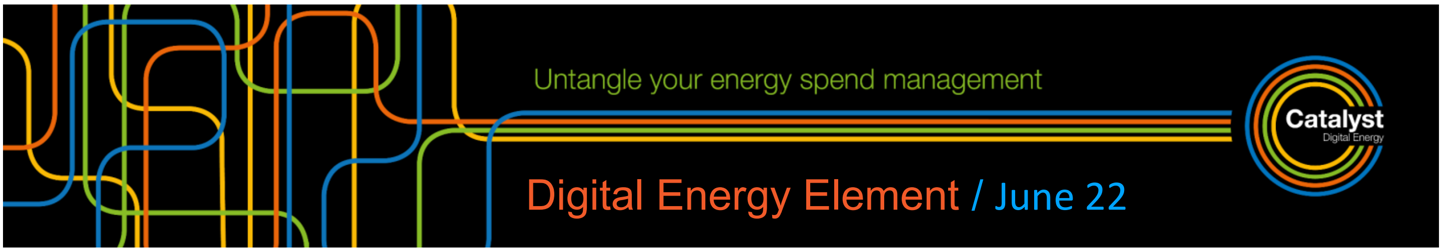
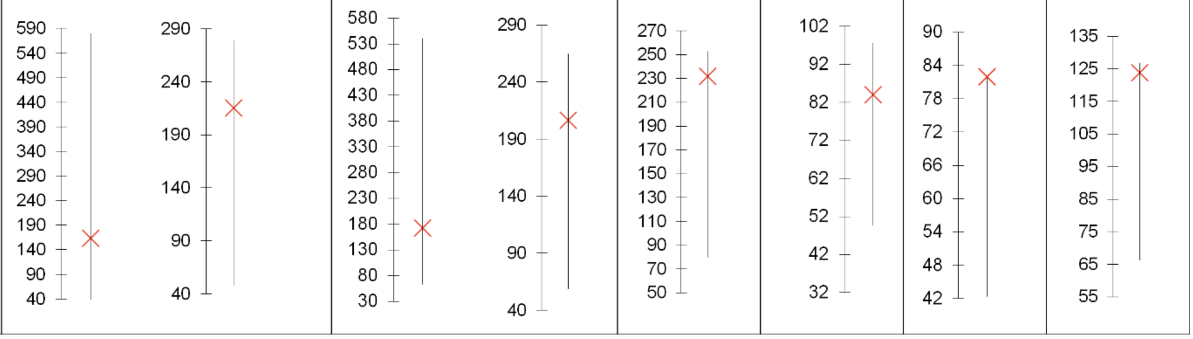


Key market indicators: 31/05/2022

		Gas (p/th)		Electricity (£/MWh)		Coal	EUA Carbon	UKA Carbon	Brent crude
		Day-ahead	Year-ahead	Day-ahead	Year-ahead	($/t)	(€/t)	(£/t)	($/bl)
This month	31 May 22	163.00	215.50	172.50	206.75	232.00	84.00	82.00	123.80
Last month	3 May 22	130.00	195.78	165.00	189.25	213.00	85.37	79.40	106.60
Last year	1 Jun 21	63.90	49.55	71.00	61.23	82.50	52.70	N/A	70.78
Year-on-year % change		155%	335%	143%	238%	181%	59%	N/A	75%
Year high		580.00	279.07	540.00	265.00	253.00	97.61	88.00	126.84
Year low		28.00	47.76	63.00	59.00	79.80	49.68	42.40	66.31
This table shows the price at the end of this month compared with prices from the previous month and year. The graphs show the position of this month's prices with a red X and the range of prices over the year is represented by the black line.									

Commodities

Carbon: EU Emissions Trading Scheme carbon is quoted as over-the-counter (OTC) latest opening prices. All carbon prices are in euros per tonne (€/EUA).

Coal: Coal is quoted as OTC latest opening prices. All coal prices are in US dollars per tonne ($/t).

Electricity: UK power base-load and peak-load are quoted as OTC latest opening prices. All UK electricity prices are in pounds per megawatt hour (£/MWh).

Gas: UK National Balancing Point (NBP) gas is quoted as OTC latest opening prices. All UK gas prices are in pence per therm (p/th).

Oil: Brent crude oil is quoted as OTC latest opening prices. All Brent crude oil prices are in US dollars per barrel ($/bl).

Language/ terms

Bearish: A bearish market shows a general decline in prices over a period of time.

Bullish: A bullish market shows a general increase in prices over a period of time.

Curve: A graph of forward prices over a future time period.

Margin: The indicated UK imbalance of a given settlement period. It is the difference between the sum of the indicated generation available, and the national demand forecast made by National Grid.

Over-the-counter (OTC): The trade of a commodity directly between two parties, often on standardised terms.

Spark/ Dark spread: The theoretical net income of a gas/ coal-fired power plant from selling electricity having purchased the necessary fuel. The clean spark/ dark spread is this net income adjusted for the cost of carbon.

Disclaimer

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New windfall tax and cost-of-living measures unveiled

On 26 May, the Chancellor of the Exchequer Rishi Sunak delivered a cost-of-living support package to Parliament – outlining £15bn of new measures and an Energy Profits Levy. The support package is to compliment the £22bn package announced previously, taking total funding to £37bn. Key commitments include the plan to double the Energy Bills Support Scheme that will see households receive £400 of support with their energy bills in the form of a one-off grant, which will no longer be recovered through higher bills in following years.

The government set out additional support measures for low-income and vulnerable households. This includes a one-off £650 cost-of-living payment to those on means tested benefits; a one-off £350 pensioner cost-of-living payment; a one-off £150 payment to around 6mn people across the UK who receive certain disability benefits; and an extra £500mn of local support, through the Household Support Fund which helps those most in need with payments towards the rising cost of food, energy and water bills.

In addition, the government outlined its new Energy Profits Levy, a surcharge on the profits of oil and gas companies operating in the UK and the UK Continental Shelf that will be used to fund the cost-of-living package. The levy will be applied to profits arising on or after 26 May 2022, with companies who have an accounting period that straddles that date to be required to apportion their profits. It will be charged at 25%, taking the headline rate of tax on those companies' profits from 40% to 65%. The government noted that the levy is a temporary measure and will be phased out when oil and gas prices return to historically more normal levels.

The government will also introduce new 80% Investment Allowance to encourage firms to invest in oil and gas extraction in the UK, meaning that businesses will overall get a 91p tax saving for every £1 they invest. It said this will nearly double the tax relief available to these companies.

Government

Queen's Speech confirms Energy Bill

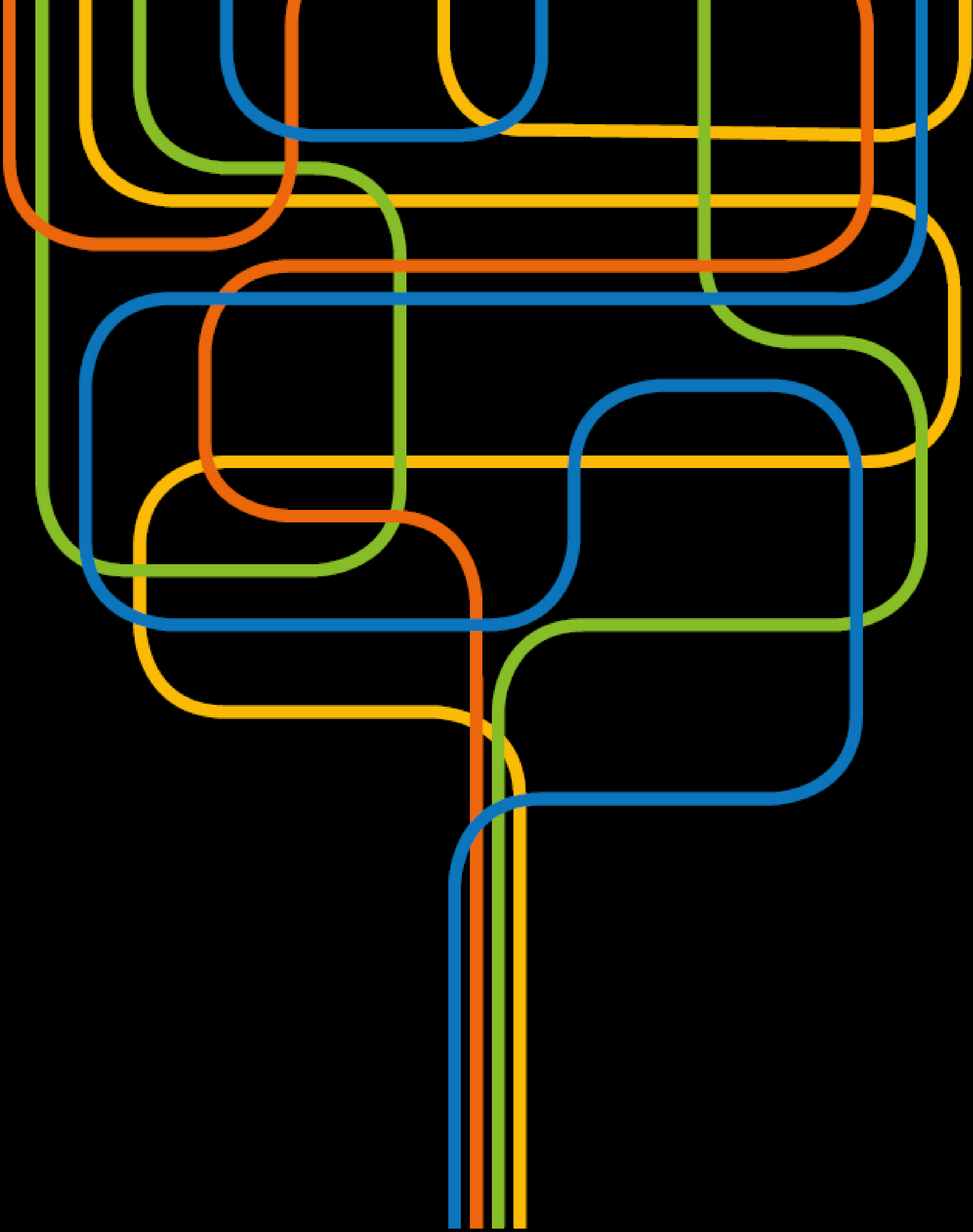
Standing in for the Queen, the Prince of Wales delivered the Queen's Speech on 10 May. In the address, he said: "My Ministers will bring forward an Energy Bill to deliver the transition to cheaper, cleaner, and more secure energy. This will build on the success of the COP26 Summit in Glasgow last year. Draft legislation to promote competition, strengthen consumer rights and protect households and businesses will be published".

Further measures mentioned included the establishment of the UK Infrastructure Bank in legislation, with aims to support economic growth and the delivery of net zero, and commitments to improve transport across the UK through cleaner services under the Transport Bill.

The following day, BEIS stated that the "Energy Security Bill delivers on the commitment to build a sustainable homegrown energy system that is more secure, clean, and affordable, as well as enabling the extension of the energy price cap beyond 2023".

It added that the legislation will also establish the new Future System Operator, which will look at the GB energy system as a whole, integrating existing networks with emerging technologies such as hydrogen. Furthermore, the bill will introduce competition in Britain's onshore electricity networks to encourage investment and innovation.

Government



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BEIS launches inquiry into power supply decarbonisation plans

On 20 May, the BEIS Committee opened an inquiry into the government's plans to decarbonise the UK's power supply sector.

The inquiry will examine proposals in the Energy Security Strategy, and the emphasis it placed on scaling up the supply of electricity from nuclear power and hydrogen technology. It will consider how these proposals were reached, and whether the strategy has hit the right balance between investing in these new technologies and existing forms of renewable energy supply. The committee will also deliberate on whether these proposals suitably tie into the government's wider net zero policy objectives.

In addition, the inquiry will ask whether there any further policy details and/or legislation required by the end of this Parliament and whether energy demand can be reduced and how much of an impact will this make on reaching power supply targets.

Evidence can be submitted until 30 June.

Government

Ofgem tells MPs price cap is expected to rise to £2,800

Speaking as a witness during a BEIS Committee, Ofgem's Chief Executive Officer Jonathan Brearley warned the typical household energy bill is expected to increase to £2,800 a year, due to continued volatility in gas prices.

This was reaffirmed in a letter published by Ofgem on 24 May and sent to the Chancellor and the BEIS Secretary of State. The letter states that: "There is still significant uncertainty about the exact level of the price cap in the next cap period – particularly because we are only halfway through the observation window which determines the wholesale costs element of the price cap, and because Ofgem is currently consulting on changes to the detail of the underlying price cap methodology." The current estimate outlined in the letter is an increase from its current level of £1,971 to approximately £2,800 in October 2022.

The letter noted that the increase has been primarily driven by the rise in global gas prices, adding that conditions have worsened considerably in the international gas market since Russia's invasion of Ukraine.

Ofgem

Consultation launched on expansion of WHD in Scotland

On 9 May, BEIS announced that it has launched a consultation on a proposed expansion of the Warm Home Discount (WHD) scheme for support in Scotland, expanding the scheme to cover an additional 50,000 Scottish households per year.

Proposals are for support in Scotland to grow by around £13mn, to £49mn per year. The uplift would mean rebates are provided to an additional 50,000 families in Scotland and boost cash paid out to help meet energy costs from £140 to £150. The consultation would also see the scheme extended to 2025 to 2026.

In addition, supplier participation thresholds will be lowered, which would allow more energy suppliers to participate, particularly from 2023 to 2024 onwards. This will also bring the scheme in line with England and Wales.

Government

Ofgem consults on price cap changes

On 16 May, Ofgem published two consultations on the price cap methodology in response to the recent increase in wholesale prices and volatility, both of which close on 14 June.

The first consultation is proposing to move to quarterly price cap updates with a shorter notice period of 25 working days between setting the cap level and it taking effect. Ofgem is also proposing to include ex ante modelled backwardation costs in the cap methodology. Suppliers would be able to recover backwardation costs over a 12-month period, although the methodology would include a deadband so recovery is only triggered when the market is more volatile than that observed in the first six cap periods. These proposals are all intended to reduce volume risk and costs to consumers.

Ofgem also issued a consultation seeking views on whether suppliers are incurring additional efficient wholesale costs, beyond existing allowances in the cap. The regulator has highlighted concern around the unexpected additional standard variable tariff (SVT) demand costs and is seeking views on whether changes are needed to support this. This consultation considers costs for the two areas relating to cap periods eight (April 22 - September 22) and nine (October 22 – March 23) and seeks views and evidence on whether suppliers are incurring additional wholesale costs in these areas.

Ofgem is proposing to offset unexpected SVT demand costs against a proportion of the 1% additional risk allowance, which was set in 2018 to account for uncertainty of wholesale costs to support suppliers. It has also proposed to offset these costs against an estimate of the cost savings suppliers have experienced from reduced switching due to higher wholesale prices. It has also made proposals to consider the Contracts for Difference benefit when deciding whether adjustments are required for cap period eight, but it will not offset this explicitly.

Updated guidance on the treatment of wholesale prices observed during the transition to a new cap mechanism in October 2022 has also been issued, to align with the consultation proposals.

Ofgem

Views sought on update of UK’s Green Finance Strategy

On 12 May, BEIS and the Department for Environment, Food & Rural Affairs opened a consultation on the development of an update for the UK’s Green Finance Strategy. The consultation closes on 22 June 2022, with the update planned for publication in late 2022.

Since its publication in July 2019, the Green Finance Strategy has aimed to support the transition of the financial sector to net zero, mobilise investment to support green projects, and allow financial services to capture the opportunity presented by net zero and cement the UK’s leadership in green finance. Several key financial initiatives have been launched off the back of it, including placing finance at the centre of COP26 in Glasgow, with a Finance Day aimed at mobilising large scale finance for global net zero targets.

The consultation aims to take stock of progress so far and set out how the UK can better ensure the financial services industry is supporting the nation’s energy security, environmental, and climate objectives, such as those outlined in the recent Energy Security Strategy.

The consultation seeks to obtain evidence and stakeholder views through 39 questions on four key areas: capturing the opportunity of green finance, greening the financial system, leading internationally, and mobilising finance for the UK’s climate, energy security, and environmental objectives.

Government

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