



Highlights

- The immediate impact from 'Brexit' was a rise in wholesale UK gas prices because of currency fluctuations. However, longer-term implications for the energy markets remain unclear.
- UK wholesale energy prices have risen during Q2, with gas infrastructure issues and more UK electricity plant shutting down, which has combined to boost prices.
- The upward turn in gas and power prices reverses a trend seen over the last two years.

Price trends

UK wholesale energy prices rose during Q2 with more supply concerns, and boosted by the Brexit referendum result at the end of the quarter.

The upward move reverses a downward trend that has lasted for two years.

In the aftermath of 'Brexit', when the UK voted to leave the EU, both gas and power prices finished Q2 near nine-month highs.

UK gas prices finished the quarter 29% higher than the end of Q1, and UK power prices 25% higher.

However, average quarterly prices were also stronger, reflecting supply concerns over Q2 as a whole.

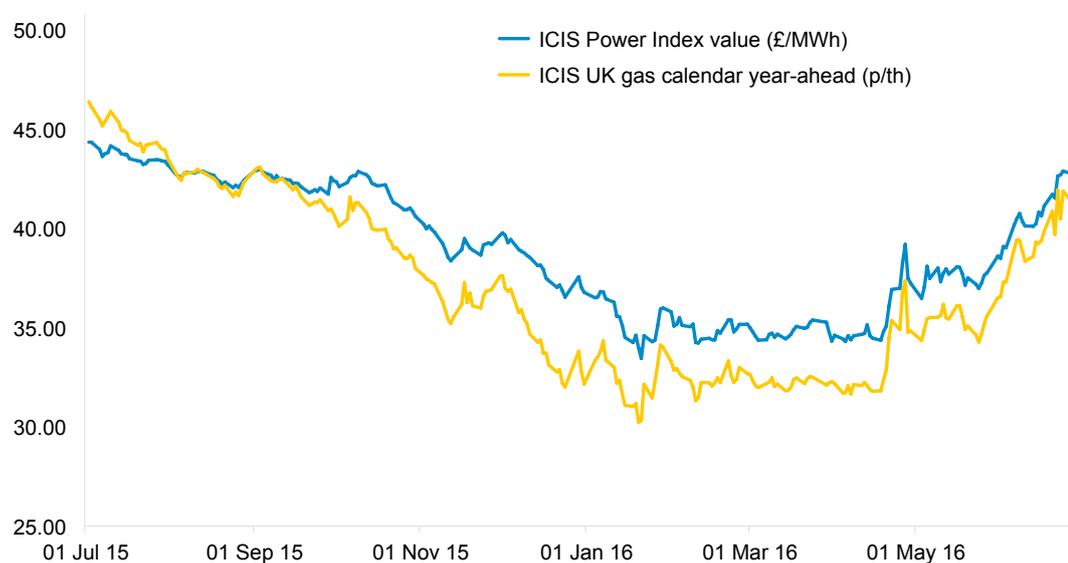
The ICIS Power Index (IPI) averaged £38.12 per megawatt-hour (MWh) over Q2, up 8.9% from the Q1 average, while gas prices averaged 36.14 pence per therm (p/th), a rise of 12% over the same period.

Q2 2016 was the most volatile quarter for energy prices in two years, with daily prices buffeted by heavy maintenance on gas infrastructure, unexpected power plant shutdowns, gains in other commodities and, latterly, swings in sentiment over Brexit.

Brexit immediate impact

The impact of the UK's decision to leave the EU is as yet unknown, with years of political negotiations ahead, even after the UK gives formal notice of its intent to leave.

Before the referendum results were announced, most market participants had expected the UK





to remain in the EU. Polls showing the UK was most likely to remain were cited as supporting oil prices in the week prior to polling day. Oil prices also fell on the day, in expectation of slower economic demand.

Once results were known, the immediate concern for UK wholesale energy prices was the fall in the value of sterling against other key currencies. A falling pound makes UK wholesale gas more attractive to purchasers from continental Europe using euros, who can get more for their money. This demand in turn tends to boost UK gas prices – in fact the UK gas price in euros for delivery over the next year fell day-on-day once the referendum result was announced, but at the same time the price in sterling rose 3.5%. The fall of sterling against the dollar was the most pronounced, although the euro also lost ground to the dollar.

Over Q2 as a whole, UK gas prices were influenced by moves that occurred in the Brent crude oil market over the last 18 months, with gains in the oil price helping to support gains in gas.

The Brent crude oil front month continued to rebound from a 13-year low of less than \$32/bbl in January, briefly breaking \$52/bbl in mid-June, but expectations for lower economic activity since the Brexit vote have undermined oil pricing once again.

Similarly, gains in the coal market have also helped to support power prices.

Gas supply concerns

Q2 was also the start of heavier maintenance schedules in the North Sea, and prices for long-term delivery responded to short-term maintenance both planned and unplanned, despite advance notice of the former.

The greatest shock to the UK's gas infrastructure was announced to the market the day before voting on the EU referendum.

Britain's largest gas storage facility Rough was announced as offline for at least 42 days. Operator Centrica Storage cited an issue with one of the site's wells, which has stopped any injection or withdrawal of gas in storage.

The Rough storage facility accounts for around three-quarters of Britain's gas storage. Traditionally the site is filled over the summer when gas demand and prices are low, in preparation for the winter, when demand and prices are high. Currently the site is 40% full, but with no changes to storage until early August at the earliest, the facility will be missing around 1.2bcm, more than one-third of its current 2.7-3bcm capacity.

There are concerns that the facility will not be filled until the end of October, which will already be into the winter season, even if there are no delays in the facility returning to service.

Storage capacity is already curtailed, from 3.8bcm to 2.7-3bcm until the end of September of this year, following technical issues last year.

Market participants are expected to use storage sites in continental Europe, and with higher gas prices, the UK could also attract more liquefied natural gas (LNG) cargoes as well.

Additional maintenance that boosted prices included extended maintenance at Norwegian infrastructure sites supplying the UK, such as Norway's largest gas field Troll, and also smaller fields such as Karsto and Skarv. The Kollsnes platform, which routes gas to the UK as well as mainland Europe, also had its maintenance programme extended, once again boosting prices.



LNG

Supply from liquefied natural gas (LNG) was expected to keep gas prices lower.

Over the last 18 months, traders have expected more LNG supply than demand, because new liquefaction capacity in Australia and the US is coming onstream faster than the expected growth in demand.

This imbalance has kept gas prices low, as there will be more supply. Market participants have also expected more LNG coming to the UK in particular, because the UK's market is one of the most actively traded in the world.

However, with low gas prices globally, more buyers have come to the market, with India and Egypt both holding tenders for additional LNG supply.

During Q2, there was also new demand from Poland, where a new LNG terminal received its first two cargoes in June, and an increase in demand from Lithuania and Italy.

Data from ICIS' LNG Edge tracking and analytics platform showed 24 cargoes coming to the UK during Q1, compared with 23 the previous quarter.

With supply to Europe fairly stable, and none of ten US cargoes coming to the UK, concerns about a looming gas glut have eased a little.

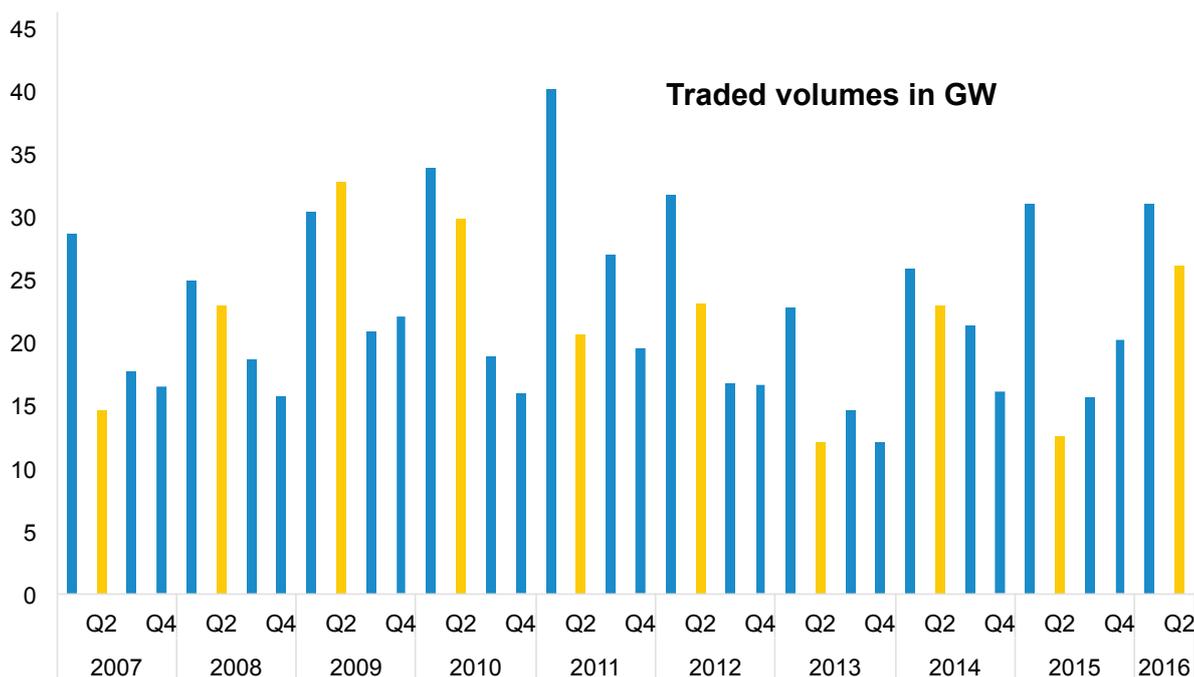
Power generation boosts gas

A drop in the amount of coal-fired power plants in the UK has encouraged demand for gas to burn for power generation, supporting both gas and power prices.

The UK lost 5GW of older coal-fired generation from the wholesale market at the end of Q1. This total is equivalent to 10% of the UK's total consumption at peak times – this winter, demand reached 51.7GW on 18 January.

However, these closures were expected. During Q2, the UK situation became worse, with Engie taking its 1GW Rugeley coal-fired plant offline, and operator RWE announcing its 1.6GW Aberthaw plant would be taken out of the market from April 2017.

Aberthaw is expected to run as part of the UK's capacity market from winter 2018, but its lack of profitability and RWE's subsequent decision to close the plant removes another 1.6GW from the UK grid for winter 2017.





In early July, data from electricity market operator Elexon showed the UK has less than 2GW of supply margin for five weeks of the winter.

The proportion of gas-fired electricity in Britain was 47%, the highest for any quarter in more than five years. The UK generated more than twice as much power from gas in Q2 2016 than in the same period the year before.

Demand for power fell 2.1% year on year during Q2, but the effect of lower electricity supply margins has already been seen with higher prices for short-term delivery. This in turn boosts the expectation for the average price of electricity delivered over a longer time period.

Liquidity

Traded volume making up the IPI was boosted by market volatility over Q2 2016, with 26GW of power trading for delivery over the next two seasons. Volume reduced from three months earlier, as trading activity is typically lower in Q2 than Q1, but trading activity for the time of year was its highest since 2010 (see graph, page 3).

Outlook

Brexit implications

Any implications from Brexit will necessarily be long-term. Even once the UK gives formal notice of its intention to leave, it will take some years to negotiate the terms of an exit.

Issues at stake for the energy industry include:

- gas imports – the UK is now a net gas importer, and any disruption in managing connections to the continent could boost the price of gas paid in the UK;
- electricity imports – the UK typically imports from France and the Netherlands, as UK prices are boosted by more gas usage and additional carbon costs for UK emitters;

- currency strength – weaker sterling could affect UK buyers' ability to attract dollar-denominated energy supplies like LNG and coal in a global market, which could send LNG to other regions;
- economic demand – less economic activity could mean lower productivity and therefore less demand, depressing energy prices, although a weaker pound could stimulate the export economy;
- climate change policy – the UK has already taken unilateral steps to incentivise low-carbon electricity generation with carbon price support, while climate change targets are part of national law;
- financial and trading regulation – the UK is a centre for commodity trading as well as financial, and a different regulatory regime could affect companies' decisions as to where to locate and trade.

In the short term, gas prices are expected to continue to be influenced by currency movements, while the potential impact on economic demand in the UK and Europe could also keep crude oil prices low.

Maintenance on the Rough gas storage facility is expected to support higher prices, while continental European buying demand for gas may increase, as the Dutch government has proposed a cap on production from its domestic gas field Groningen, which could encourage more purchasing on the wholesale market. The government is consulting on the proposal over Q3.

The tighter electricity supply margin is not expected to have a significant impact given lower demand in the summer, but any further announcements on plant closures could boost prices for long-term delivery.



About the IPI

The ICIS Power Index (IPI) gives homes and businesses an insight into price trends on the UK wholesale electricity market.

Robust energy markets are vital to the UK economy, and the IPI makes electricity price trends and activity more visible and accessible to household consumers and commercial buyers, as well as media and policy-makers.

The IPI is published daily by ICIS, an independent authority on UK electricity market pricing, and is available at:

www.icis.com/energy/electricity/icis-power-index/

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ICIS is an independent price reporting agency focusing on global energy, petrochemical and fertilizer markets, and we have covered the complex UK electricity market for nearly two decades. Every day, we assess electricity contracts for more than 40 different delivery periods in the UK market alone. The analysis and data that we produce is widely used as a reference price in energy contracts.

It is our aim to give companies in global commodities markets a competitive advantage by delivering trusted pricing data, high-value news, analysis and independent consulting, enabling our customers to make better-informed trading and planning decisions. With a global staff of more than 800, ICIS has employees based in Houston, Washington, New York, London, Montpellier, Dusseldorf, Karlsruhe, Milan, Mumbai, Singapore, Guangzhou, Beijing, Shanghai, Yantai, Tokyo and Perth. ICIS is a division of Reed Business Information, part of Reed Elsevier Plc.

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