



Highlights

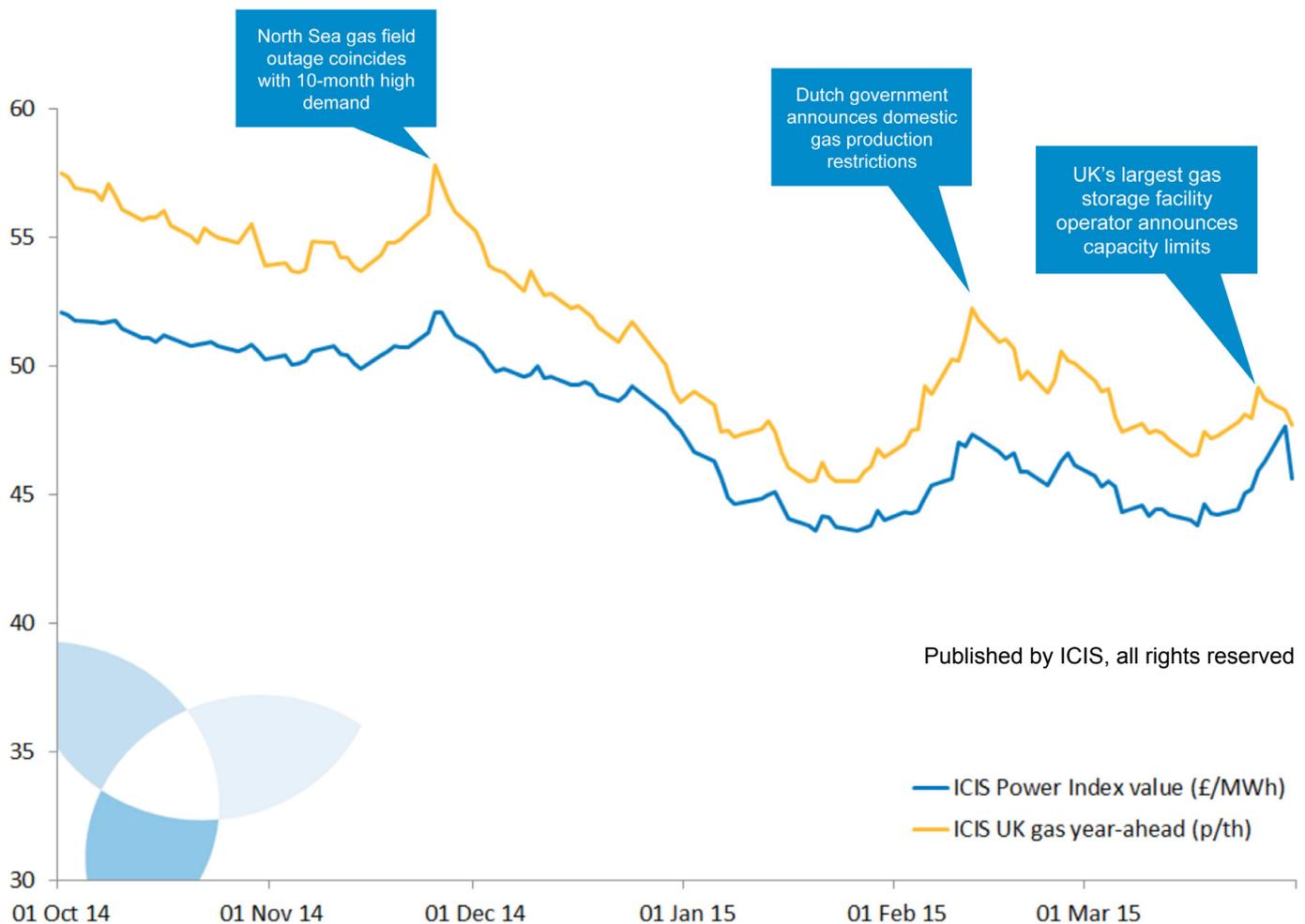
- UK wholesale electricity market prices hit their lowest levels since the IPI has been calculated, because of global gas oversupply.
- UK markets are now much more influenced by global gas supply and demand, with Asian markets exerting a strong influence on European gas prices.
- Energy prices have still spiked with issues involving Dutch gas production and the UK's long-term gas storage site called Rough, but prices have quickly returned to lower levels.

Price moves

The ICIS Power Index (IPI) continued to lose value early in Q1 2015, as the price of electricity delivered over the next summer and winter seasons fell as key generation fuels lost value – in particular, gas.

In fact, the IPI reached its lowest value ever on 26 January 2015.

The IPI averaged £45.10/MWh for the quarter as a whole – 6.5% lower than Q3 2012 when the IPI quarterly average was its lowest, according to historical data calculated back to 2011.



Source: ICIS Power Index (www.icis.com)



Underlying price trends

Fuel oversupply continues

The most significant driver of price for the UK power market is the UK gas market, and the UK gas price for delivery over the following calendar year reached its lowest level since 2010 during Q1 2015.

Increased liquefied natural gas (LNG) volumes continue to flow into the UK, so the market is oversupplied.

Low demand in Asia has caused prices to fall, and in fact, ICIS' East Asia Index (EAX) for regional LNG prices actually fell below the price of gas delivered in the UK for the first time since May 2010 on 4 February.

With Asian prices close to or even below the UK, the UK gas market was more attractive for LNG sellers, particularly because the UK gas market has more active market participants.

In Q1 this year, 25 LNG cargoes came to the UK, compared with nine over the same period last year.

Additional macroeconomic trends

Wider economic trends have also had more a more visible influence on UK energy prices during Q1 than usual.

Firstly, UK energy prices have been affected by the fall in Brent crude oil prices. Most UK gas is bought and sold based on UK market prices, but some European buyers still have long-term gas supply contracts, with prices based on an average of the crude oil price over the last six to nine months. These long-term contracts are flexible, with buyers able to vary how much gas is delivered and when.

Brent crude oil lost half of its value from the end of June 2014 to the end of March 2015, so some European gas buyers have chosen to buy gas via their long-term contracts rather than buying on the market, so there has been less buying interest, and therefore prices have fallen.

Gas buyers are also looking to delay buying larger volumes until later this year to take advantage of the lowest oil price average possible.

Currency shifts have also played a part in pushing UK gas prices lower. The euro has fallen 8% against sterling over Q1, so European companies looking to buy UK gas have had to pay more because of the shift in currency, which has lessened demand from European buyers.

Coal prices for delivery over the next year have remained low, partly because the world's largest coal importer, China, is cutting coal-fired electricity production to maintain air pollution targets. This has led to some global coal miners cutting production and closing coal mines, because the price of coal is below the cost of production at many sites.

Price shocks

The general trend for UK wholesale energy market prices has been downwards, but there were some more significant price moves in response to concerns over gas supply.

Gas import concerns

The strongest day on day gain in the IPI related to concerns over gas imports into Britain from the Netherlands.

The Dutch government tightened its restrictions on production from its giant domestic gas field Groningen on 9 February 2015. The decision to cut responded to concerns that gas extraction has caused tremors in the Netherlands, and limiting gas extraction should reduce these. The topic has become an issue ahead of local elections later this year.

Back in 2013, the Dutch government capped 2015 domestic gas production at 42.5bcm in 2015. But the maximum output for 2015 was reduced to 39.4bcm in December last year, over public concerns over the frequency and strength of the tremors in the Groningen area and on the advice of industry experts.



Then in February, the Dutch minister restricted production further until July, allowing the government to decide whether to limit annual production from the field by either 39.4bcm or 35bcm, depending on the outcome of further investigations.

More than half of Britain's natural gas demand has been met by imports since 2010, and last year, gas supply from the Netherlands accounted for 9% of total demand.

Dutch deliveries to Britain over winter 2014 were down 30% from the volumes delivered the previous winter.

Ukraine-Russia concerns

At the beginning of April, Ukrainian and Russian authorities agreed to extend a temporary winter gas supply agreement for another three months.

Geopolitical tensions between the two countries led to turbulent price moves throughout 2014 for both gas and power markets, but the winter agreement helped ease market participants' concerns about interruptions of supply into continental Europe throughout the first quarter.

The latest agreement will help to keep prices flat, or fall as participants feel more comfortable selling any surplus needed.

Gas storage concerns

Another factor that boosted gas prices for long-term delivery was concern over storage availability.

Operator Centrica announced that the UK's largest gas storage site, Rough, has been cut to 70-80% of its maximum for the next six months, due to "well integrity issues".

The Rough facility is in a depleted oil field, and accounts for 80% of the UK's gas storage availability. The announcement inflated prices, because market participants typically inject gas into storage during summer months, when demand is low and prices are cheaper, for use during the more expensive winter period.

The UK usually enters the winter period with storage levels at 85% or above, but this year, storage will be curtailed.

Last year, storage in the UK was at 53% at the end of Q1, after a mild winter and strong supply of LNG. However, at the end of Q1 this year, storage levels were 18% full-less than the 53% at the same period in 2014 after a mild winter and strong supply of LNG, but more than the 8% in 2013.

Power trends

Gas remains the strongest influence on UK power prices. However, power prices for longer-term delivery continue to come under the influence of the changing generation mix during Q1.

Extra renewable generation in the UK continues to put downward pressure on prices, with more supply. In 2014, renewable energy production grew by 20% over the year before, according to UK government figures. In total, 19% of the UK's 335TWh of electricity generated last year came from renewable sources, and this is expected to grow further in 2015.

Renewable energy is subsidised to encourage more green generation and reduce the UK's carbon dioxide emissions. However, with more energy from renewable sources, there is less demand for traditional gas- and coal-fired power generation. The traditional generation is still needed because it is more flexible and able to respond when wind or solar generation is not available, but lower prices in general means fewer opportunities to generate, putting gas- and coal-fired plants under economic pressure.

Capacity margins

Lower profit margins for flexible generation have led the government to intervene in the market as part of its Electricity Market Reform, which aims to move the UK to a low-carbon generation mix, while introducing a measure to make sure the UK has enough supply to meet peak demand.



In December, the UK government held a capacity auction for 51GW of traditional generation at a guaranteed price.

Traditional plants were encouraged to bid for a set income stream, which would require them to be available to generate at short notice from 2018, allowing them to keep running.

However, more than 3GW of coal-fired power plants failed to qualify for the UK capacity auction, as did 2.5GW of combined cycle gas turbine (CCGT) power plants.

There are now increasing concerns that those plants which failed to qualify may switch off their generation.

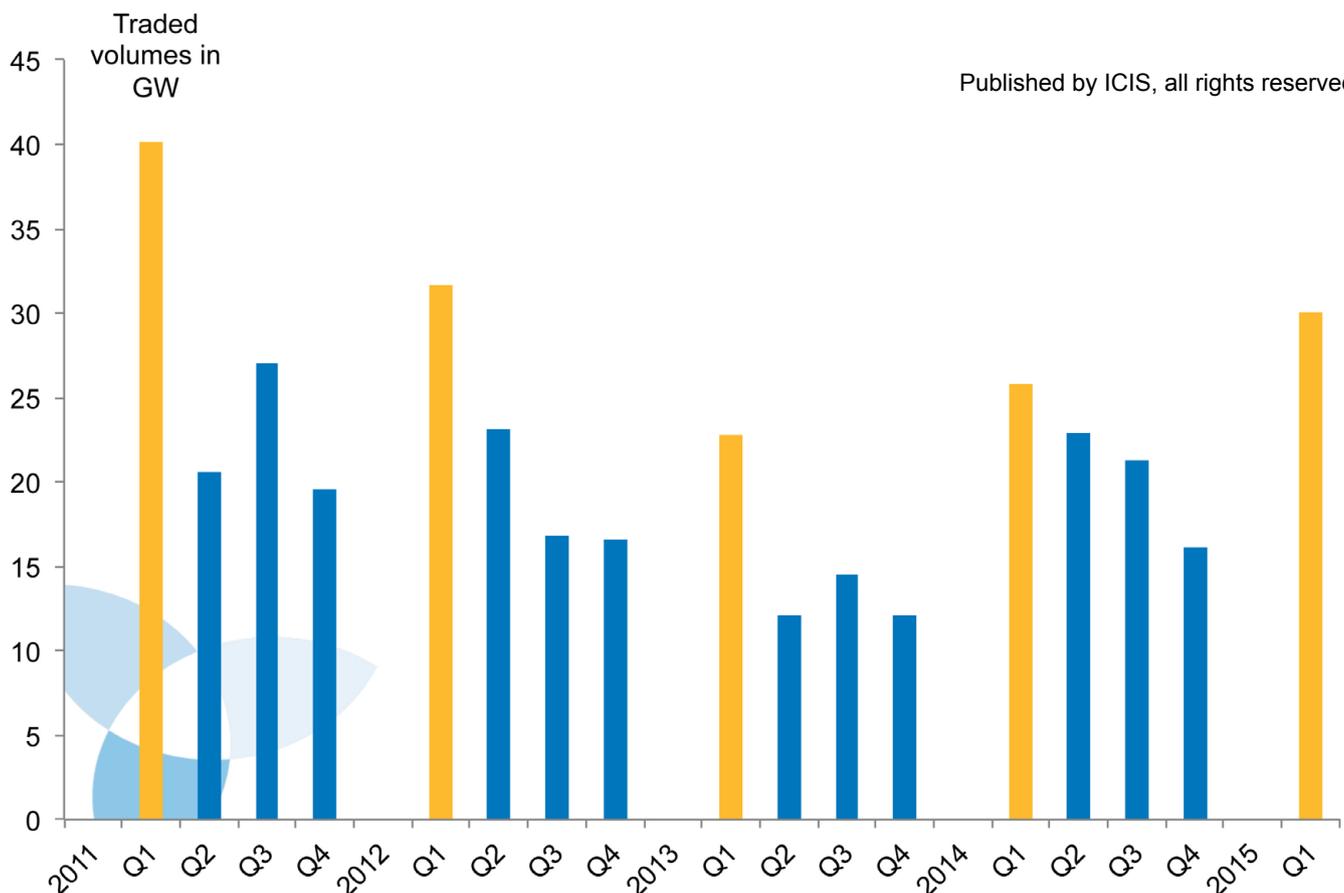
Centrica announced that it plans to close two of its CCGT plants, and E.ON has also announced that it has similar concerns.

Traded volumes

Traded volumes that contributed to the IPI were the strongest in three years.

Quarterly traded volumes for the seasonal contracts on which the IPI is calculated reached 30GW, a volume last surpassed in Q1 2012.

Strong trading volumes are important, because without electricity being made available to buy or sell, price signals are weaker.



Source: ICIS Power Index (www.icis.com)



British energy regulator Ofgem introduced a mandatory market-making obligation (MMO) on the largest market participants from April last year. This requires the biggest utilities to make power available both to buy and sell within two trading windows during the day.

Outlook

Long-term factors could continue to keep the downward trend for contracts delivered over longer periods in place.

- Global LNG oversupply is expected to continue over 2015, with more worldwide LNG production starting up in the middle of this year, particularly from Australia.
- In total, up to 49bcm of new liquefaction capacity is expected by the end of 2015. Not all of this production capacity will be used immediately, but for comparison, total worldwide LNG production last year was 330bcm.
- How much of this new supply comes to the UK depends on other demand elsewhere in the world, with uncertainty over both new LNG importers emerging and demand in the usual markets for LNG.
- Most analysts expect Brent crude oil prices to continue close to the current range, which would help to keep gas and therefore power prices low.
- Coal prices are also expected to remain low, with European coal stocks at high levels, and therefore less buying demand for imports.
- New renewable capacity is increasing as well – market participants are unsure how prices will be affected by additional solar in particular.
- However, as shown by the spikes in price, gas storage could support prices, if the problem proves to be more widespread than expected.
- Other UK power generation is coming offline, such as the Littlebrook oil-fired power plant which, although rarely used, was occasionally called upon to meet peak demand in winter time, so generation supply margins for Winter 2015 remain tight.



About the IPI

About ICIS 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/

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.

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