July 2017 - Market Summary

Review of Market Trends

Report No. 7
Martin Rawlings
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Macro Economics

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<thead>
<tr>
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<th>Closing Rate</th>
<th>% Change</th>
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<tbody>
<tr>
<td>GBP</td>
<td>1.1157</td>
<td>0.028%</td>
</tr>
<tr>
<td>EUR</td>
<td>1.157</td>
<td>0.008%</td>
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<tr>
<td>USD</td>
<td>1.3231</td>
<td>0.017%</td>
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US Dollars (USD) per British Pound (GBP)

Euros (EUR) per British Pound (GBP)

Sunday, Jul 23, 2017
1.113914
United States Dollar:

The US dollar suffered at the end of last week with the release of its Q2 growth figures. Whilst the economy grew by a staggering 0.6% over the quarter, this was less than analysts had expected and as such the dollar sold off and finished the week down against all of the major currencies apart from the Swiss Franc. GBP/USD broke through the 1.31 (IB) handle, despite the fact that the UK’s GDP figure disappointed earlier in the week, expanding by only 0.3%. In comparison, the Spanish and French economies both grew by 0.9% and 0.5% respectively. Being the first week of the new month we are set to have the release of the very important jobs data on Friday in the form of the significant Non-Farm payroll numbers and hourly earnings. With the dollar set on a downward course, all eyes will be on these unemployment figures as strong numbers could mark a reprieve and FOMC members need some clear strength in data to push ahead with their interest rate increases later in the year.

It is probably set to be an even bigger week for the pound with a trifecta of crucial data releases. It kicks off with July’s PMIs before Super Thursday grips the market with the latest Bank of England Policy Announcement and the Quarterly Inflation Report. At the last meeting in June, the market was surprised as three MPC members voted for an interest rate hike and with a couple of new faces it will be interesting to see the voting pattern, their inflation report and the sentiment of their statement. Although a hike is not expected for August, the rumours of two more BoE members joining the ‘for’ vote may build momentum for sterling strength this week.

I anticipate a range in the GBP/USD rate of 1.3000 – 1.3162

Euro:

As mentioned last week, we also saw the release of GDP numbers from a number of Eurozone economies last week. France reported Q2 growth at 0.5% and Spain hit 0.9%. For Spain this figure means that the economy has now returned to its pre-crisis levels. Alongside this, Eurozone economic sentiment reached a 10-year high and it would appear that as the two performances of the UK and EZ continue to diverge, it is Michael Barnier, the European chief negotiator for Brexit, who holds the upper hand against the UK’s David Davis during Brexit negotiations.

With the strong data releases the euro went back over the 1.17 (IB) level versus the US dollar and GBP/EUR has consolidated below 1.12 (IB). This week will also be a big week for EZ data as we have Eurozone inflation, GDP numbers and retail sales, but these releases may well be overshadowed by other news.

I anticipate a range in the GBP/EUR rate of 1.1130 – 1.1200
Oil Market: Brent $52.64/bbl, WTI $50.18/bbl

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<tr>
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<th>52.39</th>
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<tr>
<td>Brent ICE (USD/b)</td>
<td></td>
<td></td>
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<tr>
<td>Gasoil ICE (USD/t)</td>
<td>490.35</td>
<td>↑</td>
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<tr>
<td>Fuel 1% Fob cg (USD/t)</td>
<td>303.73</td>
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Close to close at $52.52/bbl for Brent ICE (This morning at $52.39/bbl)

Crude oil prices have kept on increasing to trade near $53/b for the Brent 1st nearby and $50/b for the WTI benchmark.

The number of active oil rigs in the US was marginally up last week (+2). They have actually stabilized in July, reflecting the impact of low prices on US shale producers, but the rebound in prices could again be a game-changer.

Without any surprise, CFTC data show that net hedge funds’ net long positions have rebounded to their highest level since April.

Outlook:
Prices broke their descending channel and could now target their May highs ($54.67/b for the Brent). The announcement that OPEC and non-OPEC countries will meet next week (7-8 August) to monitor why some countries are lagging behind to cut their output can only support prices. Markets are positive, still in the wake of the bullish output figures released Wednesday but the disappointment could be strong next week if production rebounds (especially because last week’s decline was likely driven by field maintenance in Alaska and the impact of Tropical Storm Cindy in gulf of Mexico). Markets will now focus on the weekly Bakker Hughes rig count as usual. The positive streak could end up slowing or, at least, take a break. Today, we see prices stable to slightly bearish with Brent first nearby prices holding between $47.8/b and $47.3/b, the 20-days average
European Gas Market NBP Price: 1.3105 pence/kWh

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<tr>
<td>Day Ahead (p/therm)</td>
<td>38.40</td>
<td>↓</td>
</tr>
<tr>
<td>August 2017 (p/therm)</td>
<td>39.35</td>
<td>↓</td>
</tr>
<tr>
<td>Winter 2017 (p/therm)</td>
<td>46.05</td>
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Close to close at EUR 15.97/MWh for TTF CAL 18 (This morning at EUR 16.10/MWh)

European gas prices were mixed on Friday. The upward revision in the impact of the Kollsnes outage supported NBP prices as Norwegian exports to the UK are the most impacted. A weaker pound against the euro provided additional support to NBP prices. At the opposite, prospects of an increase in Russian gas flows through the Nordstream pipeline in the coming days/weeks weighed on continental prices as the operator of the OPAL pipeline indicated on Friday that it plans to resume auctions as soon as this week. Strong coal and oil prices limited losses on the far curve.

NBP ICE August 2017 prices gained 0.08 p/therm at the close (+0.2%), expiring at 38.56 p/therm. TTF ICE August 2017 prices lost 15 euro cents at the close (-1%) expiring at €14.98/MWh. On the far curve, TTF Cal 2018 prices were assessed 4 euro cents lower (-0.2%) at the close, to €15.97/MWh.

Outlook:
A jump in coal prices (API 2 Cal 2018 prices are trading at a new 2017 high this morning at $75/t) on the back of strong coal demand for power generation in China and lingering supply issues in the Pacific Basin could support gas prices today. In addition, the UK system is 30 mm cm undersupplied this morning due to planned and unplanned outages affecting UKCS production and a sharp drop in Entry Segal flows from Norway, which is likely to push prompt contracts higher.
UK Electricity Market Average Buy Price: £42.68/MW

<table>
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<tr>
<th>Period</th>
<th>Price (p/kWh)</th>
<th>Change</th>
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</thead>
<tbody>
<tr>
<td>Day Ahead</td>
<td>4.150</td>
<td></td>
</tr>
<tr>
<td>August 2017</td>
<td>4.120</td>
<td></td>
</tr>
<tr>
<td>Q4 2017</td>
<td>4.585</td>
<td></td>
</tr>
<tr>
<td>Winter 2017</td>
<td>4.660</td>
<td></td>
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<tr>
<td>Summer 2018</td>
<td>4.045</td>
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Close to close at £28.34 /MWh CAL 18 (This morning at £28.55/MWh)

A large rebound in wind power over the weekend in NWE drove spot prices to their lowest levels since the beginning of May. Other sources of supply display good levels for this time of the year. Besides, as we enter the middle of summer holidays, power demand levels fell to very low levels and they are expected to fall even more despite a rebound in temperatures.

On the far curve, calendar power prices were traded sideways with a small rebound in CO2 prices, and a large rebound in coal prices at the very end of the session. The French Cal 18 contract declined slightly to €36.93/MWh. The German Cal 18 stayed at €31.21/MWh.

Outlook:
With low demand levels this week but also a lower wind power output, spot prices could come back to the previous week’s levels in the coming days. Comfortable solar supplies and a return of wind by the end of week will weigh. On the far curve, the strength of fossil fuels’ prices (oil, coal…) for year-ahead contracts should drive power contracts higher.
Coal Buy Price: £65.33/tonne

Carbon Buy Price: €5.23/tonne
News

Rough is closing – what does it mean for your business?

In June 2017, Centrica announced that it will be permanently closing its Rough gas storage facility, which is located off the coast of Yorkshire. Rough is currently the largest facility of its kind in the UK, and with its closure we lose over 65 percent of our storage capacity.

The UK remains reliant on gas, and this will continue well into the future. We’re a net importer of gas via pipelines from other countries, and this vulnerability makes it essential to store as much gas as possible within the UK. Britain has seven other major gas storage sites, but they offer shorter injection and withdrawal times and less capacity. This means that the closure of Rough will undoubtedly create uncertainty in terms of energy pricing.

Although we haven’t seen a real impact on prices yet, probably because there is still a significant amount of recoverable gas in the field, the pressure could come in the winter months, especially if we experience a cold snap. It’s possible that we could see increased price volatility if European gas flows experience disruption and storage becomes more critical to balancing the system.

The good news is that if you take action now, you could mitigate such potential cost pressure for your organisation. So what can your business do to reduce the impact on its energy bills?

Take advantage of current market prices

This winter we’ll be relying much more heavily on gas imports to balance the gas market, which leaves us more exposed to international price fluctuations. We felt the effects of this in early July, when it seemed that the delivery of two cargoes of LNG from Qatar would be missed and gas prices pushed higher. As we’re still in the summer months, with lower demand and lower prices for gas, it could be wise to renew your gas contract now even if it’s not due to be reviewed for a few months.

Review your procurement strategy

It’s a good idea to review your energy buying strategy regularly to make sure it’s still the right approach for your organisation, but we’d advise all organisations to ensure their procurement strategy is aligned before the winter months come along.

You need to think about your business’ attitude to risk – are you prepared to risk a potentially significant rise in your energy costs that the closure of Rough may cause this winter? If so, you might choose a flexible contract, which may give you greater control to manage price risks. Remember that you can set parameters around prices within a flexible contract so you never pay more than a pre-agreed price for your energy.

Alternatively, you may want to lock into a fixed contract before winter cost increases come along. A fixed contract will ensure that your organisation isn’t hit with potential price rises that could materialise this winter, and many businesses like the budget certainty that a fixed contract provides. However, fixed contracts can have a higher risk premium than flexible contracts, meaning that you pay more than cost for your energy.
Consider participating in demand management

If your gas and electricity contracts aren’t up for renewal in the near future, don’t worry – there are still ways to keep your overall energy costs under control over the winter. Businesses of all sizes can benefit from getting involved in demand management, by turning their electricity consumption up or down at certain times to match predicted generation.

Reducing consumption during peak demand periods is probably the easiest way to participate in demand management for many businesses. Over the winter months, extra costs associated with Triads, the Capacity Market and DUoS bands can make energy consumption during peak demand periods (typically 4pm-7pm on weekdays) extremely expensive. By reducing your consumption during these periods – from something as straightforward as turning off lights and machinery when not in use, to shifting your production hours to periods of lower demand – you should be able to avoid excessive electricity charges and so mitigate rising gas prices.

To further incentivise users to reduce demand during peak periods, the National Grid had introduced a series of Demand Side Response (DSR) initiatives which provide a revenue stream to those who can reduce consumption or switch on on-site generation at peak times. Revenue depends upon the amount of consumption reduced or generation produced, the notice period required and the time for which the consumption reduction or generation lasts. Revenue can often be a multiple of the costs that would have been incurred during normal usage.

Although initially most organisations believe there is little opportunity for them to take part in these schemes, it is my experience that most companies can benefit with a little support and guidance.

Terminology
- All oil prices: in US dollar
- Oil product: Brent crude or West Texas Intermediary (WTI)
- Mb/d – Million Barrels per day.
- Freight rates: US dollar per tonne.
- Natural gas prices quoted as pence per therm.
- Power prices quoted as Pounds Sterling per MWh.
- CO2 market: EURO

Information & Data Sources
1. Total Gas & Power
2. GdF Suez
3. Haven Power
4. Coal spot.com
5. Forex
6. ICIS

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