June/July 2019 - Market Summary

Review of Market Trends

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Macro Economics

<table>
<thead>
<tr>
<th>Currency</th>
<th>Closing Rate</th>
<th>% Change</th>
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<tbody>
<tr>
<td>GBP</td>
<td>1.09861</td>
<td>↓</td>
</tr>
<tr>
<td>EUR</td>
<td>1.09861</td>
<td>↓</td>
</tr>
<tr>
<td>USD</td>
<td>1.21688</td>
<td>↓</td>
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GBP to USD

GBP to EUR
The pound is under pressure as fears grow that the UK economy could be heading for the first recession in a decade.

UK GDP made for grim reading as official figures showed that the UK economy contracted in Q2. A toxic combination of Brexit uncertainty, the running down of Brexit inventories built up prior to previous Brexit deadlines and the closing of car plants, resulted in the UK economy contracting 0.2% in the second quarter. Growth of just 1.2% is expected across the year, down from 1.8% and short of expectations.

Given that the next Brexit deadline is 2½ months away, there is still time for looming Brexit jitters to continue negatively impacting the economy. This means a second consecutive quarter of contraction and therefore a technical recession is now a very real possibility. Adding to the pound’s woes, industrial production and manufacturing figures also missed expectations by large margins.

The outlook for the pound remains extremely fragile as the prospect of a no deal Brexit increases. With the blame game between the EU and the UK in full swing, the chances of the two sides renegotiating the Irish backstop appears slim; instead preparations for a worst case scenario, no deal Brexit are being prioritised. Add into the mix decidedly gloomy UK fundamentals, with little prospect for improvement in the near term and it’s easy to see why the bears are controlling the pound.

GBP/USD Levels to watch:
The pound has broken down through $1.21 and is looking towards support at $1.2080. A breakthrough here could open the door to support in the region of $1.2030 prior to the psychological level of $1.20. On the upside, resistance can be seen at $1.2180 ahead of $1.2200.

EUR/GBP levels to watch:
The cross is advancing 0.47% at 0.9255 and faces the next up barrier at 0.9265 (2019 high Aug.8) followed by 0.9306 (2018 high Aug.29) and finally 0.9411 (monthly high Oct. 2009). On the flip side, a breach of 0.9088 (low Jul.31) would open the door to 0.9074 (21-day SMA) and then 0.9051 (high Jul.17).
Oil Market: Brent $64.49/bbl, WTI $53.50/bbl

<table>
<thead>
<tr>
<th></th>
<th>Price</th>
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<tbody>
<tr>
<td>Brent ICE (USD/b)</td>
<td>64.49</td>
</tr>
<tr>
<td>Gasoil ICE (USD/t)</td>
<td>607.75</td>
</tr>
</tbody>
</table>

Crude Oil Spot Price 2019

Crude Oil Spot Price
Friday’s marginal gains and recovery from early session weakness is not enough to get excited about a rally. It’s just price action led by short-covering and position-squaring. The hedge funds are short and likely looking to add to positions in the wake of today’s bearish IEA report.

U.S. West Texas Intermediate and international-benchmark Brent crude oil futures are edging higher on Friday shortly before the regular session opening after clawing back earlier losses. Helping to keep a lid on prices are concerns that the trade dispute between the United States and China will lead to a global economic slowdown and lower demand. However, the market is also being underpinned by expectations of more OPEC production cuts.

At 09:03 GMT, September WTI crude oil is at $52.82, up $0.28 or +0.51% and October Brent crude oil is at $57.81, up $0.43 or +0.84%.

U.S.-China Relations Worsen
There is not much optimism over the U.S. and China reaching a trade deal anytime soon. Conditions could even worsen as both try to force the other side into making an unfavorable deal. President Trump raised tensions a week ago when he announced new tariffs on China. Then the world’s second largest economy retaliated by letting its currency drift below the psychologically important 7 yuan to the dollar level, and cancelling all U.S. agricultural deals.

Crude will have very little chance of sustaining a rally if the U.S. and China continue to try to weaken each other’s stance.

IEA Cuts Demand Growth Forecast
Earlier today, the International Energy Agency (IEA) cut its global oil demand growth forecasts for this year, citing fears of an economic downturn. The energy agency now expects oil demand growth to reach 1.1 million barrels per day (b/d) in 2019 and 1.3 million b/d in 2020. That constitutes a downward revision of 100,000 b/d for this year and 50,000 b/d for next year.

In its closely-watched monthly oil report, the IEA said there was “growing evidence of an economic slowdown” with many large economies reporting weak gross domestic product (GDP) growth in the first half of the year. “The situation is becoming even more uncertain,” the IEA said, before describing global demand growth in the first half of the year as “very sluggish.”

“Meanwhile, the prospects for a political agreement between China and the United States on trade have worsened. This could lead to reduced trade activity and less oil demand growth.”

Looking ahead, the IEA said the outlook for oil demand growth is “fragile,” with a greater likelihood of a downward revision than an upward one.

Daily Forecast
Friday’s marginal gains and recovery from early session weakness is not enough to get excited about a rally. It’s just price action led by short-covering and position-squaring. The hedge funds are short and likely looking to add to positions in the wake of today’s bearish IEA report.

There is a wildcard out there. It’s China’s interest in U.S. oil. Recently showed Chinese buyers rekindled their interest in U.S. crude, as imports climbed to a nine-month high of 247,000 barrels per day, according to the Energy Information Administration (EIA). This, however, may have been a
goodwill gesture tied to the on-going trade negotiations. Because of the increasing tensions between the two countries, China may decide to dramatically reduce its intake of U.S. crude imports. This could trigger another steep break in prices.

**European Gas Market NBP Price: 1.030 pence/kWh**

<table>
<thead>
<tr>
<th></th>
<th>Day Ahead (p/therm)</th>
<th>August 2019 (p/therm)</th>
<th>Winter 2019 (p/therm)</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>30.35</td>
<td>30.60</td>
<td>51.80</td>
</tr>
</tbody>
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Wholesale gas prices are now 5% higher than they were in June.

You may have seen some things in the news about high gas prices. Ofgem, the energy regulator, has been forced to increase the level of the safeguard tariff, which protects vulnerable households from being overcharged, due to these higher gas prices.

This is a good indication of the challenging wholesale environment suppliers need to work with at the moment.

This can seem strange given the hot weather we’ve been experiencing. However, there is still high demand to put gas into storage for winter, especially in Europe. This means that despite being at the lowest demand period of the year for gas, prices have remained high. Shipments of Liquified Natural Gas (LNG) to Europe have fallen over the past couple months as a result of hot weather in Asia increasing the air conditioning demand there. The UK has been exporting gas to Europe to fill the storage facilities. While storage levels continue to catch up to where they were at this point last year, prices remain high the in the meantime. I expect gas prices to stabilise in October when storage facilities are full.

**Outlook**

**Bearish Price Drivers ↓**

Healthy storage levels.

Warmer weather.

LNG arrivals.

**Bullish Price Drivers ↑**

Outages and maintenance.

Weakness in GBP - Brexit.

Strength in carbon and coal and oil.
UK Electricity Market Average Buy Price: £42.61/MW

|            |       |  
|------------|-------|---
| Day Ahead  | 4.175 | ↑  
| August 2019| 4.145 | ↑  
| Q4 2019    | 5.230 | ↑  
| Winter 2019| 5.614 | ↑  
| Summer 2020| 5.055 | ↑  

UK power prices increased in value over the 7 days, making it a bullish week. Gas – the largest element in the UK fuel mix – was the most significant driver, with additional support from continental power, oil and coal. Demand on the national grid this week was at its highest so far this winter, reaching almost 42GW. This was due to cooler weather arriving in the UK and the days getting increasingly shorter.

Secure and Promote* (Season +1, +2, +3, +4) baseload contracts experienced gains over the course of the week that averaged £0.92/MWh. This is the largest increase in value we’ve seen for a while. The strength of the UK’s NBP (National Balancing Point) gas market was the major driver for the bullish behavior of the front 4 contracts. In turn, the NBP’s strength resulted from a lack of LNG (Liquefied Natural Gas) injections into the UK and North Western Europe systems. Additional upward pressure on electricity prices came from the French power market and unexpected outages at Belgian nuclear plants, along with cooler weather forecast for North Western Europe. Prices peaked on Friday afternoon as gas gains, pulled higher by European coal, continued their influence over UK power.

Day-ahead gas was up 2.35p/th to 29.50p/th and August 19 gas climbed 2.18p/th to 29.95p/th. Baseload power contracts mirrored their gas counterparts, with day-ahead power jumping £3.90/MWh to £41.75/MWh, as wind generation is expected to halve tomorrow. August 19 power lifted £1.61/MWh to £41.45/MWh. Brent crude oil increased $0.85/bl to $65.26/bl, following reports from the American Petroleum Institute that US crude stocks had fallen by 6mn barrels the previous week. EU ETS carbon slipped €0.02/t to €28.09/t, despite auction volumes halving in August. API 2 coal was $0.25/t lower at $68.25/t.

Prompt/Day-ahead Power
The average day-ahead baseload price was up again last week, at £49.63/MWh. Day ahead prices were at their highest (£51.19/MWh) on Saturday 11th November, when wind output was at its lowest for the week. As expected, the week’s lowest day-ahead prices were on 6th November (£47.70/MWh), when wind output was much higher. This again supports the view that the wind influences short-term power prices.

Imbalance Prices
Single cash out prices over the week averaged £46.61/MWh. No negative price periods occurred last week and Tuesday 7th October saw the maximum price of £117.78/MWh. This is in sharp contrast to the same week in 2016, when system prices were far more volatile and reached a maximum of £1528.72/MWh.

Renewables and other
Average wind output over the week was 6.74GW. Sunday 12th November saw the windiest conditions of the week, with output peaking at 11.71GW. The lowest wind generation was during Saturday 11th November, at just 2.95GW.

Bearish Price Drivers ↓
Warmer weather.

**Bullish Price Drivers ↑**

Outages and maintenance.

Weakness in GBP - Brexit.

Strength in carbon and coal and oil.
Coal Buy Price: $53.80/metric tonne ↓

Carbon Buy Price: €24.59/tonne ↑
News

Massive power cut – how secure is the UK power system?

Exit Grid Electricity System Operator said the power cut on 9th August was due to the loss of two large generators – gas and offshore wind.

Business Secretary Andrea Leadsom has announced an investigation into the power cut on Friday that left nearly a million homes and businesses across England and Wales in the dark.

The incident left road and rail networks in chaos, knocked out traffic lights as well as affected hospital services and airports.

Although power had been restored to around 900,000 customers by Saturday, issues with the rail network continued.

Ms. Leadsom said she will also be commissioning the government’s Energy Emergencies Executive Committee to consider the incident.

She added National Grid must “urgently review” and report to Ofgem, with the regulator calling on the grid operator for an “urgent detailed report” to understand what went wrong and what further steps need to be taken.

A spokesperson from Ofgem said: “In any incident the priority is to get power restored to customers as quickly as possible. National Grid has now informed Ofgem that the system has been restored.

“However, Ofgem understands the frustration this power cut has caused consumers. Ofgem has asked for an urgent detailed report from National Grid so we can understand what went wrong and decide what further steps need to be taken. This could include enforcement action.”

National Grid Electricity System Operator (ESO) said the power cut was due to the loss of two large generators – gas and offshore wind – on 9th August.

A spokesperson said: “As the Electricity System Operator we do not generate power directly, but use the power made available by the industry to manage the system and balance supply and demand. The root cause of yesterday’s issue was not with our system but was a rare and unusual event, the almost simultaneous loss of two large generators, one gas and one offshore wind, at 16.54pm.

“Following the incident, the system was secured, and the Electricity System Operator gave the all clear to the Distribution Network Operators (NDOs), power companies who are responsible for supply at a local level, within 15mins, so that they could start to restore demand. All demand was reconnected by the DNOS by 17.40pm. We appreciate the disruption cause and will continue to investigate, with the generators involved and wider stakeholders, to understand the lessons learned.”

The UK energy industry and a ‘no deal’ Brexit

The Brexit picture is – currently – still as unclear as ever, with all potential scenarios on the table, including a ‘no deal’ option.
If ‘no deal’ does become an eventuality, it will inevitably have an impact on all markets – including the UK’s energy industry.

But what could Brexit negotiations actually mean for legislation and supply within the gas industry?

Considerations?

There are two main areas to consider when we look at the potential implications for Brexit: the current and future state of the UK’s gas supply, and the laws and regulations governing how energy is sources and used:

Gas supply: As it stands, the UK produces just under half (44%) of the gas it uses. The rest is imported. The UK currently has direct gas pipelines (or gas interconnectors) with three EU states: Ireland, the Netherlands and Belgium.

Energy law: As an EU member state, the UK is currently subject to EU energy laws. These provide a Europe-wide framework around energy security and supply, as well as energy efficiency and safety – and there will be a change in the legislation applying to the UK if we do see a no-deal Brexit.

Legislation change?

In the event of a no-deal situation, EU energy law will cease to apply to the UK from 29 March 2019. UK laws relating to energy will still apply (on the 17 December 2018 the government published its statutory instruments to ensure UK energy laws continue to work after Brexit).

There will be some changes to licensing and industry codes of practice to ensure they’re still valid. Ofgem – the government regulator for the gas and electricity markets in Great Britain – published guidance on modifications to licenses and industry codes related to Brexit on 6 December 2018. In Great Britain, Ofgem is responsible for ensuring the technical rules of the domestic gas market are updated in a no-deal situation. As such, Ofgem will lead the license change process in Great Britain (and the Utility Regulator will lead it in Northern Ireland).

Interconnector owners and operators will need to engage with the relevant EU regulators to ensure approved access rules are in place and to understand any changes to certifications. Support from Ofgem (and the Utility Regulator for Northern Ireland) will be available for interconnectors during this process.

Could supply prove a problem?

The big question around gas supply and Brexit is whether the UK will be able to import gas as it does now. Fundamentally, the mechanisms of cross-border gas trade aren’t expected to change – even in the event of a no-deal scenario.

This is because the UK’s national suppliers or Transmission System Operators (the National grid in Great Britain and Premier Transmission Limited in Northern Ireland) and our European interconnector operators are all currently trading via the same privately-owned platform. It’s called PRISMA. PRISMA provides a range of services for EU and non-EU countries, and the government has reported that both National Grid and Premier Transmission intend to continue using it.

However, in the absence of a deal there will be some implications to the way gas is traded with the EU’s 27 member states. As such, the government is advising interconnectors, code administrators and UK gas market participants to carry out contingency planning for a no-deal scenario. More information is available in the guidance document: Trading gas with the EU if there’s no Brexit deal.
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. MEUC
2. GdF Suez
3. Haven Power
4. EIA
5. Forex
6. ICIS

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