PROSPECT ADVISORY

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WHOLESALE ENERGY PRICES: SEPTEMBER 2016: PART I: OIL AND NATURAL GAS

In this new series of articles, Dominic Whittome covers recent changes to wholesale energy prices.

Oil

Crude drifted down, declining just over 10%. However, some traders are beginning to talk of a possible price accord between Russia and OPEC. With the market fairly tightly balanced anyway, we could see oil prices climbing back over $50/bl as we move into autumn and OPEC's next meeting in Vienna approaches on 30th November. Amid 'the end of oil' stories abound and rumours of Chinese refiners dumping strategic stockpiles onto the spot market, the actual fundamentals have been fairly stable and on the supply side they may have firmed slightly.

Non-OPEC supplies will anyway require prices sustained over $70/bl to maintain output even at current levels, although the firming US dollar over the past six months will assist producers. But the cost of most of the replacement oil production remains at or well above current prices. Even if expectations of an OPEC accord later this year are dashed, it is still doubtful we will see a return, certainly any sustained one, to the sub $30, sub $40 even, prices witnessed earlier this year. Although the world economy remains fragile, the market will be sensitive to signs of stabilisation or any pick-up in global industrial demand: a prospect that is believed to have been behind the recent rally in metals and hard commodities over the past few weeks.

Natural Gas

Warm weather and abundant supplies saw natural gas following the crude prices market down, closing the period 8% lower.

LNG deliveries into UK terminals were reported steady whilst the apparent worsening of Russia-Ukraine relations had no adverse impact on through-deliveries to the European buyers. However, like the power market, the outlook for gas modulation and peak volumes is much less settled than any calm that the forward markets may suggest. The UK does have a shortage of gas storage whilst Centrica's Rough gas storage facility in the southern gas basin remains offline. With the earliest date for resumption of supply next March, the market will be more vulnerable this winter than the last to any run on short term volumes in the event of any European cold snap. Further out on the curve, 'the tail' of low oil prices earlier this year built will be moved out of price indexation formulae soon. Although the majority of Europe's gas by volume is no longer indexed to either oil or petroleum products, many of the larger long-term contracts with swing and take-or-pay flexibility still are. Therefore the price-effect of the crude market cannot be discounted yet. Higher oil prices if we see them this winter will still have an effect on the gas market, where short-term balances will be less able to self-correct than last winter.

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Dominic Whittome is an economist with 25 years of commercial experience in oil & gas exploration, power generation, business development and supply & trading. Dominic has served as an analyst, contract negotiator and Head of Trading with four energy majors (Statoil, Mobil, ENI and EDF). As a consultant, Dominic has also advised government clients (including the UK Treasury, Met Office and Consumer Focus) and various private entities on a range of energy origination, strategy and trading issues.

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