



Energy Outlook

April 2023

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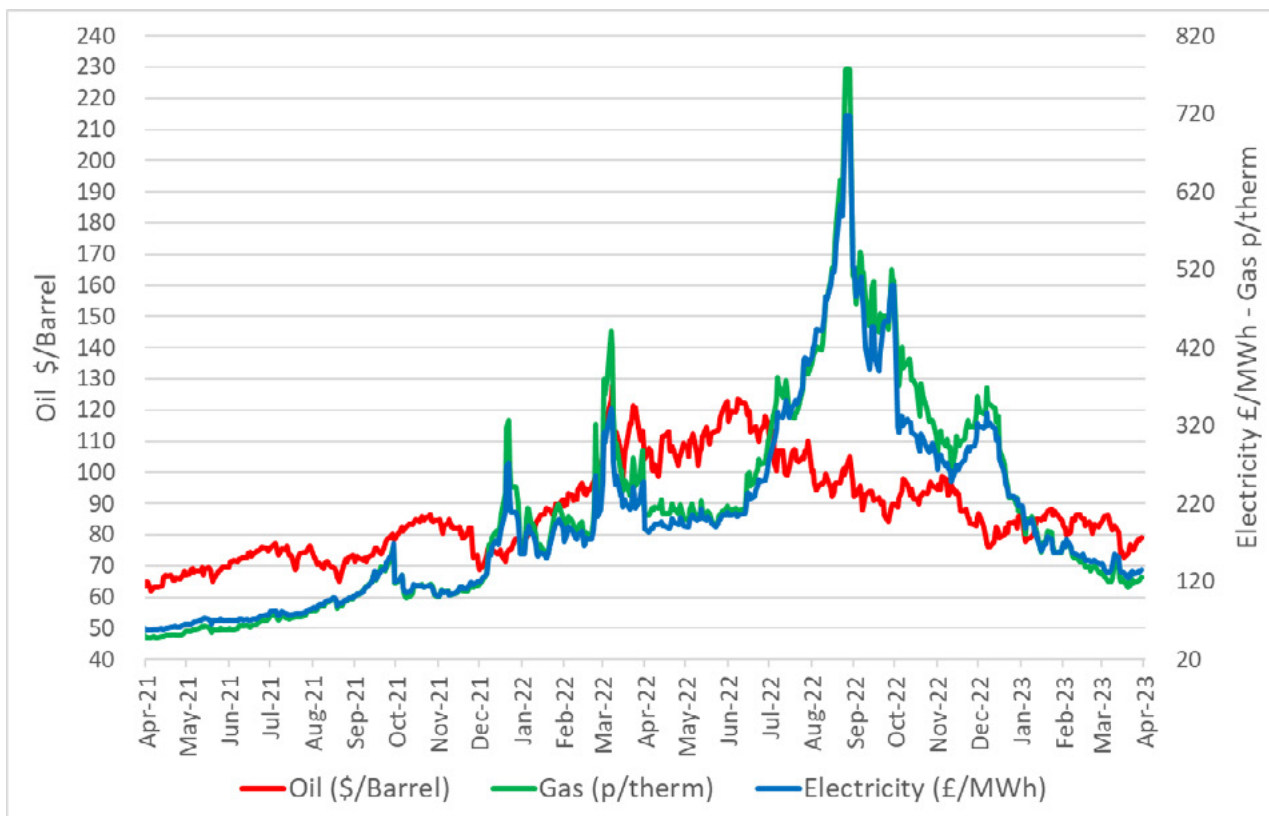
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As we enter the summer it is time to reflect back on how we have coped over this winter, following the most turbulent market conditions we have ever seen. With gas and power markets now returning from the stratosphere, the question arises as to how far they might fall.

Will they return to pre-crisis levels or have we seen a permanent upward shift? What's been happening with oil whilst our attention has shifted elsewhere? This report takes a look at these questions and considers what might happen next.

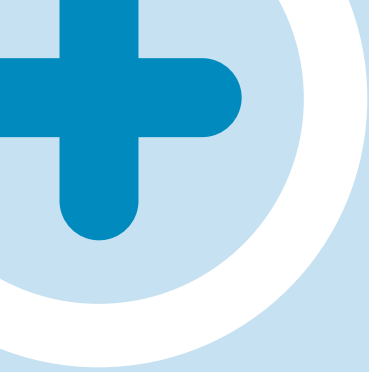
Energy Price History

The chart below shows the price history for oil, gas and power over the past two years, rising from the end of lockdown lows in 2021 to the excruciating highs of last year:



The increasing trend in gas and power prices began in the summer of 2021 on the back of the post-pandemic bounce back of industry and commerce. At the time, no one could imagine prices hitting the highs they did in the following year after Russia invaded Ukraine, simultaneously sparking a financial conflict with the West and trading a cut in gas supplies for the economic sanctions applied against it.

As we go to press there seems little prospect of a resolution to the situation in the near future. In spite of this, we have probably seen the worst of the damage Russia can apply in terms of gas supply disruption.



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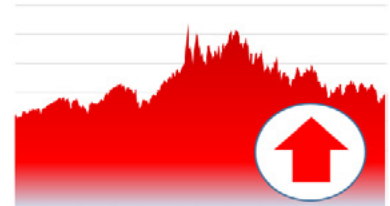
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OIL

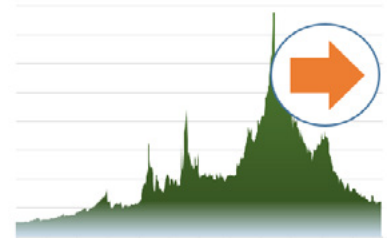
Oil prices have taken a back seat to gas and power over the last year, but as the markets revert to something of a more 'normal' state, we can expect it to start providing fundamental direction once again. Even though it has been out of focus for many, the oil industry has not been uneventful. After seeing some weakness last year on the back of global economic slowdown, oil has started to climb again. This is partly driven by increasing demand from China after easing its previously strict COVID restrictions at the end of 2022, combined with repeated cuts in production quotas by OPEC, the latest round being announced over the past weekend.



GAS

Gas continues to be the main driver of energy prices in UK (and across Europe). The highs reached ahead of autumn last year were an indication of the nervousness in the market about the prospect of facing an unknown winter with a third of normal supply of gas into European markets curtailed. The extent to which prices would come down would be reliant on how finely balanced supply and demand would be across the continent.

In reality, the system has coped much better than anyone could have hoped for six months ago. Helped by relatively mild weather over the whole season, good supply of LNG (attracted by the high prices), higher than anticipated storage levels and an overall reduction in demand (again, due to the high prices), the whole system coped extremely well. Even the very cold period in early December was a useful test of resilience, which the market passed comfortably. As a result, forward prices have tumbled as the fear has dissipated, although they remain high by historical standards.



ELECTRICITY

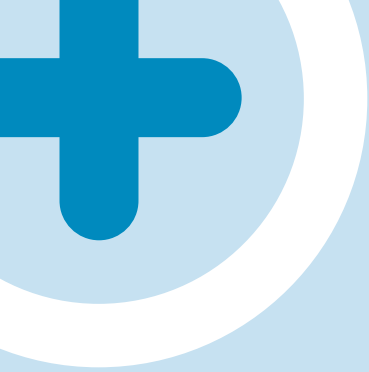
The charts show clearly that electricity prices correlate very closely with the gas market, with a few layers of complexity on top generated by UK ETS carbon prices, fluctuations in the generation mix and local supply issues.

Since the beginning of the year, electricity production has been reasonably benign, with good wind generation (up to 50% of consumption on some days) and balanced supply, in spite of continued nuclear outages in France.



OUTLOOK

Russian gas exports into Europe (ironically, the only remaining flows are through Ukraine) are at such a low level now that any further action by Russia can only have a negligible effect, so will prices fully return to pre-crisis levels? The answer is that this is unlikely - with Norwegian gas already flowing at maximum capacity, the gap in the market has been filled by LNG, which will only flow if attracted by high prices. Furthermore, a universal policy of ensuring strategic gas storage is full ahead of winter ensures that demand is maintained throughout the summer. There may be a little further to go, but forward prices are very unlikely to fall back to 2021 levels unless an unexpected peace breaks out in Eastern Europe.



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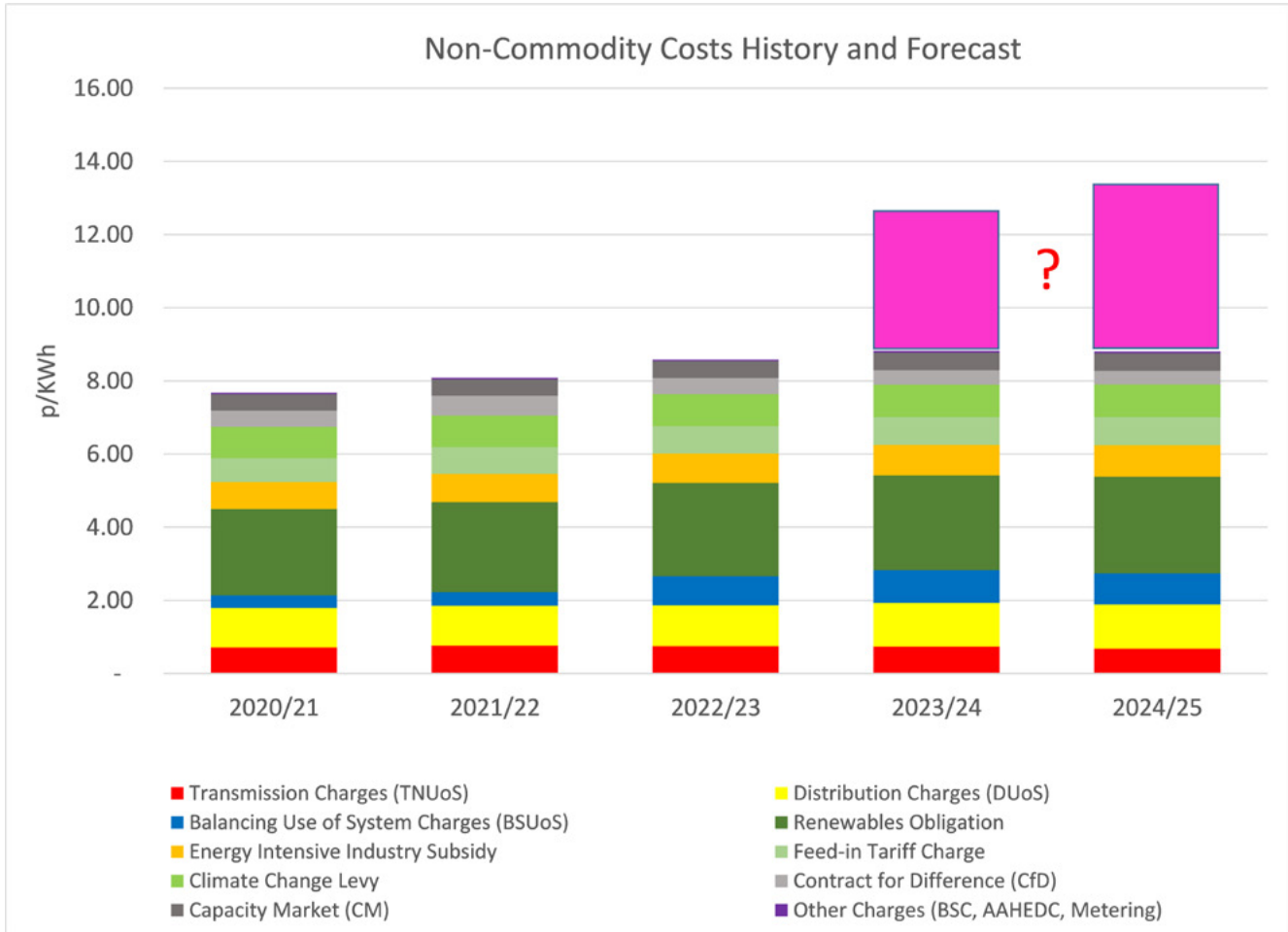
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Non-Commodity Costs

Non-commodity costs (sometimes called 'Non-Energy Costs') are included in every bill and relate to things like the fixed costs of maintaining the physical electricity network (the National Grid Transmission System and local Distribution Network Operators) as well as the costs of Environmental Charges to fund renewable subsidies and taxes.



NON-COMMODITY COSTS OUTLOOK

The outlook for non-commodity costs is mixed. Although they don't change with the same frequency as wholesale gas and power prices, they are not immune to market forces. On the positive side, the exceptionally high power prices we have seen means that generators supported by the 'Contracts for Differences' (CfD) scheme will be paying back into the scheme instead of taking from it - filtering into bills from next April.

Conversely, the high prices and volatility on wholesale markets mean that National Grid's costs to balance the electricity system have grown significantly. This means that BSUoS charges will continue to increase for at least the next two years.

Of more potential concern is the possibility that the government will seek to recoup the costs of its energy price guarantee mechanisms this winter. The pink bands above give a conservative estimate of what impact this might have - potentially adding 4p/kWh or more to everyone's bills from 2023 or 2024.

For more information, please get in touch with your Utility Aid Account Manager or call us on 0808 1788 170