

Monthly Pricing Trends Report UK Market October 2020

Commentary

Overview: The resurgence of COVID-19, and the progressively more stringent lockdown measures continued to guide market sentiment throughout October. With the growing prevalence of the disease - reflected in a doubling of hospital admissions and a 5-fold increase in daily deaths – the U.K. government's tiered virus-restriction system posed further threat to an already faltering economic recovery. The 5.5% contraction in year-on-year economic activity, forecast at the start of October, now looks rather optimistic with the latest forecasts placing the U.K.'s year-end GDP growth at -10%. A U-turn expansion of the Job Retention Scheme, introduced by the Chancellor of the Exchequer Rishi Sunak, attempts to keep the current 4.5% unemployment rate at bay; yet has seemingly done little to lift Britain's economic outlook. A Brexit deal inched closer in the last week of October: EU and U.K. negotiators managed to resolve some, but far from all, of the disagreements that have long bedevilled the Brexit talks. In all, a dismal month of progress failed to provide any truly concrete signs that a deal would be reached. Bearish sentiment, riddled with uncertainty and fuelled by a dampened economic outlook, pressured oil, equity and emissions markets. Yet, U.K. power futures received support from a gas market characterised by tight supplies and elevated demand for heating requirements.

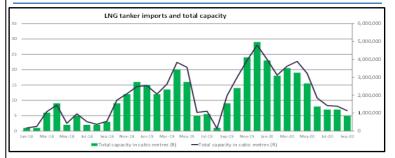
Oil: October was a tale of two halves in global oil markets. Strike action affecting Norwegian oil fields and a threat to U.S. crude production in the Gulf of Mexico, posed by Hurricane Delta, pushed global oil benchmarks higher at the beginning of October, lending bullish sentiment to the wider energy complex. However, a historic ceasefire in Libya – signalling an end, at least temporarily, to a war that's raged on since 2014 – saw the nation's oil fields and ports reopen. Libya's oil output accelerated from less than 100,000 barrels in September to 700,000 by late October. The state-owned oil company, National Oil Corp., expects output to reach to 1 million barrels per day by the end of November; pledging to send more crude oil to market at a time when global demand is already struggling to absorb supply – particularly amid the resurgence of COVID-19 across the globe. This is perhaps best reflected in U.S. crude stockpiles, which grew by 4.3 million barrels in the week ending 23rd October. December Brent crude fell sharply into the end of the month, falling below \$38/bbl. – the lowest since May.

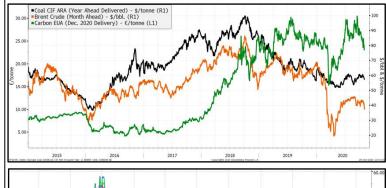
Gas: October saw the first month-on-month increase in LNG supplies to northwest Europe since April; however, total imports remained a third lower relative to October 2019. The arrival of more LNG, as well as robust pipeline supplies from Norway into the U.K. and Germany, were not enough to hold gas futures back in early October. The November NBP contract surged more than 10% into the middle of the month as Norwegian strike action and Hurricane Delta sparked supply fears in Norway and the U.S., respectively. At the same time, homes, offices and factories across Europe simultaneously required more gas for heating – Local Distribution Zone offtake in the U.K. rose by 160% between September 1st and October 28th. Accelerated gas demand for heating, and lower relative LNG flows, are well reflected in rates of European gas storage, with aggregate storage levels having been in decline since early October. Comparatively, in the latter part of October 2017, 2018 and 2019 storage levels were still yet to peak. However, European natural gas reversed its bullish price trend in the latter stages of the month, as major European countries reintroduced lockdown measures to contain a surge in COVID-19 cases; a surge that dwarfs the initial outbreak in the Spring.

Power: A bullish gas market continued to support U.K. power futures throughout October, even as the accelerated spread of COVID-19 threatened to set the economic recovery into reverse. Fears of widespread lockdown measures in Europe, and the associated economic implications, saw carbon EUAs trend sharply downward throughout the month. The December-20 benchmark carbon permit broke through its long-standing €25/tonne technical support level by midmonth, and continued to slide throughout the back end of the month, falling below €23/tonne for the first time since mid-June. Carbon, which has been one of the most influential drivers of U.K. power pricing this year, failed to apply sufficient pressure on key U.K. power futures to offset the strength in gas. The front two seasonal contracts, Summer-21 and Winter-21, held firm just below 2020 highs until the final few days of the month, even as oil, equities, and natural gas began to adjust downward to reflect the strong possibility of more demand destruction in the months to come.

Outlook: Key U.K. power futures still trade just marginally below 2020 highs, despite the historic, ongoing economic challenges engendered by the pandemic. Conversely, there has been a more pronounced adjustment in wider commodity and equity markets to reflect the recessionary pressures afoot. Theoretically, therefore, there is potential for U.K. power prices to similarly adjust further downwards to better reflect the economic picture. More specifically, there has been an asymmetric response in U.K. power to the rise and fall of carbon EUAs. An equivalent reaction in U.K. power futures to the recent fall in European carbon pricing to the vertiginous recovery in EUAs witnessed in Q2 and Q3 of this year, would beget a bearish price trend in U.K. power. However, with the post-Brexit nature of U.K. carbon pricing still yet to be determined, the wavering relationship between U.K. power and EU carbon EUAs may well be reflective of this uncertainty. In any case, a spike in unemployment and the reduction in the economy's aggregate demand – that would be induced by additional lockdown restrictions – would reduce the demand for power and gas in the U.K., and, in all likelihood, weigh on the pricing of both.

Commodity	28 Sep 2020	28 Sep 2020	Change
GBP/USD	1.2834	1.2983	1.16%
GBP/EUR	1.1001	1.1054	0.48%
Brent – Front Month	\$42.43/bbl.	\$39.12/bbl.	-7.80%
Carbon EUA – Dec20	€27.71/tonne	€23.03/tonne	-16.89%
Elec – Oct20 Annual	4.80p/kWh	4.58p/kWh	-4.42%
Gas – Oct20 Annual	1.27p/kWh	1.33p/kWh	4.49%







Apr21 Annual Oct21 Annual