



May 2011 - Market Summary

May was a month of two halves - the first was characterised by softening prices across UK Gas and Power Markets while the second half saw gains on the back of supply and demand fundamentals. What was consistent across the month was the feeling that the energy markets lacked direction while German energy markets also exerted their influence on the UK energy curves. Oil also remained a focus for the energy markets as it responded to economic data, bank reports and dollar strength while closer to home the Energy and Climate Change Committee released a report on the proposed energy market reforms suggesting the Government needed to return to the drawing board.

The US announcement of Bin Laden's death at the start of the month had little affect the energy markets. While oil did dip initially, the UK market failed to react and instead NBP gas took its lead from UK supply and demand fundamentals with robust supplies of LNG expected and warmer than seasonal norm temperatures causing low levels of demand for both power and gas. A strong German market pulled British gas supply through the interconnector and this boost in demand fed through to prices at the front end of the NBP gas curve.

A bear market then came into force across both the commodities and equity markets. Oil lost 8% on 5 May causing both UK Gas and power prices to slide. The driving factors were economic indicators with the US reporting an increase of nearly 10% of first time jobless benefit claimants (though overall employment rates are up) and Germany announcing a 4% reduction in factory orders breaking a 2 month growth trend. The average loss across seasonal contracts in the Power market was £.72/MWh with Summer 12 shedding £1.20/MWh in one day. Winter 11 gas finished at 69.45p/therm and Summer 12 at 64.45p/therm.

The bearish sentiment continued for a second week with traders commenting that the UK energy markets had a 'softer' feel to them. Temperatures remained above seasonal norm dampening demand and causing very healthy gas storage levels in the UK (above typical levels for the time of the year) alongside plentiful LNG deliveries.

The downward trend reversed mid month as gas curve prices responded to prompt supply constraints (drop in imports from Norway) along with demand increases (cooler temperatures). The markets ended the month up with UK gas and power curves reacting to the news from Germany's coalition government that it plans to phase out nuclear energy by 2022, cut consumption and further expand renewables. The phase-out reduces Germany's nuclear fleet to just nine reactors. Germany's 7 oldest reactors will remain offline permanently and an eighth will also be forced into retirement. UK power and gas prices reacted to the German decision as traders priced in the impact of Germany on gas demand as it plugs its nuclear gap. All contracts recovered the losses seen earlier in the month

Oil also remained a focus for the energy markets as it responded to economic data, bank reports and dollar strength. The IEA came out urging oil producing countries to increase supply to avoid derailing the economic recovery. It reported that the high oil prices were reducing spending power, driving up inflation and placing pressure on interest rates. The IEA suggested it would consider releasing emergency oil stock piles if OPEC failed to act. This report, along with an unexpected decline in the April Index of US leading economic indicators (the first decline in nearly a year), caused oil prices to lose value. OPEC is next due to meet 8 June with mixed views whether OPEC will oblige the IEA request. Bullish oil reports from both Goldman Sachs and Morgan Stanley towards the end of the month (both revised up their 2011 forecast oil price to \$120/barrel and their 2012 forecasts to \$140 and \$130 barrel respectively) fed into the oil markets and in turn NBP prices. UK market participants remained cautious though and continued to describe the market as 'stagnant' and directionless.

Closer to home, the Energy and Climate Change Committee released a report suggesting the market reform proposals will effectively provide subsidies to nuclear generators through the new long term contracts and carbon floor price and may hand them windfall profits. The report went on to say the reforms were an attempt to disguise a nuclear subsidy (something the coalition government said it wouldn't do) and that the government should return to the drawing board and come up with a more straightforward and coherent set of plans to reform the electricity market. In the same week, the UK's Chief nuclear inspector declared the UK's existing nuclear generation and policy as safe in an interim report with no compelling reason for the UK to rethink its nuclear policy in light of Japan. The following week a DECC spokesman confirmed the the UK White Paper on energy market reform has been delayed.