

# Energy monitor

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## Dealing with energy supply tightness

- ▶ Europe is as well prepared as possible for the upcoming heating season
- ▶ Gas prices are expected to remain high in tight market conditions for the coming years...
- ▶ ...albeit demand reduction, alternative sources, long term contracts and more (LNG) supply could trigger prices to ease somewhat in the longer run
- ▶ The European Commission has announced plans to curb high gas prices
- ▶ OPEC+ has decided to cut oil production by 2 mb/d, but the actual reduction will be much smaller
- ▶ Geopolitical tensions are building, also in oil markets
- ▶ Oil prices are expected to rise above USD 100/bbl again as the supply/demand balance will worsen

### European natural gas prices have eased ahead of the start of the heating season

With European gas inventories having been filled to more than 90%, one could state that Europe is as well prepared as it could possibly be for the coming winter. This, in combination with the discussion of a possible European price cap on (Russian) gas prices, have resulted in a significant drop in gas prices. Since 26 August, the Title Transfer Facility (TTF) – or Dutch natural gas benchmark – has dropped from a record high of EUR 340/MWh intraday to the current prices around EUR 115/MWh (monthly contract). Still it is good to keep in mind that, despite a more than 60% drop in recent weeks, gas prices do continue to trade at historically high levels.

### TTF gas prices have come down significantly recently



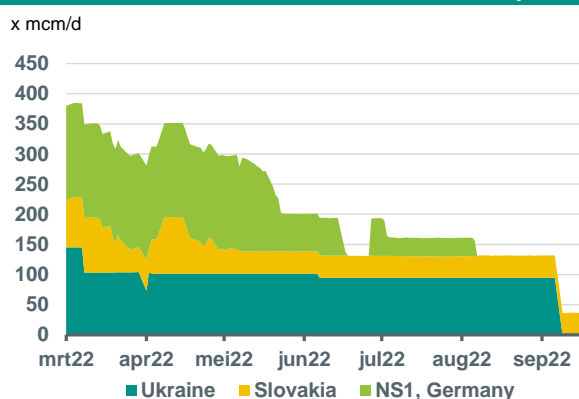
Source: Bloomberg

With inventories being filled, the market focus will slowly but surely shift towards the upcoming heating season. To meet gas demand in the coming months, and thus prevent prices rallying towards new record highs, European companies have to keep the current import of Liquefied Natural Gas (LNG) around current high levels. Especially if LNG demand in Asia starts to pick up, this may become a challenge and put new upward pressure on prices. At the same time, we continuously need to be as efficient with the available gas as possible. In other words, energy efficiency will remain key to keep the gas demand in control. On the one hand this means that the still high gas prices will continue to suppress demand from industries as it is simply too expensive to keep production/industries running at 'normal' levels. On the other hand it will remain an uncertain factor as especially residential and a large part of SME demand is strongly weather related.

### Upside prices risks outweigh the downside potential for gas prices in Europe

This means that in case of a mild winter, gas prices potentially continue to ease as shortages are prevented and it would provide a relatively good starting point to start filling the inventories for next winter. Nevertheless, the challenges to fill these inventories will be even bigger next year than they were for this winter. At the same time, in case of a harsh winter, keeping LNG inflows high will prove crucial to prevent any shortages and thus record high prices. This, in combination with demand reduction and the usage of alternative energy sources (especially coal and nuclear power). In this respect, the upside prices risks in case of a cold winter are much bigger than the downside potential for prices in case of a mild winter.

#### Gas flows from Russia to Nord/Eastern Europe



Source: Bloomberg

#### European monthly LNG imports



Source: Bloomberg

### Gas scenario base case

In the previous Energy Monitor updates we have provided several scenarios with different assumptions about Russian natural gas exports towards Europe and its impact on prices. Russian gas exports have dropped significantly in recent months and now only accounts for 5-10% of the European imports. Obviously we will continue to weigh the risks in alternative scenarios, but since the base case scenario has a significantly higher likelihood in our perspective we have decided to only reflect on our base case scenario in this Energy Monitor.

Our base case scenario implies that Russian gas exports towards Europe will not return. In fact, there is a high risk that the remaining part of Russian exports will continue to drop even further. However, since the majority of these exports have been cut back already, the impact of Russian gas exports on gas prices will become smaller over time. Europe has been very successful in finding alternatives for the import of Russian gas. Partially, this is done by switching to other energy sources like existing coal capacity and keep nuclear capacity open for longer than scheduled. Also we see increased capacity of renewable energy sources for power generation. Finally, also stepping up the import of LNG was

successful. Not only has import capacity been increased rapidly, but also attracting available LNG in – mainly – the spot markets.

For our price forecasts, we have assumed an average winter demand. We also assume that Europe will be able to maintain a high level of LNG imports, although somewhat lower than we have seen in recent months. After all, Asian LNG demand will increase if gas demand returns somewhat. Asian economic growth will trigger more energy demand whilst the alternative sources run out of capacity. Also lower gas inventories need to be filled ahead of the next Asian winter too.

The high European LNG imports come at a price. Signing long term contracts may be helpful in pushing prices somewhat lower, but since global LNG supply will only increase marginally until 2024-2025, gas prices will remain elevated in these tight market conditions. At the same time we will see strong efforts to reduce gas demand. This is seen within industries where the high prices trigger a) investments in efficiency, but also b) demand reduction, simply because continuation of business at current prices is not attractive in the short term – and in some cases also in the longer run –.

Taking the assumptions above into account, this translates in TTF prices trading at an average price of roughly EUR 110-130/MWh in 2023 (annual contract). The monthly contracts will track the annual contracts, but can show a more volatile behaviour. A normal seasonal pattern would suggest higher prices in Q4 2022 and Q1 2023 due to heating demand, whilst prices could ease below the annual average in Q2 and Q3 2023 when inventories are being filled at a normal pace. Please find the table at the end of the report for the complete price projections.

### **European Commission announces plans to fight high gas prices**

The European Commission (EC) is proposing a series of measures to fight the high gas prices whilst trying to secure the gas supply for the coming period. In a press release, the EC is suggesting joint gas purchasing, price limiting mechanisms on the TTF gas exchange, new measures on transparent infrastructure use and solidarity between Member States, and continuous efforts to reduce gas demand. The price limiting mechanisms would include a price correction mechanism to establish a dynamic price limit for transactions on the TTF gas exchange, and a temporary bandwidth to prevent extreme price spikes in derivative markets. Also the EC is willing to create a new LNG pricing benchmark by March 2023.

### **Henry Hub expectations**

Henry Hub prices have found strong support in the past 1.5 years in line with other natural gas hubs. Although the absolute level of prices remains well below the price levels of for instance TTF and Japan Korea LNG (JK LNG), the Henry Hub prices have risen to unusual levels for the time of the year. In the past, prices found strong temporary support on the back of a cold spell during the midst of the winter season. However, already in 2021, but certainly in 2022 prices have remained high throughout the year. The strong rise in US gas exports, but also an increase of gas demand for power generation are seen as the most important reasons.

Where as US gas production was on the rise in the years up to the end of 2019, production growth has stalled since. A lot of US gas is produced as associated gas, together with crude oil. Since the recent years, investments in oil and gas production had stagnated for several reasons (such as labour shortages, legislation, focus on cash flow management), the supply of US gas hardly grew anymore. At the same time, more exports and more local demand triggered a tightness in the US market, which is translated into higher price.

### Henry Hub gas prices trading above historical levels

x USD/mmBtu



Source: Bloomberg

### OPEC+ has decided to cut oil production

Recently, the members of OPEC+ decided to cut their crude production by 2 million barrels per day (mb/d). However, since many producers were already not able to meet their quotas, the net production cut will most likely be much smaller. The Saudi Energy Minister hinted at a net production cut of around 1.1 mb/d, whilst Bloomberg calculations more point towards a net cut of 800 kb/d. The production cut would according to OPEC+ be justified on the back of lower demand in times of an economic slowdown. A message which was already been set out by the International Energy Agency (IEA), which stated in its Oil Market Report of September that global oil demand is deteriorating. Still, the IEA expects a net growth of oil demand of +2 mb/d in 2022, and even +2.1 mb/d in 2023.

The announced production cut, to be effective in November, resulted in a strong reaction from the US. Whilst US president Biden was in Saudi Arabia only last July to put pressure on the country to increase oil production in order to lower the prices of oil and oil products, OPEC+ (lead by Saudi Arabia and Russia) had decided to come with an opposite move. This decision triggered an increase in tensions between the US and Saudi Arabia. Where US officials disapproved the decision to cut production whilst oil prices are trading around USD 90/bbl, the Saudis countered by questioning the lack of investments in oil and gas production in the US, given that the US government judges that oil prices – and thus gasoline prices – are too high.

### The slide in oil prices came to a halt ahead of OPEC+

x USD/bbl



Source: Bloomberg

### Slide in oil prices came to a halt...

Ahead of the OPEC+ meeting, the rumour was already out that the production levels might be cut. This had triggered support for oil prices. However, in the weeks ahead of the meeting, oil prices had been pushed lower, mainly due to recession fears. And although slower economic growth does translate in a decline in crude demand, it does not reflect the drop in oil prices which we have witnessed in recent weeks. Brent oil prices were still trading just below USD 130/bbl in March of this year, and were still trading above USD 120/bbl in June. However, due to these recession fears, prices had been pushed below USD 85/bbl in September. In other words, prices had been pushed too low. It could well be that there were quite some traders waiting for a buying signal. Something which OPEC+ - and Russia in particular – would welcome, although OPEC always indicates that they are aiming to balance the markets, and do not steer on oil price levels.

### ... but new support due to a lack of supply growth cannot be ruled out

As indicated, the IEA expects global oil demand to remain strong in 2023, even despite an economic slowdown. This matches the fact that price elasticity is relatively low for oil and oil products. But in order to meet an ongoing rise in oil demand, supply needs to follow. However, with OPEC+ under delivering by 3.6 mb/d in September, the tightness in the markets may be bigger than the headlines suggest. On top of that, Russian oil exports will continue to decline. And although this decline will most likely be not as strong as an European oil ban may suggest due to rerouting of global oil trade, the overall supply will continue to be challenged. Other OPEC members have only limited spare production capacity, and US production is already stable for months and is not expected to grow enough to be equivalent to the global growth in demand. In other words, the oil markets will become even more tight than they are currently. This fundamental outlook matches an outlook of steady rising oil prices during our forecasting (see table below).

### Refinery capacity and impact on prices of oil products

In line with higher oil prices, also the prices of oil products are expected to remain elevated. Especially in Europe, refinery capacity had been reduced in recent years. Although capacity had been expanded in other regions, mainly China and the Middle East, it does not mean that lower local capacity in Europe is equally traded with higher imports. In fact, China solely produces for the local market. And due to the ban on Russian exports, also the oil products are hit, triggering more tightness in for instance the diesel market as this cannot be fully replaced by imports from the Middle East.

#### Oil and gas price forecasts (base case scenario)

| End of period      |           | 18-Oct | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 |       |      |
|--------------------|-----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|-------|------|
| Brent *            | USD/bbl   | 91.44  | 105    | 125    | 120    | 110    | 110    | 110    | 100    | 100    | 100    |       |      |
| WTI *              | USD/bbl   | 85.17  | 100    | 120    | 115    | 105    | 105    | 105    | 95     | 95     | 95     |       |      |
| Natural Gas (HH) * | USD/mmBtu | 5.97   | 7.30   | 6.00   | 5.50   | 5.60   | 6.50   | 5.00   | 4.50   | 4.60   | 5.20   |       |      |
| TTF *              | EUR/MWh   | 144.25 | 150    | 150    | 120    | 100    | 130    | 130    | 90     | 80     | 100    |       |      |
|                    |           |        |        |        |        |        |        |        |        |        |        |       |      |
| Average            |           | 2021   | Q4 22  | 2022   | Q1 23  | Q2 23  | Q3 23  | Q4 23  | 2023   | Q1 24  | Q2 24  | Q3 24 | 2024 |
| Brent              | USD/bbl   | 70.95  | 97     | 100    | 115    | 123    | 115    | 110    | 115    | 110    | 105    | 100   | 100  |
| WTI                | USD/bbl   | 68.08  | 92     | 94     | 110    | 118    | 110    | 105    | 110    | 105    | 100    | 95    | 95   |
| Natural Gas (HH)   | USD/mmBtu | 3.72   | 7.00   | 6.00   | 6.70   | 5.80   | 5.50   | 6.00   | 6.00   | 5.80   | 4.80   | 4.50  | 5.00 |
| TTF                | EUR/MWh   | 31.34  | 166    | 115    | 150    | 135    | 110    | 115    | 130    | 130    | 110    | 85    | 105  |

\* Brent, WTI and Henry Hub: active month contract; TTF: next calendar year

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