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Electricity Monitor

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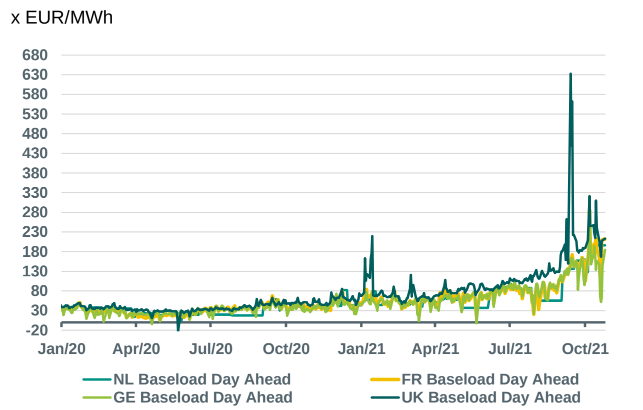
Power prices are skyrocketing

- **Electricity prices have been rising sharply, partly due to higher prices for natural gas, coal and CO2-emission rights (EU ETS)**
- **These effects also support future prices for delivery in 2023 and 2024**
- **The EU ETS prices seem to have reached a plateau… for now**
- **The European Commission is investigating limiting market speculation in EU ETS allowances**

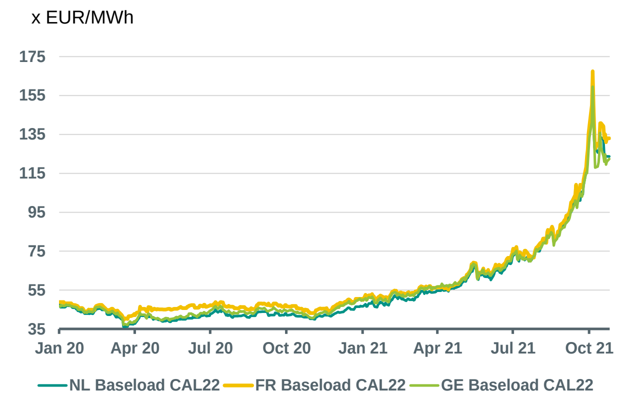
Electricity price increases fuelled by many factors
Almost all drivers affecting electricity prices are currently creating upward price pressures. Natural gas prices had been trading around record highs. The price of coal has reached its highest point since 2008. Furthermore, the price of EU ETS (Emission Trading Scheme / CO2 rights) is still hovering around EUR 60/tonne, a level that is only 10% below the record of EUR 65.77/tonne of 28 September. If we add to this the fact that wind energy yields were disappointing this year, and thus created more demand for fossil fuels, then the sharp increase in the price of electricity is easy to explain.

Electricity: Day-ahead prices on the rise



Source: Bloomberg

Electricity prices for calendar year 2022 (CAL22)



Source: Bloomberg

The graph on the left shows the day-ahead prices (prices for next-day delivery) for the main north western European countries. What is striking is not only the upward trend of recent months, but also the huge increase in volatility compared to the period before. The availability of renewable energy is an important driver of increased price volatility. It was, and is, therefore expected that as the percentage of renewable energy increases, price volatility will also remain higher. After all, the availability of sun and wind can defer strongly from day to day, and even from hour to hour. Less expected was the fact that now also the strongly fluctuating market prices for fossil fuels, such as coal and gas, as well as for EU ETS allowances sometimes turn out to be determining factors.

The figure on the right shows the price development of electricity with delivery in calendar year 2022 (CAL22). It is notable that the price developments in the Netherlands, France and Germany are almost the same. This is in a way remarkable because the electricity mix of these countries is quite different. The Netherlands largely runs on natural gas, France on nuclear energy and Germany on coal and renewables. Due the ever-increasing interconnection capacity between these countries (infrastructure that makes it possible to import or export electricity), we see that the prices are also moving in line with each other. Besides that, of course, the development of the EU ETS prices is the same for all these countries.

Short-term stress has also translated into contracts with delivery after 2022

The forward curve (see left-hand figure below) shows that the greatest uncertainty lies in the coming months. The question of whether there will be enough gas available in Europe to make it through the winter, the current increased demand for coal and the effect of this on other energy prices, translates mainly into price increases for contracts with delivery between November of this year and March 2022. For contracts with delivery thereafter, prices are significantly lower. Just as well, those price levels are also a factor of 2-3 higher than last year.

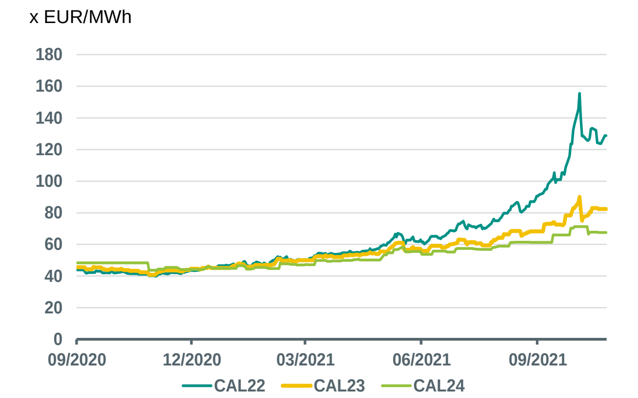
Yet it is not only the prices for delivery of electricity in the coming months that have been rising. Also baseload futures for delivery in calendar year 2022, despite the recent decline, are still trading about three times higher than a year ago (see right-hand figure below). Many analysts in the market assume that these increases are the result of a coincidence of various short term circumstances. Therefore, it is all the more striking that electricity prices with delivery in 2023 and 2024 are also showing increases between 60% and 120% compared to October 2020.

We also expect gas prices to be higher in 2022 as well, as there is a good chance that inventories could be very empty by the end of the winter this time. In addition, next year we will still be competing with countries in Asia to get available gas and coal towards Europe. Therefore, prices may well remain relatively high for a longer period. That these effects will carry over into 2023 and even later is difficult to predict now, but - under normal circumstances - less likely.

Forward curve NL baseload (monthly contracts)

Source: Bloomberg

Big increase for 2022, but also higher prices thereafter



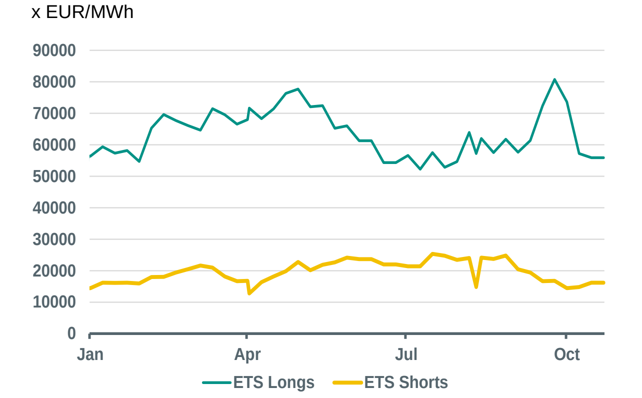
Source: Bloomberg

Ahead of the Climate Summit in Glasgow (31 October until 12 November), it seems that parties are taking profits on their (speculative) positions in EU ETS / CO2 rights. The increase in the use of coal fired power plants compared to gas fired power plants actually creates more demand for EU ETS rights and should push the price higher. This is not surprising since a coal plant emits more CO_2 than a gas plant. Nevertheless, the price has stabilized in recent weeks and even appears to be declining somewhat. This could have to do with the confidence in the 'Fit-for-55' plans and the sustainability or necessity thereof, now that other countries are also announcing their more ambitious climate plans. On the right-hand side of the chart it can be seen that the number of open long positions (speculating on price increases) has decreased again in recent weeks. This is one of the reasons for the recent price decline.

EU ETS prices are stabilising

Source: Bloomberg

Less speculation on further price gains



Source: Bloomberg

Measures to curb market speculation?

European leaders have backed the European Commission's plan to explore whether further regulation is needed to limit market speculation in EU ETS allowances. This call followed complaints from Poland, Denmark and Spain, among others. These countries believe that market speculation has too great an effect on the price movement of EU ETS emission allowances. As a result, price volatility increases significantly and prices can rise and fall very quickly. The fear in these countries is that a too rapid rise in prices will slow down the energy transition and make it unnecessarily - if not impossible - for companies to finance their transition. Other countries though fear that the rapid price increase will be slowed down too quickly, for example by releasing more emission rights, thus weakening the policy instrument. A first report on this topic is expected from the European Securities and Markets Authority (ESMA) around November 15.

It will also look at changing the link between gas and electricity markets to ensure security of supply and affordability while promoting the transition to a sustainable energy mix. According to Montel News, the European Commission is expected to come up with proposals before the end of the year looking at accelerating the sustainability of the energy mix, gas storage, joint gas purchasing and other security of supply issues.