

Bord Gáis
Energy Index
Understanding energy

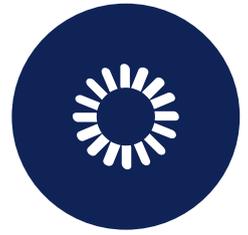
AUGUST 2017

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Bord Gáis Energy Index

August 2017



Bord Gáis Energy Index (Dec 31st 2009 = 100)



Summary

The Bord Gáis Energy Index has increased by 11% over the last year and is 3% higher since last month.

The primary driver of the rise in this month's index has been gas and electricity where prices have increased by 28% and 17% respectively over the same month last year. Both markets saw significant rallies in August of 14% and 9% respectively which highlights the potential volatility of global energy markets. As was the case the last month, the increases were mitigated somewhat by a rallying euro. Oil, which has rallied by over \$7 since the middle of June, stalled in August while coal increased by 5%.

In August, the Bord Gáis Energy Index stood at 87 (+3%).

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Oil Index



Index adjusted for currency movements.

Data Source: ICE

Oil

The recent rally in oil, which has increased by over \$7 a barrel since the middle of June, stalled in August as oil prices finished the month 27 cents lower. The Brent crude benchmark settled at \$52.38 at the end of August.

Brent crude has increased over 11% in dollars and 5% in euros, as the single currency strengthens versus the US currency, in the past year as OPEC and key non-OPEC producers, such as Russia and Mexico, limit oil production in an effort to address a supply glut which has weighed on oil prices since 2014.

The fracking revolution in the United States resulted in exponential growth in US crude production from around 2011. Fracking, or hydraulic fracturing, is a means of extracting gas from sedimentary shale rock using a combination of horizontal drilling and pumping a mixture of water, sand and chemicals at high pressure into underground rock to release gas.

The application of these techniques has transformed the US energy outlook in both oil and gas and, by 2015, US oil production rivalled that of Saudi Arabia. The world found itself awash with oil, pushing the oil price to a low of \$27 and crude inventory levels to historic highs in early 2016.

This oil price crash, however, placed considerable financial strain on US shale and other higher cost producers, resulting in significant drops in investment and drilling activity. In addition, a production cut agreement between OPEC and key non-OPEC producers in November 2016 took 1.8 million barrels per day off the global markets in an effort to reduce the supply glut and draw global inventories.

As a consequence, oil prices rebounded above \$50 a barrel. In recent months however, the oil price has encountered resistance at levels in the mid-fifties. It appears that US shale producers, who have cut costs and improved productivity, are able to produce profitably at prices above \$50. US shale, with its fast production cycle, is able to respond much more quickly to changing price signals. Unlike conventional drilling, the time scale between investment and extraction can be measured in months rather than years.

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Natural Gas Index



Index adjusted for currency movements.

Data Source: Spectron Group

Natural Gas

The NBP day-ahead contract, the price for gas delivered tomorrow, averaged 42.3p in August, posting a strong 28% increase in euro terms over the comparable month last year. Prices were up by over 14% on the July average of 36p.

A litany of unplanned outages on Norwegian gas pipelines and processing facilities was one of the primary drivers of the strong rally in August. Continual delays to the return dates for these assets caused traders to close short positions and take a “buy now and ask questions later” attitude for most of the month. Bullish momentum at the UK’s NBP trading point fed through to neighbouring gas hubs as it is a key price driver for other European gas and power markets.

Despite the rise in prompt gas prices throughout the month, flows through the IUK pipeline, connecting the UK to Belgium, continued to flow at near maximum capacity as gas was exported to storage sites in Europe for use during the colder winter months. The closure of the UK’s largest storage facility, Rough storage, means that gas which is intended for use in the UK needs to be transported to continental Europe to be stored.

Imports of LNG (liquefied natural gas) to the UK market continued to be lacklustre in August, as more shipments were sent to higher priced Asian markets. Despite rapid increases in the level of LNG being produced globally, deliveries to the UK have disappointed as it has to compete on a global basis to attract production. Chinese imports of LNG have been increasing this year as more domestic homes switch to gas from oil for home heating.

Further out the curve, bullish sentiment from the oil market as a result of Hurricane Harvey fed through to forward prices. The benchmark Winter ’17 contract averaged 47.5p over August, a 6% increase on the July average of 44.925p. Oil prices have an impact on gas prices as long-term supply contracts have traditionally been tied to the price of oil.

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Coal Index



Index adjusted for currency movements.

Data Source: ICE

Coal

The positive momentum in coal markets gathered pace in August, as coal settled 5% higher at \$87.65 a tonne, an increase of over four dollars on July's closing price of \$83.25 a tonne. Coal, which remains the marginal price-setting fuel in many European power markets, has increased by over 43% in dollar terms this year but a stronger euro has mitigated some of this increase and coal is up 34% in euro terms.

Coal prices had experienced a rapid decline from 2012 as coal was phased out of many power markets and replaced by renewables and more less carbon intensive alternatives. However, measures to restrict production implemented by the Chinese authorities in 2016 reversed the decline. China is the world's largest consumer and producer of coal, consuming over half of the world's supplies. The Chinese imposed restrictions on coal production and closed some unprofitable mines in 2016. These restrictions reduced domestic production and increased the import requirement pushing global coal prices higher.

In August, strikes in Australian mines, flooding in Indonesia and increased sanctions on North Korea following missile tests, all contributed to the strength in coal prices. In 2016, North Korea exported 25 million tonnes of coal, mostly to China. This potential shortfall will now need to be replaced by other producers.

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Electricity Index



Data Source: SEMO

Electricity

The average wholesale price of electricity rose by 9% in August. Wholesale prices are 17% higher than the same period 12 months ago.

Irish wholesale electricity prices typically track the cost of imported gas as it is the most significant cost in the production of electricity. However, this can vary on a month-to-month basis.

Excluding supplier capacity payments, the average wholesale price for August was €42.14/MWh, compared to €39.93/MWh in July - an increase of €2.21/MWh on the average monthly wholesale price. An average monthly clean spark of approximately €7.90/MWh was recorded in August, which decreased 21% from the €10.05 observed in July. The proportion of demand met by wind in August was 24%.

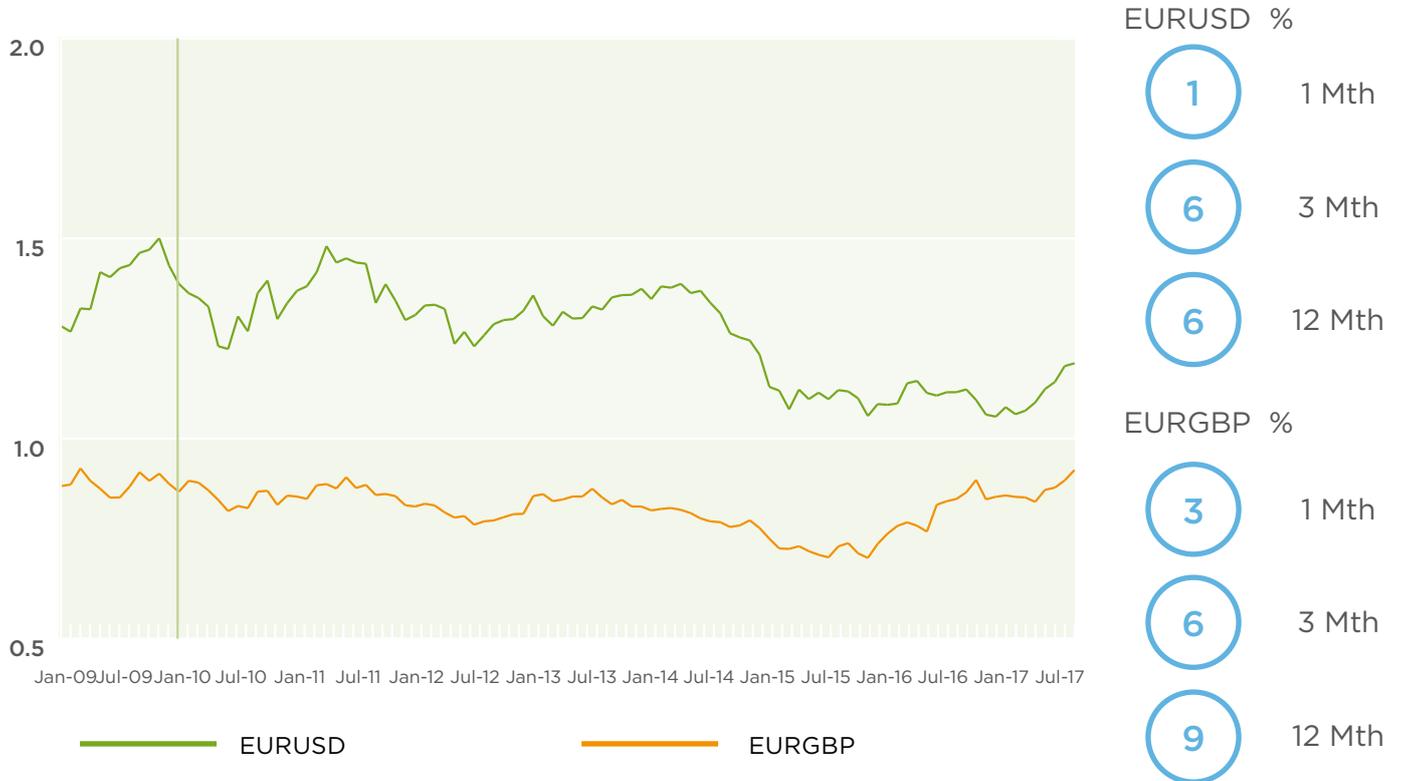
Separately, the Commission for Energy Regulation announced combined transmission and distribution adjustments which it expects will result in an annual average residential customer bill rising by 0.95%. In addition, SEMO (the market operator) has announced a 148% increase in the cost of operating the grid, bringing it up to €5/MWh.

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FX Rates



FX Rates

The euro continued its recent trend in August by strengthening further versus both the pound and the dollar. The euro gained 3% against sterling to settle at £0.9214p and climbed 1% on the US dollar which finished at \$1.1881.

The ECB President Mario Draghi was firmly in focus during his speech at the annual gathering of central bankers in Jackson Hole, Wyoming during the month. Given that he did not focus on monetary policy and the recent strength of the euro as had been expected, market participants took this as a signal to buy the euro which traded as high as \$1.20 for the first time since early 2015. Recent euro strength has led to speculation that the ECB may seek to delay tapering its bond purchase programme.

In sharp contrast to the euro, the pound has continued its recent fall in August reaching the lowest level against the euro since 2009. The weakness in sterling is being driven by concern over the uncertainty around the outcome of the ongoing Brexit negotiations. The possibility of a leadership challenge to Prime Minister Theresa May at the Conservative Party's annual conference in October has also been cited as fuelling investors' concerns. The renewed weakness in the pound also reflects investor expectation that the Bank of England will be forced to maintain its current low interest rate policy for some time.

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