Bord Gáis Energy Index

Understanding energy

JULY 2015

BGE/EI/UE/0815

Bord Gáis Energy

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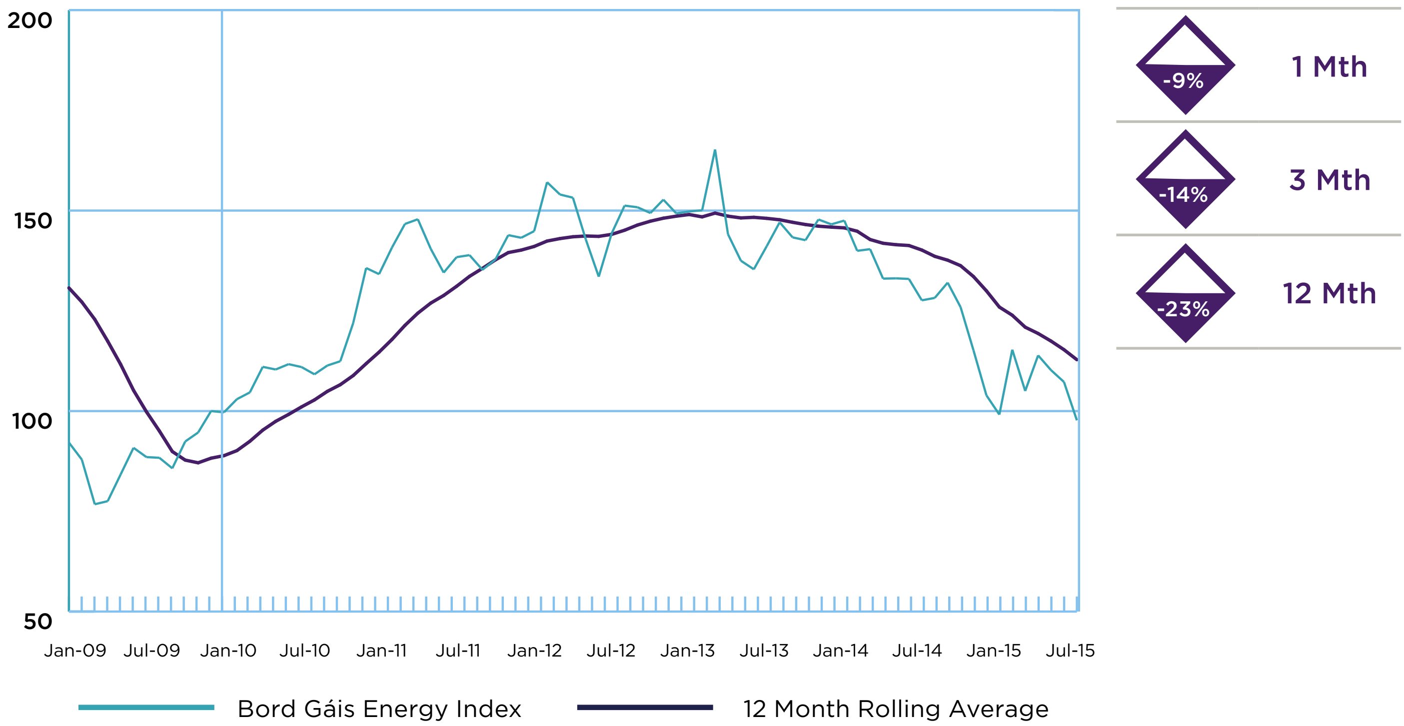
Commentary

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



Summary

The July 15 Bord Gáis Energy Index fell by 9% month-on-month, again due to weaker oil prices. The key to the falling price is that supply is stubbornly abundant.

In July 2015 the Index stood at 98, which is the lowest point since the Index was set at 100 on 31 December 2009.

(Continued overleaf)

Bord Gáis Energy Index (continued)

HOT TOPIC

In July, the Chancellor of the Exchequer George Osborne sent shockwaves through the renewables industry when he announced plans to scrap the Climate Change Levy (CCL) exemption for renewable electricity. This aimed to incentivise energy efficiency and reduce emissions.

The CCL is an environmental tax on UK businesses' energy use charged at the time of supply. However, non-domestic users had the ability to avoid this levy since April 2001 by using electricity from renewable sources. The purpose of the exemption was to encourage business electricity users to seek renewable sources of energy from their suppliers to avoid the levy. From when it was introduced, the levy was frozen at 0.43p/kWh on electricity, 0.15p/kWh on coal and 0.15p/kWh on gas. The Chancellor's changes to the CCL were not welcomed by the Green energy sector.

In a statement, the Renewable UK's director of policy, Gordon Edge, said "The chancellor's announcement that renewable electricity will no longer be exempt from the Climate Change Levy is a punitive measure for the clean energy sector..and that the..Levy Exemption Certificates generated as a result of the CCL had provided vital financial support for renewable energy producers".

However, the UK Government will welcome the expected revenue boost with the scrapping of the exemption expected to earn the Treasury GBP450 million in 2015-16, climbing up to GBP910 million in 2020-21. Research firm Bernstein analysts said the removal of the exemption for green power will "effectively reduce the level of support available for existing and future renewable projects in the UK."

The CCL exemption has been described as a key component of the renewable support regime in the UK since 2001 and the phase out was expected to start after 2020. Despite the concerns raised by the green energy sector the UK government has defended its position and has stated that the measure will have no direct impact on the achievement of UK Carbon Budget targets. Emissions from electricity generation are capped through the EU Emissions Trading System.

Furthermore, according to the Government, the measure is not expected to impact on the UK's renewable energy target and it is on track to meet its ambition for at least 30% of electricity demand to be met by renewable sources. Osborne also promised to bring forward proposals for a sovereign wealth fund for communities that host shale gas developments, to expand the North Sea investment, and cluster area allowances to include additional activities.

In contrast to the actions taken by the UK government, US president Obama unveiled the final version of his Clean Power Plan. The plan has three components.

- One is an EPA regulation that would require a 32 per cent overall reduction in greenhouse gas emitted by existing power plants from 2005 levels by 2025. This will probably lead to the closing of hundreds of plants.
- The second regulation would require future power plants to produce about half the pollution of current plants, effectively ensuring no new coal plants are built in the US.
- The plan also gives every state a target for reducing emissions and requires each to come up with a plan for how to do it.

Amid the shale boom in the US, the green energy sector has something finally to shout about. However, their cousins in the UK may be concerned about the direction being taken by their new government.

Bord Gáis Energy Index

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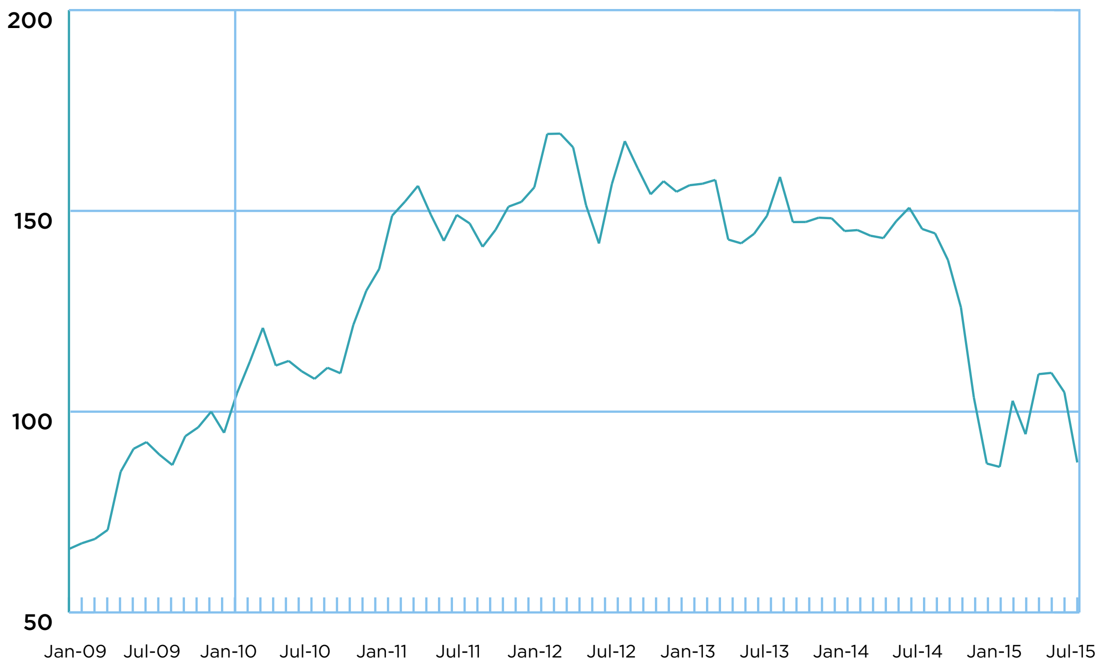
Oil Index



-17%	1 Mth
-20%	3 Mth
-40%	12 Mth

*Index adjusted for currency movements.

Data Source: ICE

Oil

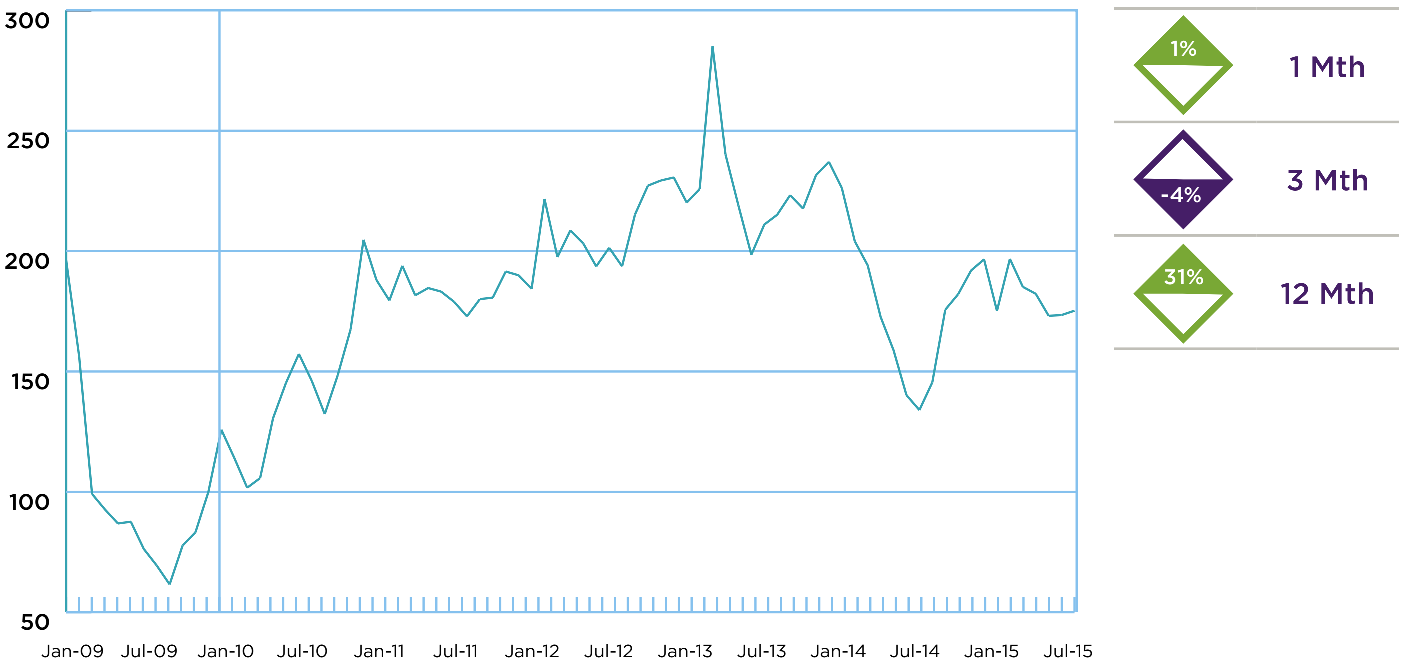
Month-on-month Brent crude oil prices continued to weaken and at US$52.21, the closing price was the lowest recorded by the Bord Gáis Energy Index. The key to the falling price is that supply is stubbornly abundant. Productivity gains mean output from North America's shale beds has defied the gloomsters.

Saudi Arabia is pumping a record 10.6m barrels a day in a bid to keep market share. The West's nuclear deal with the Saudis' arch-rival Iran will bring yet more crude to an already over-supplied market: Iran wants to raise post-sanctions production to 4.7m b/d, up from 2.85m now. The demand outlook brings no joy either: Chinese growth is slowing and the European economies are sputtering.

Something will give eventually;oil-industry investment is plunging while debts are mounting, but for now, consumers can frolic while the oilmen sweat. The best hope for America's oil industry is a lifting of the export ban which means foreign customers pay more. That passed a small hurdle in a US Senate sub-committee in July. If low prices kibosh protectionism, they may prove to be the oilmen's best friend.

Commentary

Natural Gas Index



*Index adjusted for currency movements.

Data Source: Spectron Group

Natural Gas

The average day-ahead price for July was 43.36 pence per therm, in line with the previous month's average price of 43.31p/th. By way of comparison, the July outturn in recent years was 37.38p in 2014, 64.95p in 2013 and 55.61p in 2012. UK demand in July averaged 170mcm, 21mcm above expected demand levels for the month as calculated by the National Grid.

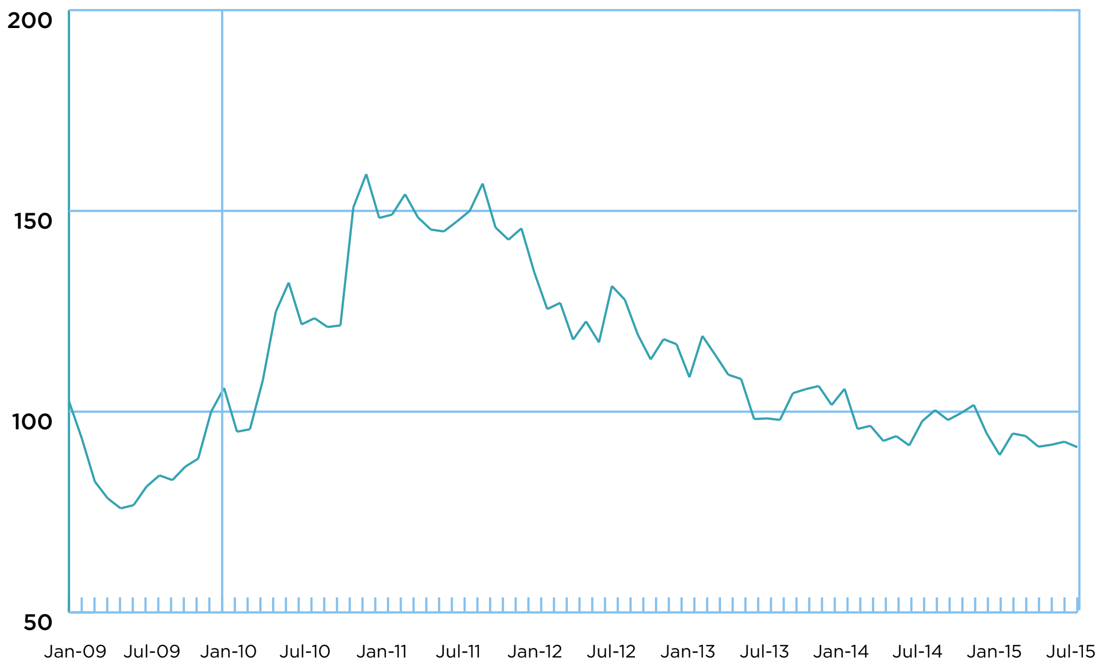
Forward prices over the month continued to hit fresh lows as the Winter 15 and Summer 16 contracts traded 1.7p and 2.1p lower respectively, driven in large part by accelerated weakness in oil prices. As outlined, the Brent benchmark contract dropped over $10 a barrel over the month to close at $52.21 a barrel.

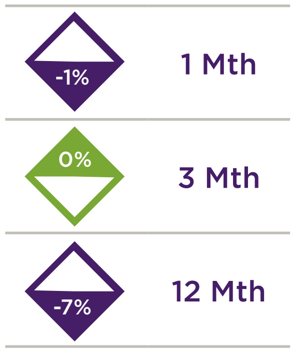
In July, LNG arrivals were 44% down on this month last year. Historically, July and August are the cheapest months of the year spurring injection into storage for the coming winter. However, this year the September contract has been the weakest priced contract resulting in many market participants deferring injections until September. This left more gas in the system for July and displaced some LNG. In addition, there were increased pipeline deliveries from Norway as much of the required maintenance on key fields such as Troll was completed earlier in the summer.

A further bearish factor over the month was the continued weakening of the euro versus sterling, which increases the relative cost of UK gas for euro buyers thereby reducing demand for gas at the NBP, the UK's virtual trading hub.

Russian gas supplies to Ukraine remained suspended over July following the failure to agree a new gas deal for supplies in the third quarter. This has resulted in increased imports from Europe into Ukraine. The two parties are expected to resume talks on a deal in the next few weeks, which appears to have stalled on the issue of price.

Coal Index





*Index adjusted for currency movements.

Data Source: ICE

Coal

The ICE Rotterdam Monthly Coal Futures Contract continued its slow decline in July. In general, commodities suffered the biggest monthly decline in almost four years on concern that supplies are rising as demand slows. This sent copper to a six-year low and oil into a bear market.

The Bloomberg Commodity Index retreated 10.6% in July, the most since September 2011. The prospect of higher borrowing costs in the US strengthened the dollar and drove gold to the lowest in five years. Grains including wheat, corn and soybeans had their worst monthly performance this year.

At a close of US$58.45, the ICE Rotterdam Monthly Coal Futures Contract recorded a record Bord Gáis Energy Index low. In early August the Year-ahead Europe-delivered CIF ARA thermal coal swaps slipped to a new historic low, with sources citing an overall weak energy complex and ongoing weak market fundamentals. Weakening oil, gas, German power prices and a strengthening dollar were all contributing factors.

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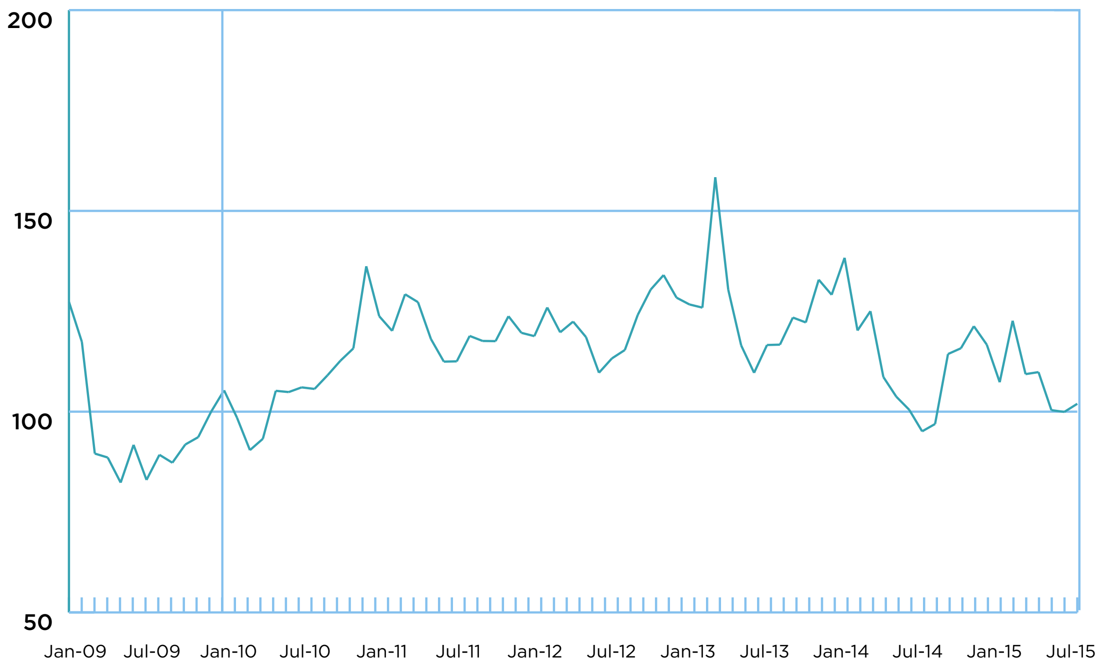
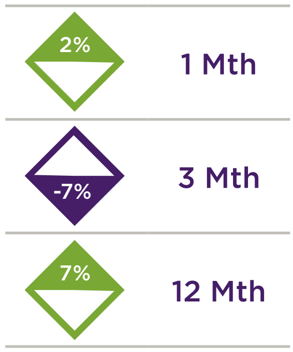
Electricity Index





Data Source: SEMO

Electricity

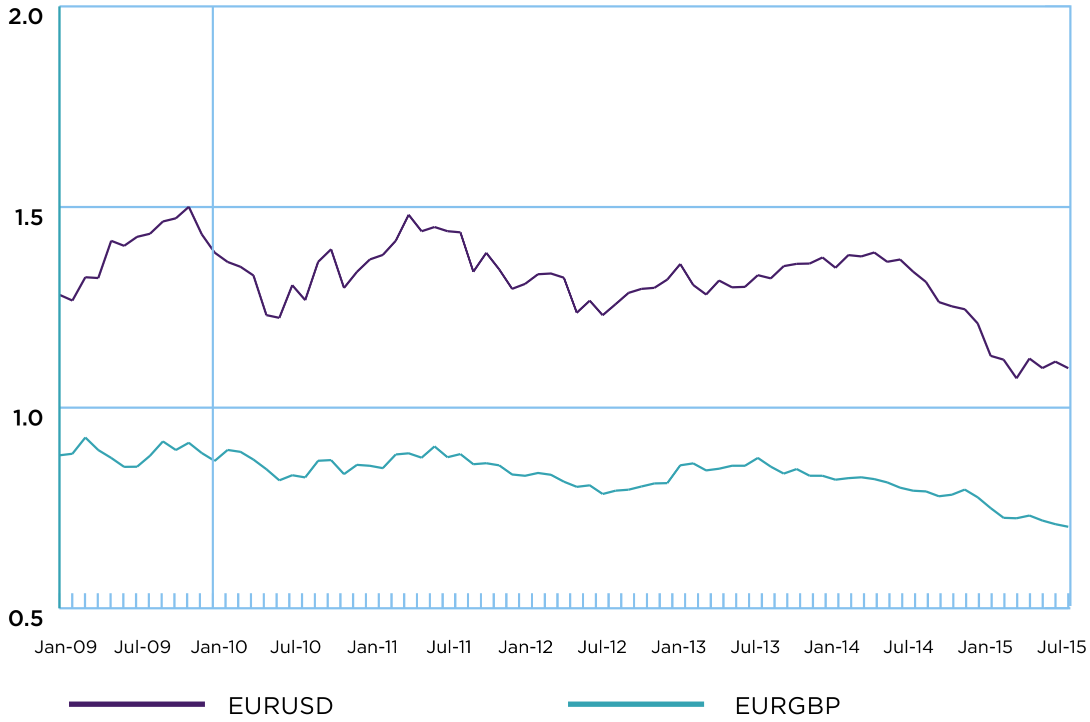
Including capacity payments, the monthly average wholesale price of electricity rose 2% in July 2015 with the monthly average wholesale price of gas rising to €51.55/MWh from €49.93/MWh. In sterling terms,day-ahead gas prices were static but a weaker euro applied upward pressure on the cost of gas. This has a significant influence on the cost of producing electricity.

A monthly average clean spark of approximately €5.75/MWh was observed in July with typical negative night-time sparks being observed as the wholesale prices were being set by coal powered plants amid periods of low demand. During these times of negative spark, gas units called upon to generate lose money while doing so, a peculiarity of the Irish centrally dispatched regime. This low average monthly spark was similar to that observed in June which was the third lowest since 2008.

A factor that supported gas plant running, and in turn the influence of the day-ahead UK gas prices on wholesale power prices, was a scheduled outage at one of the Moneypoint coal units during the second half of July. Amid a seasonal fall in demand, wind powered production contributed 17% of the power required to meet demand during July which compares favourably to the 14% figure in June.

Commentary

FX Rates



EURUSD

-1%	1 Mth
-2%	3 Mth
-18%	12 Mth

EURGBP

-1%	1 Mth
-4%	3 Mth
-11%	12 Mth

FX Rates

Amid growing expectations of rate hikes in both the US and UK, the euro weakened versus both currencies in July. According to the Economist Magazine, America's first interest-rate rise since 2006 is nearing.

July's employment report, which was released in early August, looks unlikely to change that. Economists expect another strong month: their median estimate is jobs growth of 225,000, above the year's already healthy average. Despite it coming in at 215,000, a US rate hike is still on track. Unemployment in June was down to 5.3%, and GDP is growing steadily after a wobbly winter. Wages, though, have been weak: hourly earnings have struggled to rise by more than 2%, year-on-year.

This is one reason why the Federal Reserve has held off raising rates. But in the Fed's latest policy statement the word "some" qualified the "further improvement" it had long said the labour market needed for rates to rise. Subsequently, two officials have hinted at support for an increase next month, despite subdued wages and inflation (still below the 2% target). The Fed's head, Janet Yellen, may also agree given July's positive jobs report.

In July, the mood was perceived as equally positive and this fed through to a stronger pound. In the month, the markets looked forward to the Bank of England's monetary-policy committee which was due in early August. Despite the expectation that the committee would keep interest rates at 0.5% for the 78th month running, the meeting mattered as two (or three) of its nine members were expected to vote for an increase. Decent GDP growth—0.7% in the second quarter, 0.4% in the first—is emboldening the hawks. Inflation is still around zero, far below the 2% target, and the governor Mark Carney is not of their number. He has, however, suggested rates may rise at around year-end.

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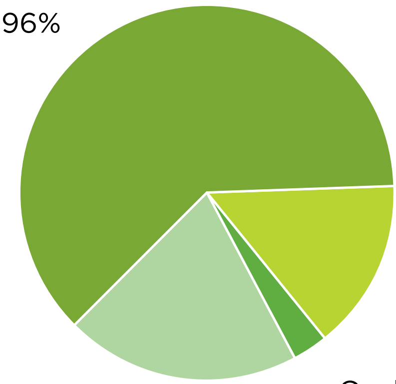
Market Outlook

Ultimately, commodity markets are rendering a pessimistic view of the debt-fuelled support for the recovery in Greece, the larger Eurozone and in China. This more downbeat view of the near future will likely be reinforced once conditions in capital markets begin to return to normal, a transition that may start this September with an initial interest rate increase in the United States. The big question in the oil markets is how much longer can American shale-oil producers keep going, as losses mount and investors fume? Until oil supply abates, the bears are in control.

Re-weighting of Bord Gáis Energy Index

Following the SEAI's 2011 review of energy consumption in Ireland, there was a 6.4% drop in overall energy consumption. Oil continues to be the dominant energy source with most of the oil used in transport and the remainder being used for thermal energy. For the purposes of the Bord Gáis Energy Index, the total final energy consumption in Ireland fell 1,089 ktoe (toe: a tonne of oil equivalent is a unit of energy, roughly equivalent to the energy content of one tonne of crude oil) between 2009 and 2011. This fall was made up of a 1,022 ktoe drop in oil consumption (down 13.5%), a 20 ktoe drop in natural gas (down 12.6%), a 7 ktoe drop in electricity (down 0.3%) and a 40 ktoe drop in coal (down 10.98%). The Bord Gáis Energy Index has been re-weighted in January 2013 to reflect the latest consumption data. The impact has been minimal and has resulted in slight reductions in the share of oil and gas and a slight increase in the weighting of electricity in the overall Index.



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