Electricity

Energy Research Strategy

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Tight electricity markets are taking a breather

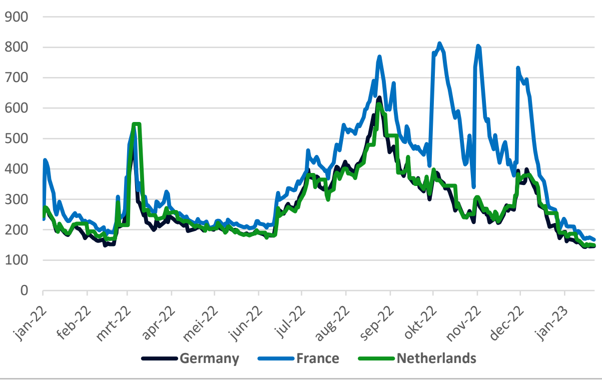
Electricity prices have fallen sharply in recent weeks. The mild winter, higher-than-average (EU) gas inventories, but also the return of French nuclear power plants contributed to this price drop. Against the trend, prices of EU ETS allowances have actually risen since the beginning of the year. Besides gas markets, weather forecasts and EU ETS allowances, French strikes and water levels of some European rivers are on the radar as possible aspects that could affect electricity prices in the coming period. We also zoom in on the European consultation on electricity market reform in this update. Finally, we briefly mention some other relevant issues that (may) affect the electricity market.

Electricity prices follow downward trend of gas prices

In the European energy market landscape, where the tightness of natural gas supply is still a dominant factor, electricity prices follow the downward trend of the Title Transfer Facility (TTF) gas price (the Dutch natural gas benchmark). As a result, the Dutch electricity price (baseload active monthly contract) has fallen from its record high of EUR 613/MWh at the end of August to EUR 140/MWh on 1 February 2023.

As shown in the chart below, electricity prices in France have also come back reasonably in line with prices in other Northwestern European countries as more and more nuclear power plants are back in operation (see section below on French nuclear plants). Although the stress in the energy markets have calmed down somewhat, several risks remain that could still trigger price increases in the coming months.

Electricity prices have strongly declined
(front month baseload)
x EUR/MWh



Source: Refinitiv Eikon

Europe's gas inventories are well stocked, partly due to the mild above-average winter. European gas inventories stand at 73% as of 31 January 2023. With around 69% of storage being filled, the Netherlands is also not doing badly for the time of year. In addition, the winter with relatively high wind yields has kept the share of wind power in electricity generation relatively high. That too has had a price depressing effect on electricity prices. In the day-ahead market, where electricity is traded almost immediately from producer to consumer, the electricity price has even been negative on a number of occasions. This happens at times when the supply of renewable energy is so high that the total supply of electricity exceeds demand. Something that until recently happened only during the summers.

Nonetheless, despite the recent drop in electricity prices, the average price for electricity in the Netherlands is currently still roughly three times higher than the 2016-2020 average price. In part, this is because the Netherlands has now become a net importer of natural gas, and is therefore largely dependent on international gas tariffs. At the same time, that effect is partly mitigated by the fact that the share of renewable energy has risen sharply in recent years. But the main reasons are still mainly the tight market conditions in the various (energy-related) commodity markets, in both gas, coal, and renewable energy generation capacity.

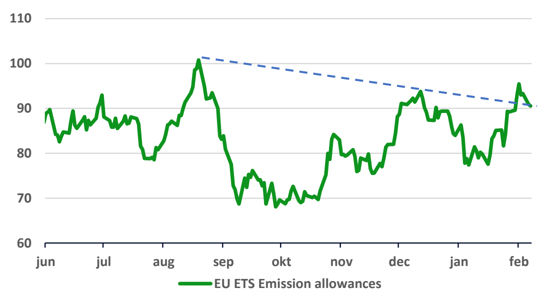
EU ETS price on the rise again

The price of EU ETS allowances has risen sharply in recent weeks (left chart below). In 2022, the price of allowances was volatile, but nevertheless, the year ended for EU ETS allowances at almost the same price as it started. Nevertheless, the price rose again during January to its current level around EUR 95/tonne. With the recent price rise, the downward trend line was broken (blue dotted line).

The reason for the recent price rise can be largely explained by a slight upward revision of expectations about the economy. If a recession is avoided, or less deep than previously expected, economic activity will be higher than expected. This coincides with more demand for allowances. We also see less renewable energy being generated in recent weeks, which leads to increased use of coal and gas plants. This too leads to higher demand for allowances. Another reason could be found in having to buy allowances from industrial demand. This is to cover any shortfalls from the previous year or to cover expected extra production in this year.

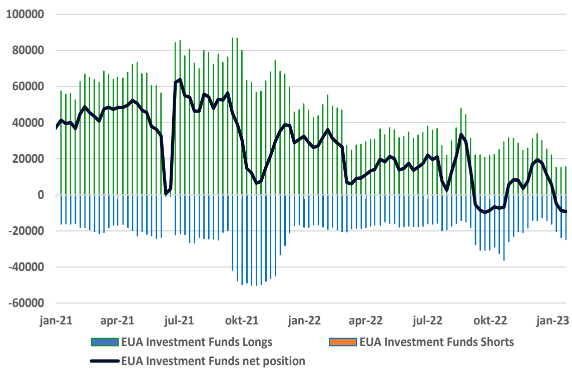
Prices EU ETS allowances have gained

x EUR/MWh



Net short position EUA

x EUR/MWh



Source: Refinitiv Eikon

In itself, the recent price rise is remarkable. In fact, if we take a closer look at the outstanding speculative positions of investment funds, we see that the number of long positions (speculating on price rises) has decreased further slightly in recent weeks. At the same time, the number of short positions (speculating on price falls) has actually increased firmly (see right-hand chart above1). This results in an expansion of the net short position. This should rather put downward pressure on EU ETS allowance prices, similar to the movement we saw in mid-August and in September. In August, this move was explained by a decline in demand for allowances, in line with the decline in industrial activity. With gas and electricity prices now lower, a similar explanation is harder to come by. Perhaps the explanation should rather be found in higher interest rates and continued positive sentiment in stock markets, causing investors to reallocate investments.

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