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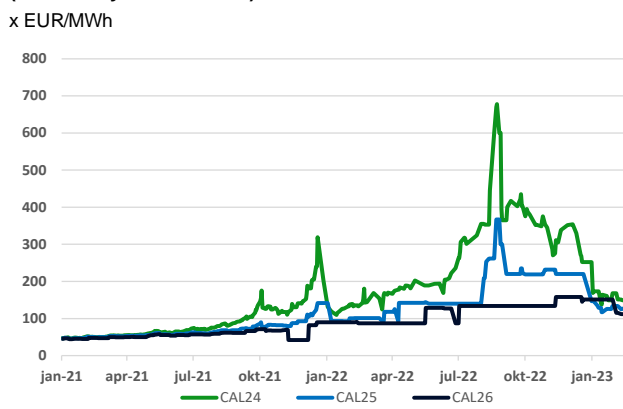
Electricity prices at odds with EU ETS

The Dutch electricity prices have entered slightly calmer waters. Any direction - and hence price volatility - is mainly determined by changing weather conditions. Nevertheless, the general trend is sideways. The price of EU ETS allowances (active contract) reached a fresh record and, with a price of more than EUR 100/tonne, supports the development of greening the energy mix. Market expectations also point to a further increase in the price in the coming years. In line with gas prices, the prices of (thermal) coal have also fallen strongly in recent months. Nevertheless, coal prices in Europe are still three times higher than in 2021, and in Asia even four times higher. This makes the profitability of coal fired power plants deteriorate to the extent that it pays to run gas plants harder again. Expectations of drought in spring could again negatively affect electricity supply in Europe. For now, however, water resources in Norway have recovered to normal levels, so electricity exports to Europe should not be hampered.

Electricity prices trading sideways

So far in 2023, the Dutch electricity price has been in slightly calmer waters. The active monthly contract (April 2023) has been fluctuating between about EUR 115/MWh and EUR 140/MWh for the last month. Thus, it is fluctuating below the EUR 140/MWh level reported in the previous market update. Calendar year (CAL) 2024, 2025 and 2026 supply contracts have also calmed down somewhat and are currently quoting within this same range (see chart below).

Dutch Electricity prices have dropped (calendar year baseload)



Source: Refinitiv Eikon

The move follows the drop in gas prices. TTF gas (delivery April 2023) is trading well below EUR 50/MWh, the 2024 annual contract just above that level. The downward trend thus continues for the moment. The fluctuations of the active monthly electricity price contract are mainly shaped by developments in the gas market. Thus, the TTF gas price and, in a broader perspective, gas market developments as a whole remain critical in shaping the electricity price.

Ample gas supplies for the time of year, relatively mild weather and the fact that winter is coming to an end make the situation look relatively favorable for the coming months. Nevertheless, the gas price is still more than three times higher than the average price of 2021 or earlier. So, markets may have calmed down a bit, but the energy crisis is certainly not over yet.

EU ETS prices reached highest point in six months

Unlike electricity prices, the price of EU ETS CO₂ allowances did continue its upward trend. The current annual contract (delivery December 2023) reached its highest price of EUR 101.25/tonne on 21 February. Although this is below the 19 August 2022 record of this contract (EUR 101.95), it shows that the positive sentiment of recent weeks continues. However, the active annual contract was then still the 2022 contract, so the record above EUR 100/tonne was not mentioned as such. The main reason for these price increases is the improved sentiment regarding economic growth. As a result, demand for allowances has increased from both industrial applications and the power sector.

EU ETS prices reached a fresh record



Source: Refinitiv Eikon

Other reasons also contribute to the positive sentiment. Expectations in the market that the reforms to the EU ETS resulting from the REPowerEU and Fit-for-55 packages will lead to further price increases in the coming years is driving purchases of allowances by both users and investors. The positioning of traders shows that the number of open positions in general has increased significantly. Interestingly, the number of open long contracts (speculating on price increases) has more than tripled since the beginning of this year. The number of short contracts (speculating on price falls) has also increased, but 'only' by 30%. Nevertheless, the number of positions is still only a fraction of the outstanding positions in 2021. Positions reduced due to financial uncertainty during the COVID-19 period.

The *forward curve* (series of contracts with the current price for delivery in the future) also reflects the expectation of future price increases well (see chart below). With the principle that the number of available allowances will only continue to decrease in the coming years, it is to be expected that this will lead to further price increases. Indeed, there remains a chance that the number of EU ETS allowances will be further accelerated by the European Commission, if the energy transition lags behind the set CO₂ emission reduction targets.

In contrast, the likelihood that the number of emission rights will be expanded is considered small. Although short-term price movements can be volatile and influenced by a variety of secondary or external factors (economic growth, interest rate movements, financial market sentiment, et cetera), the overall picture is that the upward price trend will therefore remain unchanged. In our view, the biggest risks in terms of possible price declines lie in the political support for the policy instrument. At a time when the EU ETS price might rise too fast, creating - especially in eastern Europe - more resistance to the instrument, the Market Stability Reserve (MSR) could be called upon and the number of available allowances could be increased. This would trigger a fall in the price. A more positive scenario where price declines could occur is at the time when the energy transition is ahead of the intended CO₂ emission reduction path.

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