

How to manage the effect of COVID-19 on the Energy Markets

The COVID-19 crisis has, or will, affect the entire population of the world. The impact this has had on financial markets has been widely reported, with the biggest losses seen on the Dow Jones and many of the leading equity markets since 1987. We are living through unprecedented times, and the future is uncertain.

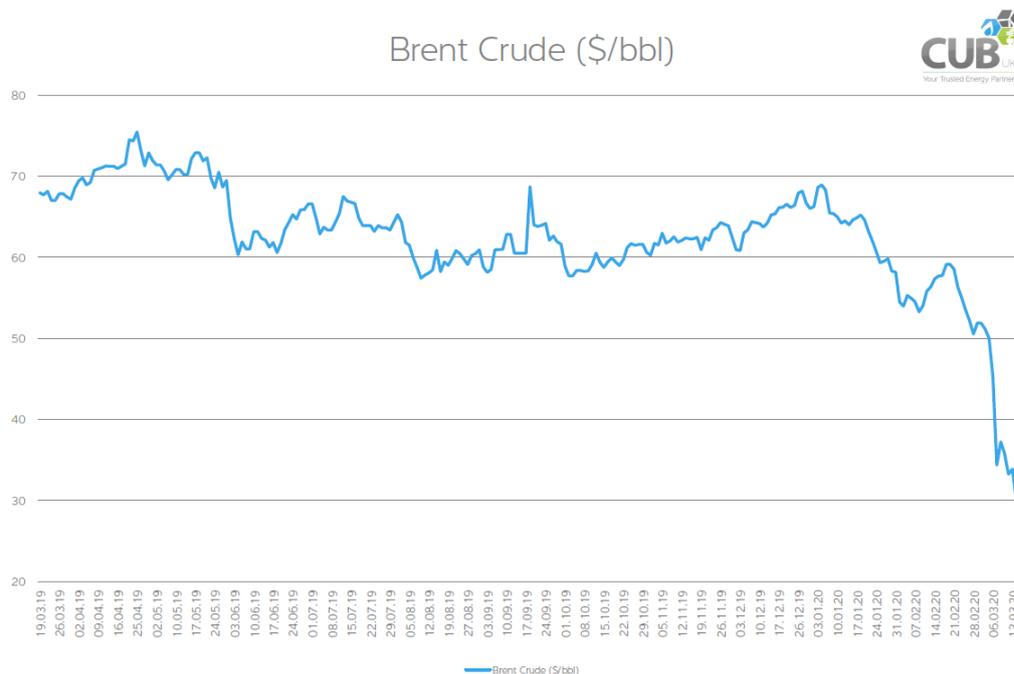
In these times it is human nature to put "non-essential" work on the back burner. To concentrate on the immediate impact and day to day actions to protect our families, business, and try and live life as normally as possible.

There is, however, a huge opportunity present in the energy markets, and also a fairly significant risk on the horizon that brings the need to renew your energy contracts up the agenda.

The Oil Market

Away from the COVID-19 crisis for a moment. On 6th March, the OPEC+ group met to discuss further output cuts. The outcome of that was rather unexpected with Russia effectively walking away from the table refusing to agree to further cuts or even an extension of the cuts that were in place.

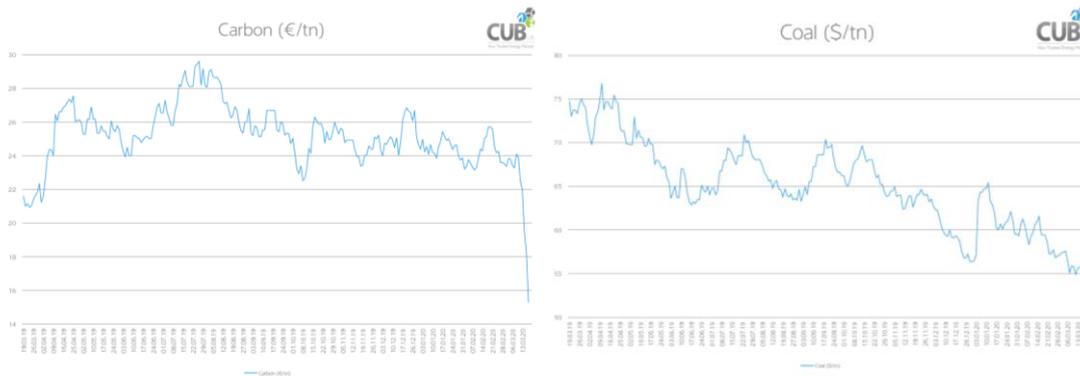
Saudi Arabia then decided to make a complete U-Turn on its production output. The result of this is effectively a market unexpectedly flooded with supply, at a time when the demand has fallen dramatically due to the COVID-19 pandemic. Consequently, we have since seen the Oil price at its lowest levels since 2003.



Other Influencing Markets

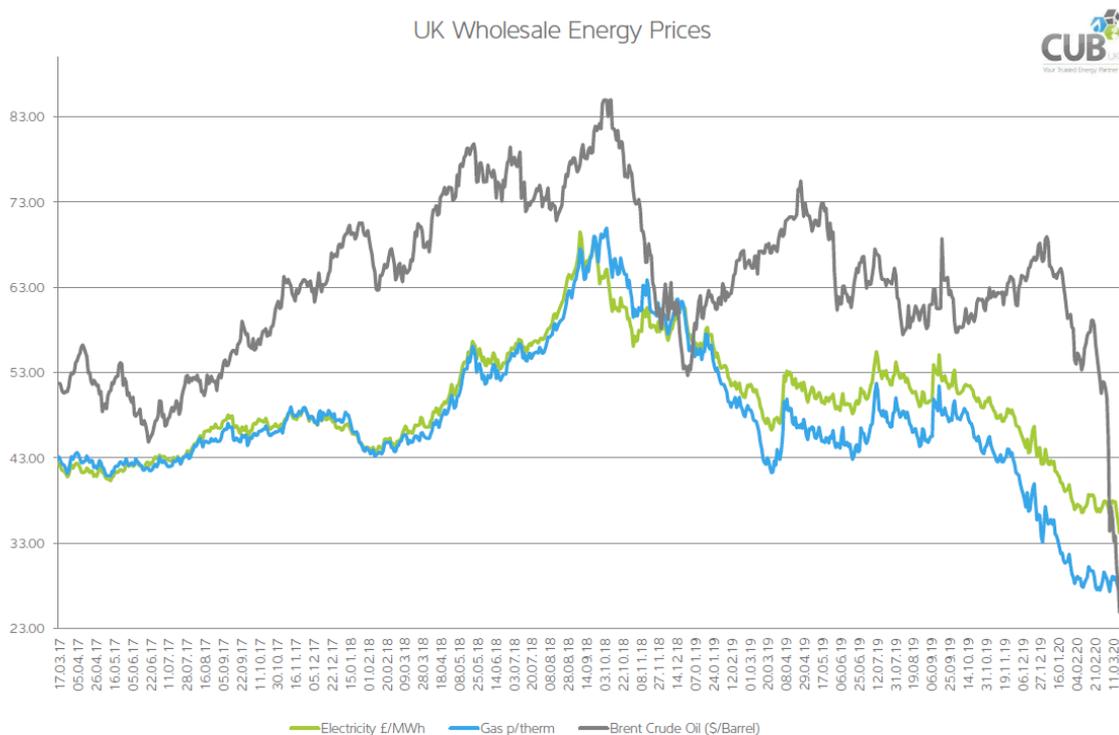
The price of any commodity is affected by a significant number of influencing markets, and the U.K. energy price isn't exempt from this. The price of Carbon, Coal and LNG (Liquefied Natural Gas), to name but a few, dictate the market price in different ways.

Almost all these markets have seen significant losses, pulled down by various things including Brexit negotiations, but more recently through demand destruction from COVID-19.



U.K. Gas and Power

To round things off, let's look at the U.K. wholesale gas and power markets. The influence of a mild winter, healthy supply and for a while a strengthening pound we saw prices tumble. The wholesale cost of energy in the U.K. is at its lowest levels for over a decade. With some near term markets trading in the 20s.



So What?

We all know markets go up and down, the cyclical nature of bust and boom is something that we have all seen in our lifetime. This time things are different. We have seen an immediate and unprecedented drop in demand, sell-off in the equity markets, and a U-turn in the confidence of economic stability. Price falls in price will, logically, correct (increase) when confidence returns. How long the impact of the damage to the economy weighs on prices will determine how quickly and how sustained this increase will be.

Data from China <https://www.ft.com/content/318ae26c-6733-11ea-800d-da70cff6e4d3> shows industrial output shrank by about 13% during the lockdown period. If the same happens in the U.K., this represents a huge swing in consumption, and when the lockdown period ends the system may struggle to cope with the sudden surge in demand.

One thing we can be sure of, however, is that resources will continue to be stretched for an extended period. Simply from an administrative perspective, should the market start to increase, customers will inundate energy suppliers with requests to renew their contracts. They will want to secure the low prices created by the current situation.

At CUB we are contacting all our customers with a renewal date within the next 12 months (and beyond in some cases) and suggesting to them, and helping them, to carry out a benchmark renewal tender with a view of securing prices now. This way, at the very least, we can ensure that we complete the groundwork and are in a position to hit the go button when the time is right for them.

One Last Point

Most energy supply contracts include a take or pay clause which penalises customers for large swings in the volume of energy agreed to be used at the start of the contract. If your business is affected by Coronavirus, then let your energy consultant or supplier know. Communication is vital to ensure that you aren't penalised.

P.S. (and this is the very last point) – If you are an energy manager, or the person responsible for monitoring the energy usage of your site, and you are in a shutdown period, use this opportunity to establish your site's baseload (This is the site's lowest usage when unoccupied). It is an important piece of information when looking at future energy-saving projects. You can find this figure by looking at your half-hourly data for any days the site is unoccupied. This exercise may also highlight any anomalies in usage, such as unexpected spikes (e.g. air conditioning timers left on).

Let's all try and make the most of a bad situation. As always, I am keen to hear what you are doing during this time, or any other helpful information, tips or advice you can share.

Louis Fairfax

Managing Director – CUB UK