

UK Gas Market Review 2009

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The Energy Contract Company has just published its annual UK Gas Market Review. The review has been published since 1996. It has a unique track record in accurately predicting changes in the market. For example the 2004 review was one of the first publications to identify the current over-supply in the UK. In 2006, we predicted the current decline in prices. Some of the key features of the report are as follows:

1. Falling Spot prices

Most of the gas supplies to customers in the UK come from the Spot market and these prices have fallen substantially in the last year. On September 17th 2009 the cost of 1 year spot gas was 35p/therm, down almost 60% from the level a year before (85p/therm).

2. The Economics of the Domestic Market

This massive fall in spot prices has transformed the economics of supplying gas to domestic customers. The market has been open to new suppliers for over 10 years and in almost every year the suppliers have lost money on domestic sales; sometimes a great deal of money. The fall in spot prices has meant that the domestic market is now highly profitable. Allowing for their hedging of gas purchase costs this year, the suppliers are probably making a profit of 20-30p/therm on domestic sales at the moment (a profit margin of around 20-30%).

3. Gas Over-Supply

The reason for the decline in spot prices is that the gas market is currently very over-supplied. Demand has fallen due to high prices and the world recession, at a time when new gas supplies from imports are rising rapidly. This period of oversupply is expected to last for the next 3-4 years. During this period the prices in the spot market are expected to remain relatively low. However, they may be dragged up a little in the next three years by a combination of rising (oil-related) gas prices in the rest of Europe and by possible influence of gas prices in the United States. The US gas market may well provide a floor price level for the LNG market. This in turn could provide a floor level for our summer gas prices, especially in the next decade.

4. Problems in the longer term

Although the UK market is currently well supplied, in the medium and longer term, the prospects are much less rosy. As the oversupply disappears beyond 2013 we will become much more vulnerable to supply disruptions. Our gas market is ill-equipped to deal with this and the poorly functioning spot market and the lack of storage means that we may then enter a period of higher and more volatile prices. The UK, together with the US, is the only market where most gas comes from the spot market. The USA is well equipped with storage to modulate the variations in supply and demand. Their gas storage capacity is equal to 18% of annual gas demand. Whenever a problem arises then gas floods out of storage and so any price spikes that arise, tend to be relatively moderate. In contrast, gas storage capacity in Britain is only 4-5% of demand at the moment. Even with new facilities under development, it is unlikely to exceed 7-8% of demand in the next decade unless major new facilities are built offshore. This is not enough to provide a stable and secure gas market.

5. Spot Prices Outlook

The market outlook means that spot prices are likely to remain moderately low for the next three years or so, perhaps reaching 45p/therm in 2010/11. However, as the oversupply ends, prices should rise sharply, reaching 60p by 2013/14.

6. More Competition in Europe

Despite these increases, UK prices are expected to be significantly lower than prices in the rest of North West Europe over the next 5 years. The presence of a new lower price source of gas may help the new comers to the gas market in the rest of Europe. They will have access to cheaper gas than the incumbents. The expected low prices in the UK may stimulate the emergence of real competition in other European Gas Markets.

Note to Editors: The Energy Contract Company's **UK GAS MARKET REVIEW** has been published since 1996 and is sold to many of the leading players in the European energy industries. For further information or questions, please call the author Niall Trimble on 02088 912905 or 07941 159793.