



PORTLAND MARKET REPORT



THE GAS CRISIS – A PROBLEM FAR FROM OVER AND WITH POTENTIALLY PROFOUND GLOBAL IMPACTS

When we wrote last month's report on oil prices and Hurricane Ida, we casually wondered whether the concurrent gas crisis would still be raging when we came to write this month's report. The answer to that question was an emphatic yes, with gas prices already at record levels by the beginning of October and now so high that they have the potential to derail the global economy – just as it pokes its head out of its covid-induced hibernation.

The causes of these incredible rises have largely been sequential although, in Britain's case, supply problems have been compounded by very specific, localised issues. Globally speaking, the first signs of potential problems came in Q2 2021, when an unseasonably cold spring in the Northern Hemisphere marked the start of the "run on gas". By May, gas storage levels in Europe and America were perilously low and in need of replenishment, but this didn't happen because long-delayed maintenance of gas production facilities was now in full swing (after months of lockdown enforced inactivity). Furthermore, any spare gas capacity was being diverted to Asian markets in response to rapidly improving post-Covid economic circumstances. And, to cap it all, the summer then experienced record-breaking heatwaves in North America that sent energy intensive air-conditioning units into overdrive.

"A LONG TRAIN OF ENERGY POLICY FAILURES"

In the UK, gas supply problems were exacerbated by a fire in September on the UK side of the cross-channel French interconnector. At the same time, prolonged periods of high-pressure weather meant that wind generation was virtually down to zero (from an average of 30% of UK power needs in Q1 2021). This resulted in even greater demands on (non-existent) gas and even resulted in the firing up of a dormant coal-fired power station in Nottinghamshire. Underlying these local issues remained the fundamental problem of "floating"

gas supply (ie, Liquefied Natural Gas transported by ship) being diverted to Asian markets because – to put it bluntly – they were willing to pay much more for their gas than UK buyers.

It was only when smaller UK energy companies started going to the wall that consumers, politicians and the media began to take note of the serious state of affairs. Seasoned market observers were less surprised by the "sudden" turn of events, pointing out that the current crisis had its roots in historical decisions and a long train of energy policy failures. This included the consumer price cap imposed on UK gas suppliers, which was rooted in 6th-form ideological decision making, rather than how commodity markets actually function. More serious still is the fact that policy makers and Big Energy plc have presided over a sustained period of UK gas infrastructure neglect.

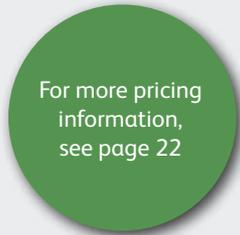
In 2017, it was announced that the Rough Gas Storage Facility in the North Sea would no longer be maintained, taking away, in one fell swoop, 50% (3.3bn cubic metres) of the UK's total emergency gas storage capacity. There were several reasons given at the time for this decision, but most stemmed from the kind of short-term thinking that arises when prices are super-low, and thoughts of supply resilience are far from people's minds. Without Rough, the UK became reliant on 1.5bn m3 of storage in ancient salt caverns on the Humber Estuary and 3 Liquefied Natural Gas Terminals (Isle of Grain and two in Milford Haven) with a combined capacity of 2bn m3. Of course, it shouldn't be overlooked that 50% of UK gas supplies still come from indigenous North Sea production and, to a certain extent, this insulates much of our market from supply shocks. That still leaves a great deal of "overseas" gas to source though and because our resilience planning has been poor, the UK is pretty much in the same boat as those countries who do not have the luxury of North Sea gas (but have a great deal more reserves at their disposal).

The knock-on effects of all this are everywhere, and we have already seen gas dependent industries, such as fertiliser and steel, reduce their production rates sharply. Electricity prices have shot up and with gas now

approximately 3 times the price equivalence of crude oil, so have prices of oil and even coal, as major users switch to cheaper (and dirtier) fossil fuels. This particular environmental own goal is one of the more difficult "circles to square" in this current crisis. The bottom line is that without sufficient gas, the world actually goes backwards on its CO2 emissions because of the alternatives (oil and coal) that users turn to in times of shortage. Which means that, until renewables are fully ready to fill the gap left by diminishing gas supply, new gas exploration is required – however out of kilter that may be with our green energy plans.

"AN ENVIRONMENTAL OWN GOAL"

One beneficiary of the whole crisis will almost certainly be Russia, whose Nord Stream 2 pipeline is ready to supply gas to Europe but is held up by geo-political arguments regarding the Ukraine and a desire to minimise European reliance on Russian gas. Expect those arguments to end shortly, as no European politician is going to stand in the way of free-flowing gas from a brand-new Russian pipeline, if it is effectively the only show in town. However, even if Nord Stream 2 is speedily approved, this still may not be enough to avert a crisis. How big the crisis will be, entirely depends on how cold the forthcoming winter is and how windy it is. A warm, breezy winter will allow the market to re-balance, but a prolonged cold period with minimal wind, could send prices even further upwards and result in some profound changes to energy policy, the global economy and even political administrations.



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