

Credit Crunch Reducing Liquidity & Prices

According to Moffatt Associates, the majority of market participants believe that both market liquidity and wholesale electricity and gas prices will deteriorate further in the next 12 months.

By Moffatt Associates

THE CREDIT CRUNCH and recession are having a significant impact on both EU wholesale energy market trading and the commercial activities of energy market participants (utilities, energy users and traders).

Market participants see the credit crunch impacting significantly on trading and investment in energy markets (see Table below).

We asked our Panel of Experts about the likely impact of the credit crunch and recession on medium/longer term development of the EU energy market.

Key Conclusions

- 70% expect wholesale market prices will fall in the wake of reduced industrial demand and lower fossil fuel prices.
- 64% expect wholesale market liquidity will fall in the next 12 months and a significant minority (47%) expect financial trading will decrease.
- A majority believe tightening credit markets will reduce investment in fossil and renewable power generation.
- A majority believe that the recession will restrict user investment in energy efficiency but it will not motivate governments to intervene to regulate end-user tariffs.

KEY CONCLUSIONS OF THE 'CREDIT CRUNCH' ON EU ENERGY MARKETS – RESPONSES (%)

Scenario	Strongly Agree	Agree	Disagree	Strongly Disagree	Don't Know
Wholesale gas prices will fall in the next twelve months	22	48	15	8	7
Wholesale electricity prices will fall in the next twelve months	19	52	22	4	3
The CO ₂ price will fall in Phase II of EU ETS: [2008-2012]	19	33	37	4	7
The CO ₂ price will rise in Phase II of EU ETS	8	35	15	35	7
Financial trading in carbon, gas and electricity markets will decline in the next twelve months	11	36	36	14	3
Wholesale energy market liquidity in general will decline in the next twelve months	14	50	25	7	4
The recession will force major energy users to increase investment in energy efficiency	0	36	36	18	10
Tightening credit markets will reduce new investment in renewable generation	21	54	14	4	7
Tightening credit markets will reduce new investment in carbon generation (gas & coal)	15	37	26	4	18
Tightening credit markets will reduce M&A activity in the EU energy sector	14	36	25	11	14
The recession will increase the likelihood of governmental intervention to regulate end-user tariffs	14	29	39	11	7

Source: Moffatt Associates, 2009



Below are some of the respondents' comments:

"In the power market, a lot of recent government interventions or attempts at intervention, will have a negative impact on developments because politicians will be more inclined to meddle in the free energy market."

"There will be a big impact in the next 18 months but in the longer-term growth will come back, I think it will come back strongly. Any infrastructure will be put on hold, but when demand increases again it will be built and prices will rocket. It could be 3, 4 or 5 years but it will definitely come back."

"There will be pressure on the type of investment, which will tend to be low risk e.g. gas-fired generation, which is easy to construct, not difficult investments such as nuclear. Also there will be more about affordability for customers, and the environmental agenda will be the short-term victim of the recession."

"I think overall it will delay the further development of functioning wholesale and retail markets by taking out smaller and more aggressive players who would help competition."

"In the short-term, there will be greater consolidation and increased market share in generation e.g. the large players such as E.ON and EDF. So in the medium to longer-term there will be increased concerns about effective competition and sufficient market liquidity."

"Energy will play a stronger role in the return to economic nationalism and there will be a move from the 'let the market provide' attitude to a desire to control energy policy and support economic recovery."

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"With falling liquidity and high volatility the cost of balance sheet resources will come in strongly to wholesale pricing. We may get to the point where risk is properly costed into power and gas."

"Investment in new supply and infrastructure will be curtailed leading to supply shortages. When things do pick up, there will not be the supply available."

"There will be two main effects in opposite directions: Shrinking economies will lower energy demand in medium term. The credit crunch will make financing of new infrastructure more difficult, supply may be affected in the long run if projects are not realised. The first effect is likely to dominate the latter, at least in the short and medium run, since energy is relatively price-inelastic, while the credit crunch poses a severe problem for financing."

Currently, it would appear that the market is a) uncertain about the duration of the bearish impact of the recession on wholesale energy prices, b) convinced that when recovery begins then electricity and gas prices will bounce back sharply and, c) hopeful that market liquidity will hold up.

The market detects a clear shift in energy policy focus towards energy security and economic nationalism and away from liberalisation and a belief in market mechanisms.

The biggest threat to wholesale markets is not the credit crunch but the reaction or over-reaction of governments and regulators keen to try and intervene in markets to ensure the lights stay on and energy prices and future energy prices remain low and stable. ●

The survey was sponsored by APX in association with EFET and conducted by Moffatt Associates, an independent energy market research and business strategy consultancy based in London. A version of this article first appeared in APX's quarterly *Energy Viewpoints* bulletin – Winter 2008.

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