Market correction mechanism

Effects report and relevance in view of recent energy market developments

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Agenda

- Recent energy market developments
- MCM effects report
Recent energy market developments
Wholesale prices keep falling, after a ‘rollercoaster’ ride

Electricity & natural gas price evolution, January 2021 - March 2023 (Month Ahead, EUR/MWh)

Better than expected demand-supply balance has driven energy prices further down during the last months. China’s LNG demand remains an important factor for EU gas prices going forward.

Uncertainty Russian supply
Tight LNG supply; low pipeline flows
Low nuclear & hydro output
Low nuclear & wind output
Increased nuclear & wind output

Sizeable increase in EU LNG supply
High storage stocks; mild weather; continuous LNG supply and limited Chinese LNG demand

22 March 2023: TTF price drops below 40 EUR/MWh for the first time since July 2021.

Note: TTF Month-ahead and EEX Germany Month-ahead contracts are, respectively, the referential EU price benchmarks for gas and electricity delivery.
Given the current and foreseeable market conditions, it is unlikely that the MCM activation thresholds will be met in the near to mid-term future.
The drop in Russian pipeline supply continues to be offset by rising LNG imports and lower demand. This, together with mild weather, has resulted in lower gas storage outflows during winter.

Source: ACER calculation based ENTSOG TP
Gas demand reductions played a key role

Drivers of change in natural gas demand in the European Union, 2022 versus 2021 - bcm

Gas consumption in the European Union fell by 55 bcm in 2022, a 13% drop year-on-year. Mild winter lowered heating needs, next to overall demand reduction efforts and demand destruction. The highest contribution came from industry (-26% YoY). Power sector contributions varied per Member State.

Source: International Energy Agency

Note: EU gas-fired power generation rose slightly year-on-year in 2022 (+ 5 TWh, approx. 1-2%), with summer and early autumn accounting for most of rise, whilst in winter it dropped back again.
Gas storage remains high

Storage filling levels are significantly above last years’ average and have contributed to driving prices down. Stocks will finish above 50% by the end of March, thus alleviating price competition for injections this summer.

Source: ACER based on GIE data and Platts’ estimates
Whilst past ‘LNG receiving bottlenecks’ are improving

More LNG terminals are coming online, and the aim is to double EU LNG import capacity by 2025. Quicker planning, permitting and building for what normally takes several years has already had a positive impact.

Source: Platts and Bruegel. The map overview also comprises selected new pipeline capacity developments.
Highlights from ACER’s MCM Effects Report
ACER & ESMA assessed the effects and design of the MCM:

- Assessment of effects caused by the MCM on financial and energy markets and on security of supply
- Analysis of MCM extension to other EU Virtual trading points
- Appropriateness of the key MCM design elements

Publications:

- Preliminary data report published on 23 January
- Final Report submitted to the Commission and published on 1 March

Market Correction Mechanism | www.acer.europa.eu
Effects monitoring: main findings

• ACER and ESMA remain unable to identify significant impacts, either positive or negative:

1. TTF prices have dropped by 60% after the MCM adoption, driven by supply and demand fundamentals.

2. Demand reduction and mild weather conditions have contributed to ensuring security of supply.

3. The MCM Regulation has not prompted a discernible shift in trading activity:
   • Total hub traded volumes remain stable
   • Gas derivatives liquidity has not been negatively impacted

Source: ACER based on REMIT data.
Note: ‘LT average’ includes data from 1 January 2021 until 1 April 2022, ‘post-MCM adoption’ includes data from 22 December 2022 up to 15 February 2023.
TTF is by far the most liquid gas trading hub in the EU, with more than 10,000 derivatives’ transactions per day, representing 95% of EU gas derivatives’ trading (for comparison, 100 derivatives are daily traded at the second most liquid hub, the German THE).
ACER could not identify a need for revising the price indexes used to calculate the MCM reference price: they offer a valid proxy of global spot LNG pricing, their price differences are under 5-7 EUR/MWh - as of the first quarter of 2023 - whilst the inclusion of several indexes makes the MRM price reference relatively robust.

Source: Argus, Platts, ICE Endex and ACER. The price of the NBP front-month tends to set the maximum price level of the basket, as NBP prices are in many trading days determined by the price of spot LNG deliveries plus the British VTP access cost. Yet, NBP inclusion is beneficial given that its price signal is reliable and transparent as it is connected to a highly liquid trading venue.
ACER’s view on MCM extension

1. On the sufficiency of EU VTPs’ liquidity¹.
   - Implement the MCM only at VTPs where gas derivatives’ liquidity is sufficiently high.
   - Nonetheless, the extension to other VTPs is unlikely to lead to ‘significant negative effects’.

2. On the prices to activate the extended MCM.
   - Use the same activation and de-activation conditions for all EU VTPs, relying on the TTF front-month price as the most liquid one.

3. On the bidding limits to apply.
   - Use the same dynamic price bidding limit at the EU VTPs to which the MCM is extended.

Note: VTP stands for Virtual Trading Point.
Thank you for your attention. Looking forward to the discussion.
ACER: Role & governance

- **Supporting the integration of energy markets in the EU** (by common rules at EU level). Primarily directed towards transmission system operators and power exchanges.

- **Contributing to efficient trans-European energy infrastructure**, ensuring alignment with EU priorities.

- Monitoring the well-functioning and transparency of energy markets, deterring market **manipulation** and abusive behaviour.

- Where necessary, coordinating **cross-national regulatory action**.

- Governance: **Regulatory oversight** is shared with national regulators. **Decision-making** within ACER is collaborative and joint (formal decisions requiring 2/3 majority of national regulators). **Decentralised enforcement** at national level.
ACER calculates daily the MCM reference price

1. Calculation and Publication of the ‘reference price’
2. Check whether conditions to activate/deactivate market correction mechanism are fulfilled

Tasks are performed every working day between 21h and 23:59h.
ACER calculates daily the LNG price assessment

- ACER collects real-time market data to compute its daily LNG price assessment. Deliverables so far:
  - Detailed Guidance on reporting
  - IT tool for data collection (TERMINAL)
  - Methodology document
  - Establishment of an LNG Expert Group
  - Establishment of an Oversight Committee

- Procedure:
  - Daily data collection and processing
  - Daily publication at the dedicated ACER site
  - Resources: 5 FTEs - not yet hired - and dedicated IT budget

New task: from 31 March, ACER to publish an LNG benchmark = ACER LNG price – TTF ICE Endex Front month settlement price

Example of ACER’s LNG price daily publication – 24 March 2023 – EUR/MWh

Source: ACER based on market participants’ reported data
ACER's tasks on MCM suspension monitoring

- ACER must continuously monitor the market effects of the dynamic bidding limit, alongside ESMA, ENTSOG, GCG, and ECB.

- The EC can suspend the MCM with an implementing decision. Reasons for suspension:
  1. Unintended market disturbances
  2. Manifest risks with a negative effect on the security of supply, intra-Union flows of gas, or financial stability

- ACER key focus is on monitoring market-based intra-Union flows of gas

Source: ACER based on ENTSOG TP and ICIS Heren.
Energy price expectations remain higher than pre-crisis

Although gas and power futures’ prices have substantially dropped in last months, they remain almost two times above recent historical average.

Source: ACER based on ICE Endex and European Energy Exchange (EEX)

Note: EEX Power and TTF gas average prices are shown for comparison and are based on the front-month products traded in the period 2017-2021 (i.e., they are not future prices for delivery in 2023-2024).
Global LNG supply remains tight the next two years

The EU will compete for extra LNG volumes with Asia, which will see growing demand driven partly by overall economic growth, partly by lowering coal usage. Given market tightness, unexpected events, such as outages, can have outsized impacts, adding tension to global LNG supply and hence to EU gas prices.

China’s COVID-19 driven demand decline in LNG volumes (-20% YoY) was absorbed by Europe, while US LNG supply continues to grow. However, in 2023, in line with the expected increase in its economic growth, China’s LNG demand is expected to gradually rise (+3% YTD), intensifying competition for overall LNG resources.