E.ON Monthly Market Report

February 2016

Market summary for December and January

Gas: Mild temperatures and healthy supply depressed prices despite weather-driven surge in early January.

Power: Lower fuel costs drove power prices down.

Oil: Oil prices fell further as oversupply persists – but rallied late in the month.

Carbon: Carbon prices fell sharply on oversupply expectations.

Direction of commodity prices (January 2015 to January 2016)	
	Year
Gas price	▼
Power price	▼
Oil price	▼
Carbon price	▼

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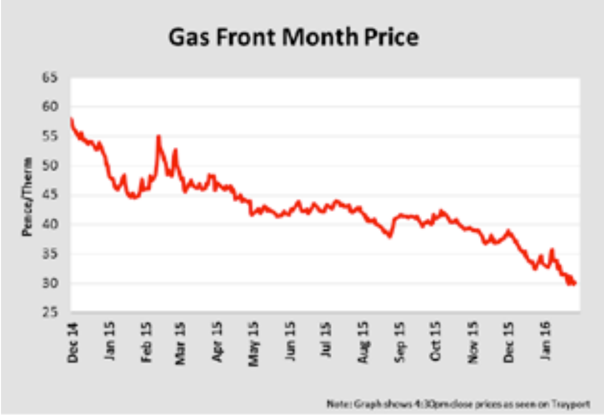
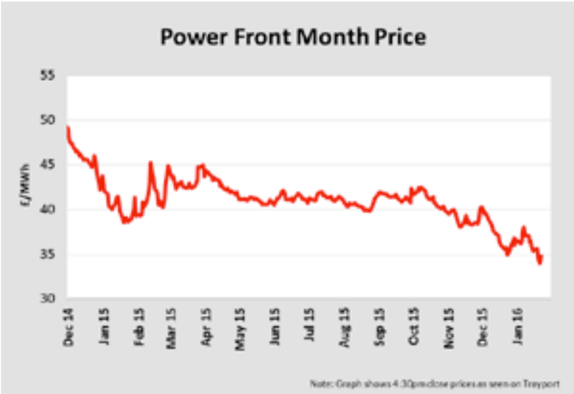
Gas

Mild temperatures and healthy supply depressed prices despite weather-driven surge in early January



Front month gas prices fell throughout December and January, with a short period of stable and rising prices mid-January. This resistance was a result of temperatures across Europe being significantly colder than normal. Otherwise, temperatures were consistently warmer than normal and storage facilities were not called on at all times, meaning the stock levels remain healthy. Total demand stayed low for the time of year, despite January seeing the highest demand for gas in UK power generation in two years. Supply to Europe was strong from Norway and Russia, and there was also an increase from North Africa. Consequently, Europe was well supplied and the market fell.

Power

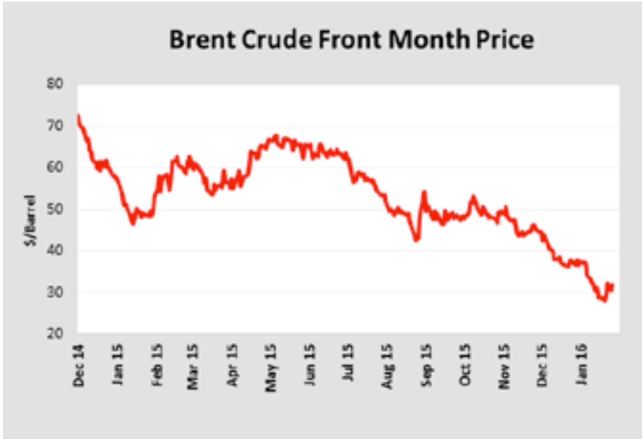


Lower fuel costs drove power prices down

December and January both saw declines in the price of gas and coal, which reduced the expected cost of generation. There was a short period when day-ahead prices rose strongly (up to £48/MWh) because of high weather-driven demand and low wind generation. However this didn't impact forward prices, which continued to fall. For most of the remainder of December and January wind generation was very strong. This alleviated the risk of supply tightness, which exists because of unavailable power plants, that would otherwise have caused higher prices. An auction for generating capacity for winter 2016/17 was held in December which awarded capacity contracts to 3.6 GW of capacity at a price of £34.21/kW. This was twice the price achieved for capacity in the auction for the previous year, and is another indicator of tightness in the generation market.

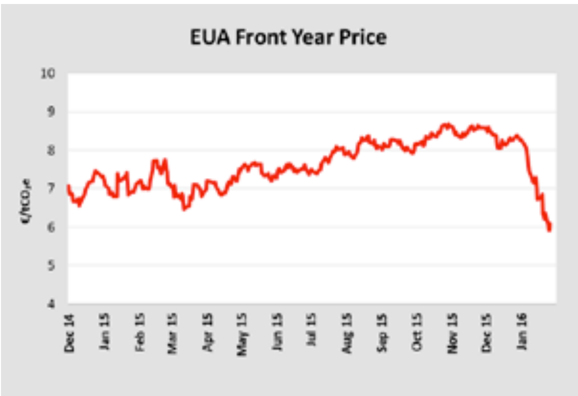
Oil

Oil prices fell further as oversupply persists



Oil prices fell strongly in December and January, primarily driven by further data showing the extent of the oversupply, and also the lifting of sanctions against Iran following a deal on the country's nuclear programme. This strong oversupply was then compounded by dollar strength and weak economic data in the global economy, particularly from China. Data released by Iraq showed that the country achieved record production in December and, with Iran now allowed to sell oil on the international market, the market expects that a lot more physical supply will be available in coming months. In December, the US Federal Reserve increased its base interest rate which caused the dollar to strengthen slightly. In late January, oil prices rose following rumours that a deal between OPEC and Russia may coordinate to withdraw supply from the market.

Carbon



Carbon prices fell sharply on oversupply expectations

The price of carbon rose steadily through December and then fell sharply from the start of 2016. December saw a rise in the price, as there was strong appetite for carbon allowances to allow running of coal plants as coal prices fell. However, since the New Year, there has been a firming of the coal prices at a time of falling power prices, which has caused the profitability of coal-fired power plants to reduce. This in turn has reduced the demand for EUAs and the market fell strongly, losing all the gains that had been made over 2015. The bearish sentiment and relatively illiquid market meant that when players were forced to close long positions, this worsened the market fall.

Things to watch out for in February

In February, the Bank of England (BoE) should release further data on inflation (Feb 4th) which will give an indication of the strength of price growth in the UK. This in turn will influence the BoE's decision on whether to change interest rates later in the month (Feb 29th). Market consensus is for there to be no change in rate until late this year, if not 2017.

An important new phase in the gas market is imminent, in that the US will start exporting gas, in the form of LNG, in February or March. This will connect the markets of North America and Europe and could see new pricing dynamics evolve. Additionally, new supply to the market from Angola and a major new project in Australia should commence. This will continue the very strong supply picture in the gas market and should see more LNG arrive in the UK.

As mentioned in the oil section, there are rumours of a deal between OPEC and Russia to reduce production. Should a formal deal be agreed, this could be bullish for the oil market, and gas prices would probably react in line.

Jargon buster

CCGT:	Combined Cycle Gas Turbine
LDZ:	Local Distribution Zones
LNG:	Liquefied Natural Gas
MCM:	Million Cubic Meters
NBP:	National Balancing Point
NTS:	National Transmission System
OFGEM:	Office of Gas and Electricity Markets
OPEC:	Organization of the Petroleum Exporting Countries
RO:	Renewables Obligation
CPI:	Consumer Price Index
ILO:	International Labour Organisation
UKCS:	UK Continental Shelf
IMF:	International Monetary Fund
IEA:	International Energy Agency
EUA:	European Union Allowance
BoE:	Bank of England

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