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The wholesale market for electricity

THE EVOLUTION OF PRICES AND POLICIES IN TICINO, SWITZERLAND, AND THE EUROPEAN UNION

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Executive summary

2019: an unexpected decline of electricity prices

Contrary to the expectations, 2019 was a difficult year for the energy industry. Electricity prices slumped by more than 20% between 2018 and 2019 in Switzerland and the neighbouring countries. The yearly averages for day-ahead prices fell from 52.2 to 41.1 EUR/MWh in Switzerland, from 50.2 to 39.5 EUR/MWh in France, from 61.3 to 52.4 EUR/MWh in Italy, from 46.3 to 40.1 EUR/MWh in Austria, from 45.0 to 37.7 EUR/MWh in Germany.

Weakening economic growth and oversupplied LNG market sink fossil fuel prices

The trend observed in the electricity wholesale market is directly connected to the downward trend observed in the prices of fossil fuels, that in turn can be explained by a general slowdown in global economic growth and an unexpected supply overhang in the natural gas market. The surge in LNG availability, due to the faltering of gas demand in Japan and in Europe and the fast commissioning of new liquefaction capacity in the United States, caused an unprecedented downward price convergence in the three main gas market areas, namely USA, Europe, and Japan. Hence, while all fossil fuel prices declined throughout 2019 due to the weak demand for energy, gas prices plunged even deeper. The yearly average of spot prices dropped from 71.2 to 64.8 USD/bbl for the Brent, from 91.9 to 61.8 USD/MT for coal, and from 22.9 EUR/MWh to 13.6 EUR/MWh for natural gas at the Dutch hub TTF. In the European Union natural gas eventually became cheaper than coal for electricity generation, also thanks to the growth in the price of emission allowances (EUA) induced by the introduction of the Market Stability Reserve. Between 2018 and 2019, indeed, the EUA prices climbed from 15.7 to 24.7 EUR/tCO2.

The increased competitiveness of natural gas with respect to coal determined a change in the electricity production mix in Germany, as well as a sizeable reduction in the country's electricity exports, that impacted the interconnected electricity markets.

Switzerland: fast progress in the energy transition, deadlock in the relationship with the EU institutions

During 2019 Switzerland steadily progressed in the implementation of the Energy Strategy 2050: the contribution of new renewable-based generation increased as expected and the Mühleberg nuclear plant went off-line in December for its decommissioning. The negotiations for an institutional agreement allowing the full integration of the Swiss electricity market within the Internal Energy Market have instead been stalling. According to the EU delegation, indeed, the institutional agreement is conditional on the approval of a broader framework agreement between Switzerland and the European Union; so far, the latter has not collected sufficient political support among Swiss citizens. The full liberalization of the retail electricity market, also a precondition for the institutional agreement, is instead still in the agenda of the Federal Council for the medium term. Finally, during 2019 the Federal Parliament rejected the Federal Council proposal for a reduction or revision of the so-called "water levy" imposed on hydroelectric generation plants. Indeed, the Federal Council decided to retain the existing cap of 110 CHF/kW at least until the full revision of the electricity market design planned for 2025.

The European Union: ambitious plans for 2030 and positive results in the Ukraine and Brexit issues

In the European Union 2019 brough about interesting news as regards the long-term energy policy and a few geopolitical issues.

- In the first semester the outgoing European Parliament approved the last four bills of the Clean Energy Package, aimed at defining the sustainability and competitiveness targets for the Internal Energy Market by 2030. The Package entails ambitious plans, but fails to provide binding national targets. Member States are indeed requested to define 10-year national action plans and submit them to the European Commission, that is expected to approve the final versions by summer 2020,
- A few months after the approval of the Clean Energy Package, the new European Commission led by Ursula van der Leyen announced a "Green New Deal", an overarching plan that should push forward the climate neutrality goal,
- However, while the European Union as a whole is in line with its 2020 targets for the penetration of renewable energy sources and the reduction of greenhouse gas emissions, some Member States are not in line with their binding national targets,
- Looking instead at the geopolitical developments, 2019 recorded the last-minute renewal of the long-awaited gas transit agreement between Gazprom (Russia) and Naftogaz (Ukraine). The new agreement allowing the flow of Russian gas through Ukraine to European buyers is crucial for the security of gas supply to Europe at least until 2021. The parties settled for a 5-year contract covering a smaller quantity of gas as compared to the previous years. The negotiation was facilitated by the delays occurred in the construction of the Nord Stream 2 pipeline and of some downstream connections for the same Nord Stream 2 and for the Turkstream pipeline, which made the Ukraininan route still essential,
- Finally, January 2020 saw the approval of the withdrawal agreement between the United Kingdom and the European Union. According to the agreement, the United Kindgom will be part of the Internal Energy Market until the end of 2020, and a new solution will be negotiated for the following years. Northern Ireland will instead remain within the "Single Electricity Market" of the Irish island even after December 2020.

2020: the Covid-19 pandemics drags prices towards new lows

After weakening along 2019, in the first months of 2020 energy prices sank further, as a consequence of the Covid-19 pandemics that forced China and, later on, several other countries to enact strict containment measures. Within a constantly worsening scenario, oil prices plunged deeper after the refusal of Russian oil producers to stick to the prolonged production cuts set in the OPEC+ meeting at the beginning of March. The next few weeks will be crucial to understand who will blink first among Russia, Saudi Arabia, and the United States, and call a halt to the collapse of oil prices.

Electricity prices plunge in Switzerland too, but electricity companies in Canton Ticino are ready to react

The Swiss electricity market also experienced a strong downward pressure in the first weeks of 2020. The first two quarters of the year will most likely show very low prices, but a slow rebound can be expected starting from the third quarter, in the hypothesis of a reasonably fast recovery from the pandemic.

The low prices on the wholesale electricity market might impact the AET, one of the largest producers in Canton Ticino, that relies heavily on clean, but not cheap hydroelectricity. The AET might overcome the critical times by resorting its sound relationship with local retailers, to a sensible marketing of its environmental-friendly productions and, in the medium term, to a further development of its technical and commercial know-how, already strengthened through the recent cooperation with the local retailer AEM. Distributors and retailers active in the Canton are protected against the worst consequences of the crisis, as their core businesses are still largely managed in a monopolistic regime. These smaller companies face however the challenge of constant technological and commercial innovation: this Report provides an overview of the steps they have already undertaken in this respect.