Energy UK

The voice of the energy industry

Energy UK Briefing – Energy Prices

Introduction

UPDATED 13/1/15:

- Wholesale prices in 2014 (p.2)
- Current forward buying (p.3)

Average dual fuel energy tariffs fell during 2014. The average of the ten best dual fuel deals in the market dropped 10 per cent over the course of 2014, with tariffs in Q4 alone seeing a 5 per cent fall.

This comes at a time when competition is increasing in the UK's energy market with more energy suppliers than ever, offering a range of deals to suit customers' needs. The latest bulletin from Cornwall Energy, looking at July to October 2014, shows there are now 26 suppliers in the market, an all-time high, with 21 of these offering dual fuel deals. The dual fuel market share of the six largest suppliers fell below 90 per cent meaning small suppliers now make up 10.5 per cent of the market as opposed to 6.1 per cent in January 2014, only nine months earlier.

Key Points

- **The average annual bill for the top ten best tariffs was £959 at the end of 2014, 10% lower than at the start of the year.**
- The market share of the small suppliers is now at 10.5% - the highest on record.
- Make up of an energy bill: **around four fifths of the make-up of a typical energy bill is outside the control of the energy supplier**. The typical dual fuel energy bill can be broken down as follows[1]:
  - 49% wholesale cost
  - 21% network and distribution costs
  - 13% operating costs
  - 8% environmental and social costs
  - 5% VAT
  - 4% pre-tax profit

Changes in average tariffs – prices are falling

Data for 2014 shows that the average price for the top ten tariffs on offer fell by between 6 per cent and 11 percent for dual fuel, gas and electricity. The largest reduction was in gas which dropped by 11 per cent over the twelve month period. The dual fuel average fell by 10 per cent and the electricity average fell by 6 per cent. Energy UK breaks down the figures into four categories per account type: cheapest tariff; median tariff; average tariff; and top ten average. The results for the whole of 2014 show prices falling over the year in every single case.

The average of the ten best dual fuel deals on offer is £959 and there are six deals cheaper than that. The cheapest deal was £934 for the year. The top ten was made up of both large and small suppliers. It is worth noting that even in the last few days the average of the top ten has fallen even further.

		All tariffs and payment methods – 1st Jan – 31st Dec 2014[2]			
		01/01/2014	31/12/2014	Difference	%
Gas	Cheapest	£517	£504	-£13	-2%
	Median	£705	£696	-£8	-1%
	Average	£702	£674	-£27	-4%
	Top 10 average	£588	£524	-£64	-11%
Electricity	Cheapest	£454	£432	-£22	-5%
	Median	£541	£541	-£0	-0%
	Average	£546	£538	-£8	-1%
	Top 10 average	£475	£446	-£28	-6%
Dual	Cheapest	£1,025	£937	-£88	-9%
	Median	£1,232	£1,200	-£32	-3%
	Average	£1,230	£1,191	-£38	-3%
	Top 10 average	£1,061	£959	-£102	-10%

Source: Energylinx

[1] Source: Ofgem SMI 2013 (based on Consolidated Segmental Statements)

[2] Customer profile: Medium User (3,200 KWh electricity and 13,500 KWh gas)

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Wholesale markets and forward purchasing

Wholesale energy prices fluctuate in response to a number of factors including supply and demand, geopolitical risk and market trends. Companies try to stabilise how these prices feed through to customers via their individual forward buying strategies. If customers were to be subject to the volatile prices of the wholesale markets, household bills would be much less manageable and the cost of particular usage patterns much less certain. Therefore, just as when wholesale prices go up on a day-to-day basis, when they fall on a day-to-day basis companies do not instantly reflect these changes but incorporate them into a longer-term stable price for customers.

- **Energy Suppliers do not buy at today's prices -** In their modelling, Ofgem assumes that energy suppliers purchase wholesale electricity / gas up to 18 months ahead of delivery, although the actual contracts bought will depend upon each firms hedging strategy. Therefore, recent falls in wholesale costs will not alter the price of delivery in the short term.

- **The time lag applies whether prices are rising or falling -** Ofgem's report: The Energy Supply Probe – Initial Findings 2008 found that for a number of reasons, including those set out above, there is a lag between changes in wholesale prices and retail prices. No evidence was found that this lag is greater when prices are falling than when they are rising.

Energy UK publishes monthly wholesale market reports for gas and electricity which summarise the wholesale markets:

Wholesale Electricity Market Report – November 2014

Wholesale Gas Market Report – November 2014

Wholesale prices in 2014

There is no single wholesale gas or electricity price. As outlined in the table below, there are a number of different time periods over which to buy gas and electricity. Prices on the wholesale markets fluctuated throughout 2014. The price for buying energy on the day it is delivered fell by 16 per cent for gas and 6 per cent for electricity. However, suppliers are able to buy energy ahead of time to protect companies and customers from volatility in the wholesale market. Wholesale prices for gas bought in 2014 for delivery one year ahead fell by only 3 per cent while electricity did not fall at all.

This tendency to buy ahead means that drops in spot and short term prices do not translate directly into falls in retail prices. However, the drop in the price of new tariffs in the table on page one shows companies have been passing on savings as and when they can.

	Average baseload prices[3] to deliver electricity and gas in January and December 2014 (£/MWh)			
	Jan 14	Dec 14	Difference	% change
Spot E	£48	£45	-£3	-6%
Month ahead E	£54	£48	-£6	-12%
Season ahead E	£54	£50	-£5	-8%
Year ahead E	£54	£55	£0	0%
Two years ahead E	£56	£56	£1	1%
Spot G	£22	£19	-£3	-16%
Month ahead G	£24	£19	-£6	-23%
Season ahead G	£24	£21	-£4	-16%
Year ahead G	£24	£23	-£1	-3%
Two years ahead G	£24	£24	-£0	-1%

Sources: ICE, APX, National Grid, LEBA

[3] Spot = average of daily prices, month ahead = average of month ahead contracts, season ahead = average to deliver winter 13-14 / winter 14-15, year ahead = average to deliver winter 13-14 / winter 14-15 two seasons ahead, two year ahead = average to deliver winter 13-14 / winter 14-15 four seasons ahead. All average prices are baseload prices.

Current forward buying

Falls in the current spot market will not necessarily translate into cheaper prices in a year's time. Energy suppliers can still forward buy energy into the future to protect customers. The figures below illustrate trading prices to deliver up until January 2016.

Electricity for delivery in January 2016 could have been bought at £58 per MWh two years ahead (bought in January 2014) and £52 per MWh one year ahead (bought in January 2015). These prices are respectively 5 per cent lower and 3 per higher than for delivery in January 2015.

For gas, the figures are 13 per lower and 4 per cent lower respectively for delivery in January 2016 than for delivery in January 2015.

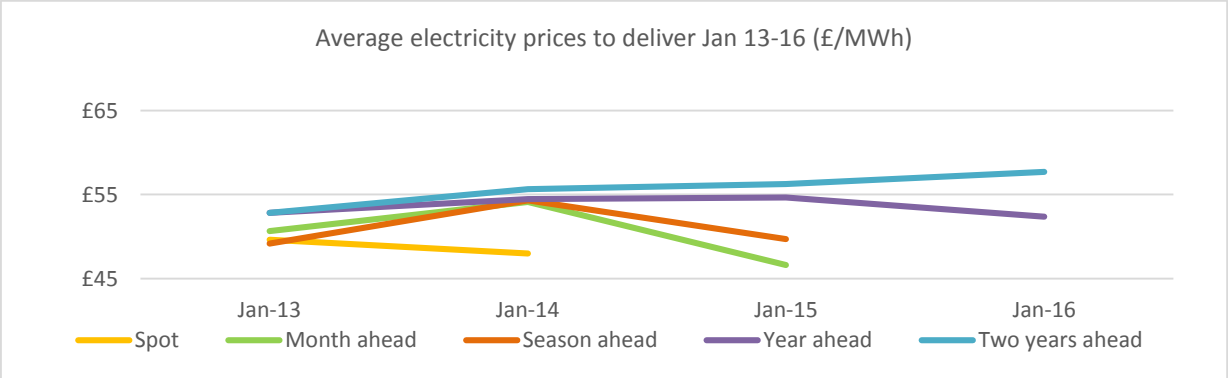
The table also shows that the cost of electricity bought a year ahead for delivery in January 2015 was 3 per cent higher than the cost of electricity bought a year ahead for delivery in January 2014. This means that some of the electricity being used now but bought a year ago is more expensive than the electricity used this time last year but bought a year prior.

The cost of gas bought and delivered for the same time period dropped by around 4 per cent.

	Average baseload prices4 to deliver electricity and gas (£/MWh)							
	Electricity				Gas			
	Jan-13	Jan-14	Jan-15	Jan-16	Jan-13	Jan-14	Jan-15	Jan-16
Spot	£50	£48			£23	£22		
Month ahead	£51	£54	£47		£23	£24		
Season ahead	£49	£54	£50		£23	£24	£21	
Year ahead	£53	£54	£55	£52	£24	£24	£23	£20
Two years ahead	£53	£56	£56	£58	£21	£24	£24	£23

Sources: ICE, APX, National Grid, LEBA

The graph below shows trading currently taking place on five trading periods. The price in the short-term periods (spot, month and season) have dropped whereas the one-year and two-year ahead periods have remained comparatively steady or even risen.



[4] Spot = average of daily prices, month ahead = average of month ahead contracts, season ahead = average to deliver winter 13-14 / winter 14-15, year ahead = average to deliver winter 13-14 / winter 14-15 two seasons ahead, two year ahead = average to deliver winter 13-14 / winter 14-15 four seasons ahead. All average prices are baseload prices.

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Competition in the energy market

Number of suppliers

The number of suppliers operating in the UK domestic market has reached an **all-time high of 26**. This follows the launch of a new dual fuel supplier and the conversion of an electricity supplier to dual fuel. There are now 21 suppliers offering dual fuel tariff to domestic customers. A further three suppliers offer only gas and a further two offer only electricity. This means **four out of five suppliers offer dual fuel tariffs**.

Aggregate market share

The combined market share of the UK's six largest energy suppliers fell between 31 July and 31 October. Small suppliers passed a significant milestone by gaining a further 1.5 per cent of the dual fuel market bringing their market share to 10.5 per cent. The aggregate market share of the major suppliers also fell by 1.2 per cent for gas and electricity accounts bringing the totals to 91.2 per cent and 91.4 per cent respectively.

Measure of competitiveness

Energy UK uses the Herfindahl-Hirschman Index (HHI) to measure market concentration in the energy sector. Between the months in questions the scores for gas, electricity and dual fuel fell across the board meaning that there was increased competition in all three markets.

	Domestic energy market competition indicators at 31 October 2014		
	Electricity	Gas	Dual Fuel
Customers ('000)	27,325 (135)	22,665 (70)	19,150 (60)
HHI	1,521 (-34)	2,135 (-50)	1,689 (-36)
Number of suppliers	23 (22)	24 (22)	21 (19)
Aggregate major supplier share	91.4% (-1.2pp)	91.2% (-1.2pp)	89.5% (-1.5pp)

Source: Cornwall Energy

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