

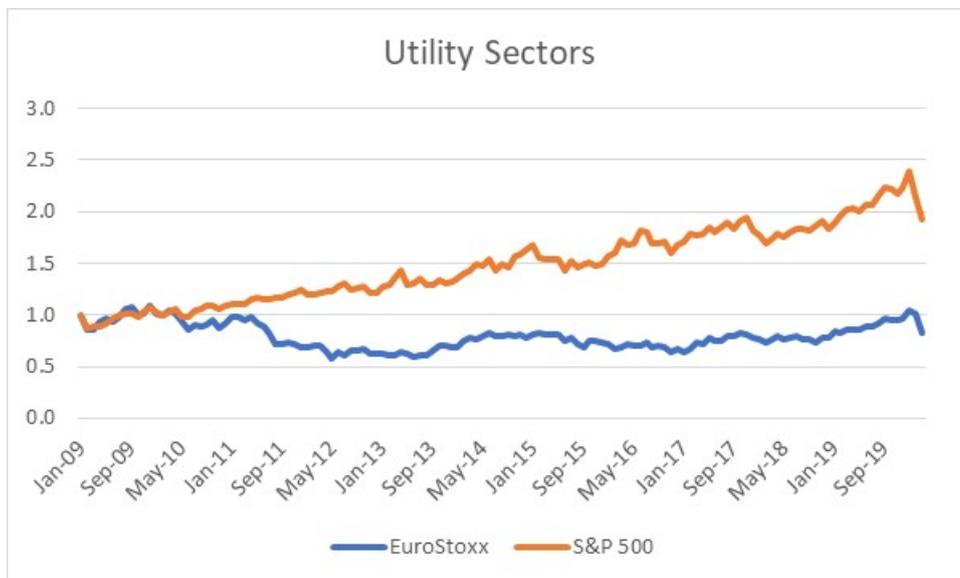
MAXIMUM UTILITY



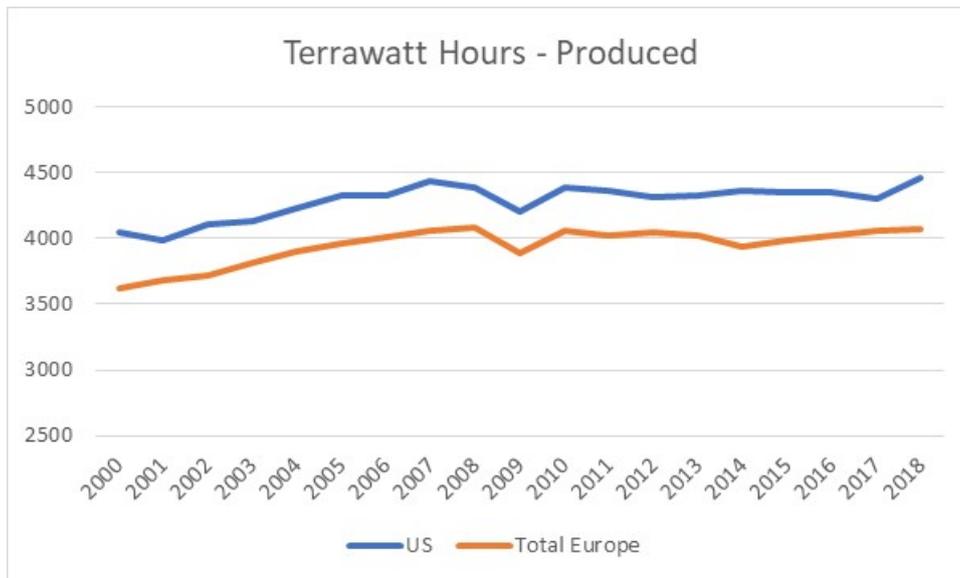
Russell Clark's
Market Views

“The biggest US utility sector is electricity generation, and locally produced natural gas is its main fuel source. What if the growth of US natural gas production comes to an end?”

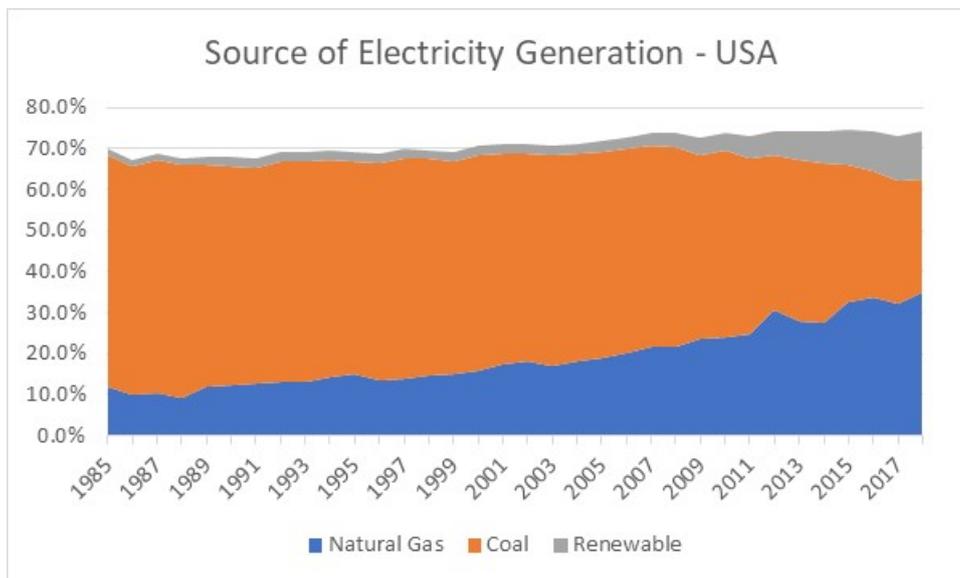
Since the 2009 financial crisis, the US utility sector has outperformed the European utility sectors substantially. This is despite the US having higher interest rates for most of this period.



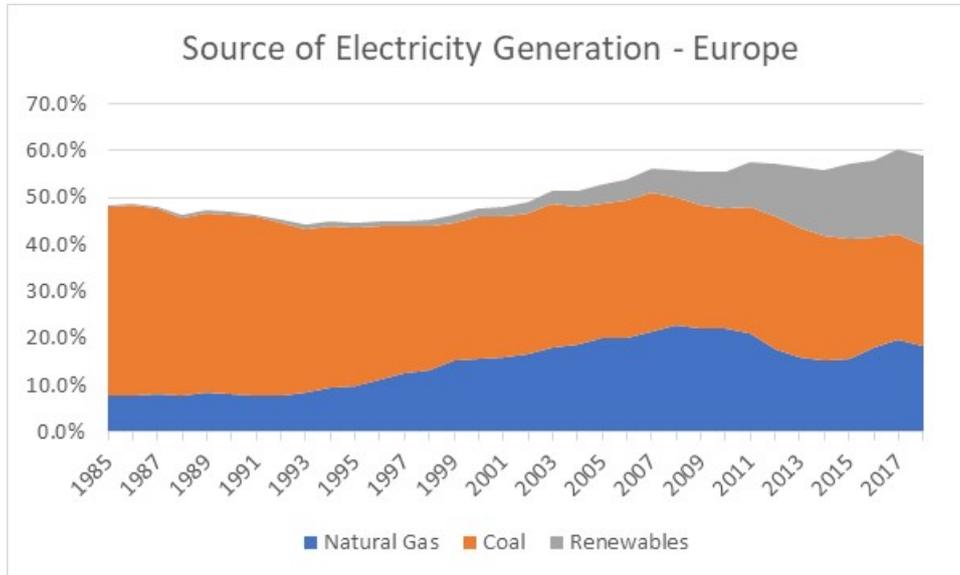
The biggest utility sector tends to be electricity generation. Both regions have seen similar trends in electricity generation over the last 20 years.



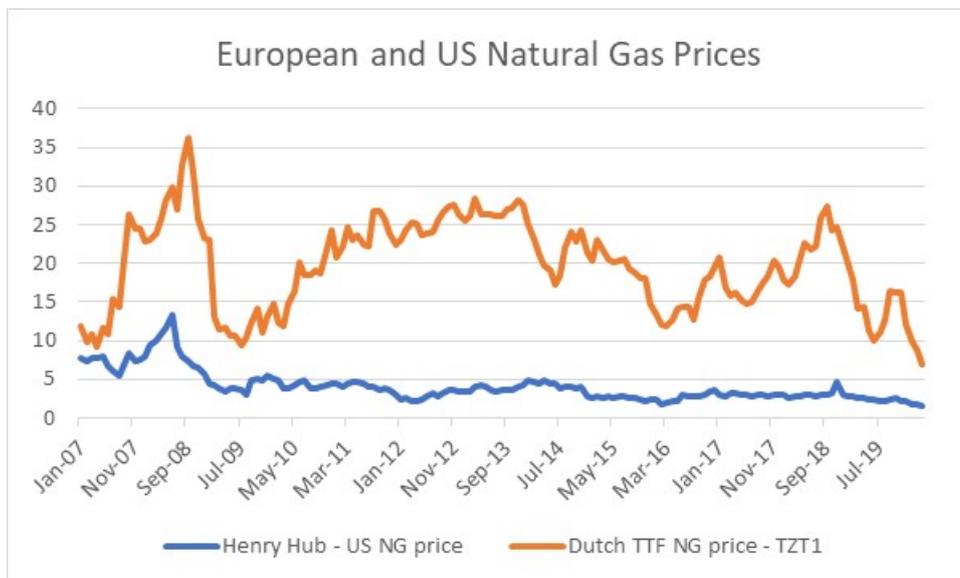
One driver of the difference in performance of the US versus European electricity generation has been the change in composition of fuel sources for the US and Europe. In the US, natural gas has increased its share of electricity generation significantly, followed by renewables. Coal has seen a steep reduction in its use as a power source.



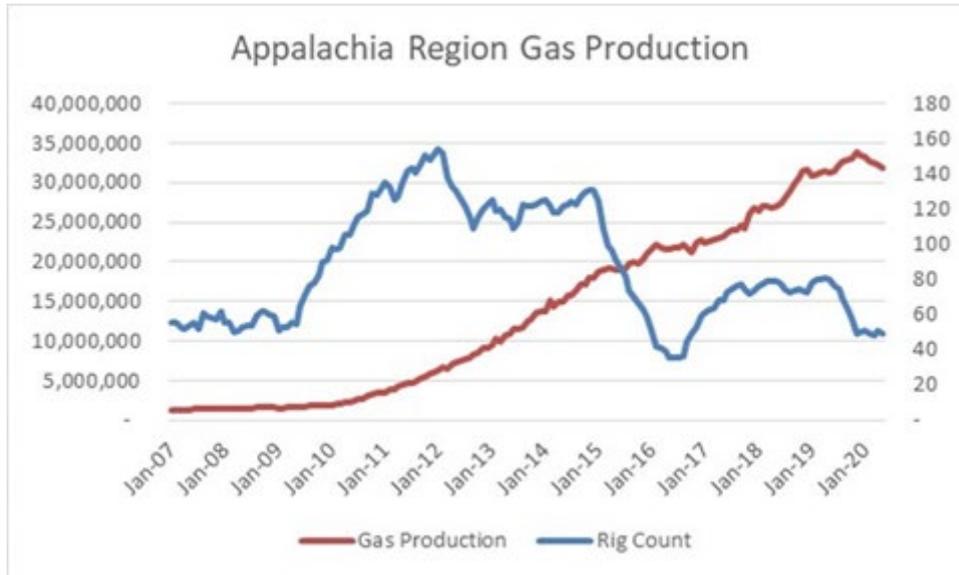
In contrast, Europe has seen the growth of renewable generation sources reduce the usage of both natural gas and coal as a source of power generation.



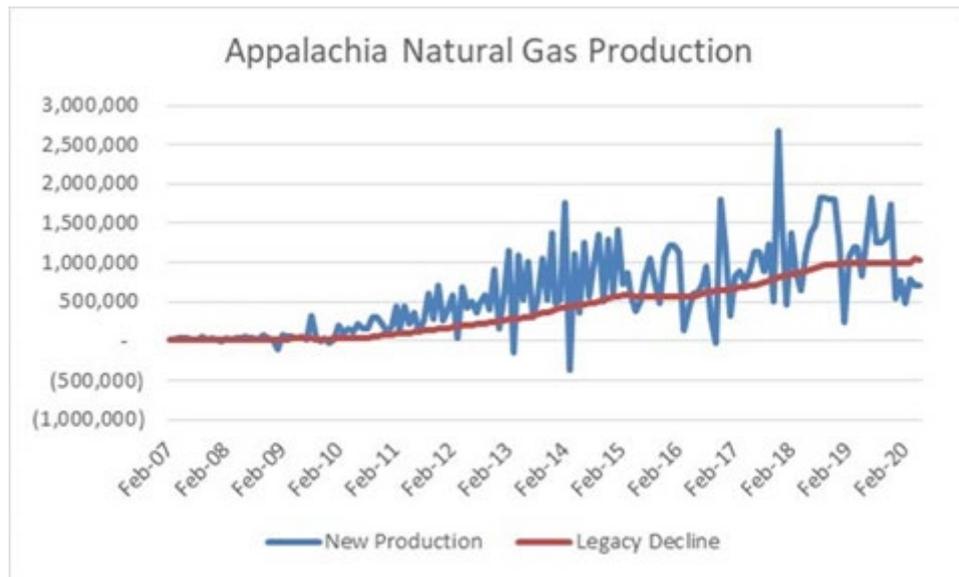
The cost of coal and renewable generation in Europe and the USA is roughly comparable. However, electricity generation using natural gas is very different between the US and Europe. Natural gas prices in the US have collapsed relative to Europe, making electricity generation from natural gas more profitable. European natural gas prices have remained much higher than the US, due to the falling Euro and a much tighter link to oil prices.



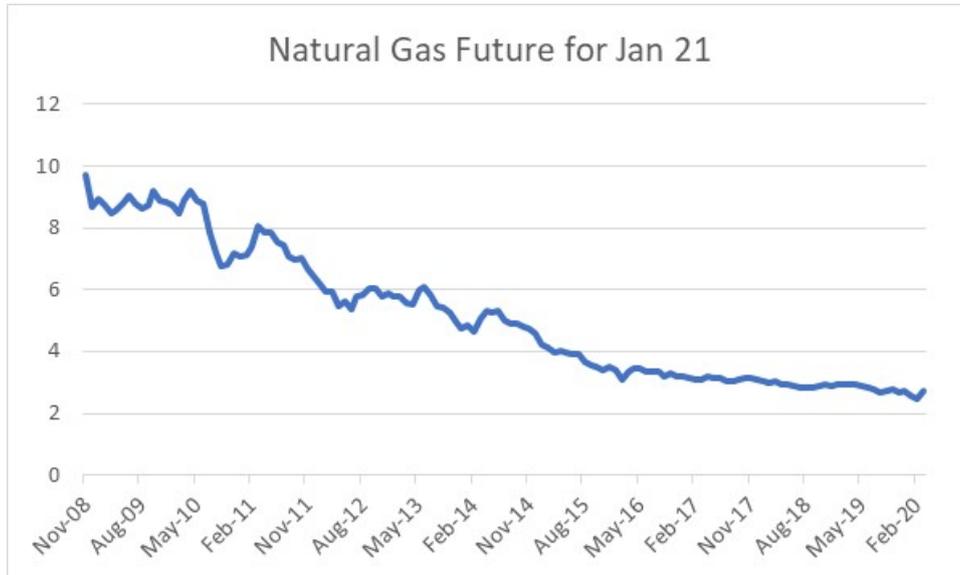
The problem for US utilities is that the endless growth in US natural gas production looks to be coming to an end. The giant Appalachia basin has seen production fall in recent months, rig count has declined significantly, and this is even before the recent fall in oil prices.



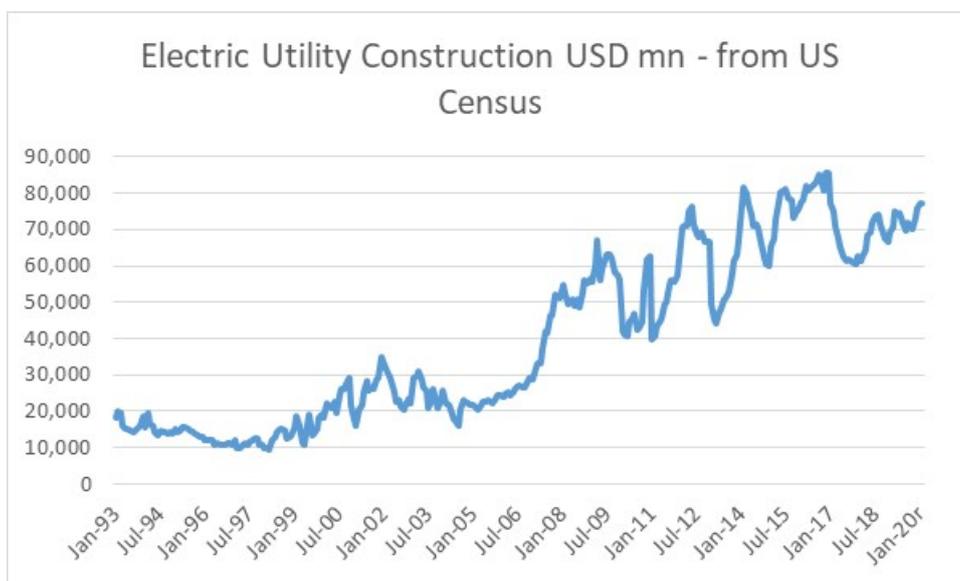
The decline in production has been driven by an ever-rising decline ratio, which means that reversing this decline will be very difficult.



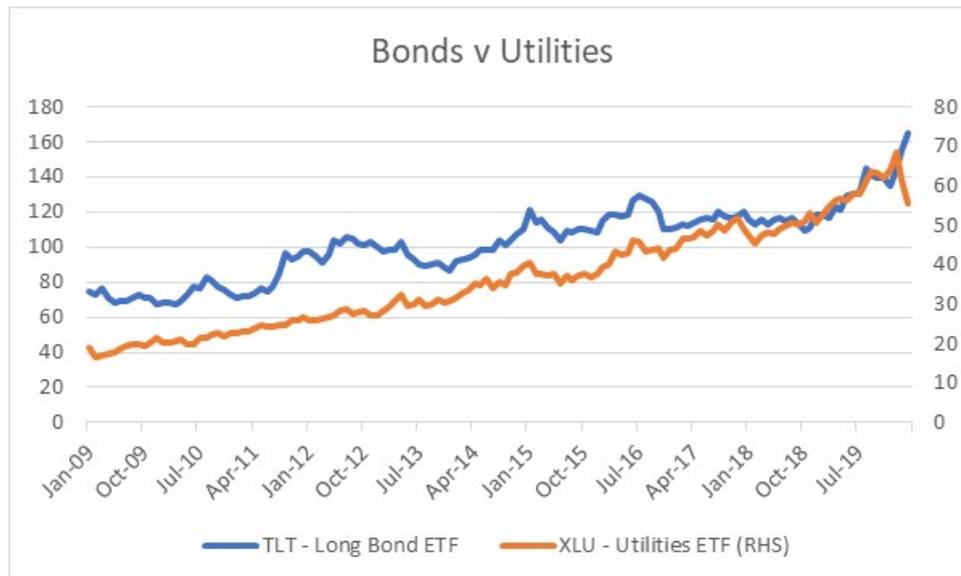
The huge growth (and now possible fall) in US natural gas production can be seen in the history of the January 2021 natural gas future. From a high of USD 10 in 2008, it has been in continual decline. However, in March 2020, as oil prices collapsed, this gas future rose in price.



This falling cost has seen the utility sector embark on a building boom. Construction of electricity generation has been very strong. The building boom into stagnant electricity demand suggests profitability could be at risk in a recession.



This change in the natural gas market may explain the sudden weakness in utilities in comparison to government bonds, a relationship that has been in place for more than 10 years.



US utilities have been maximising their profits through shifting from coal to gas, but this macro trend looks to be ending. We have probably seen maximum utility.

INFORMATION

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