ERCOT Market Not Phased
U.S. Power and Gas Weekly

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Data Sources Used in This Publication
ERCOT
ICE

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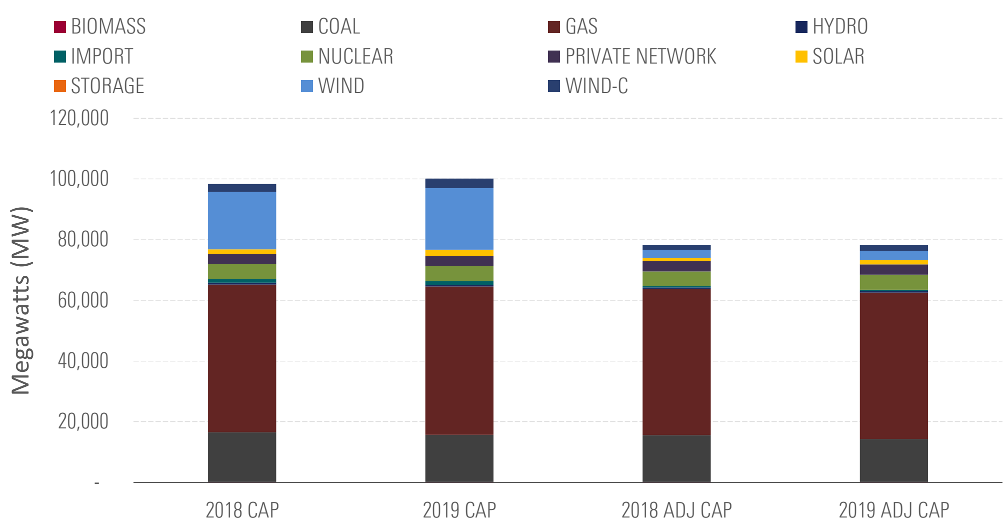
ERCOT Summer Reserve

ERCOT's preliminary summer reserve estimate, released earlier this month, is a low 3,301 megawatts (MW) compared with last year's final assessment at 5,428 MW. ERCOT officials have also indicated heightened alarm risk potential for needed emergency actions over the summer to maintain reliability. One would think the market might take note and experience exciting and elevated prices. Yet relative to last year when North Hub futures rallied near $200/Mwh, it is now only just over $100. This note reviews ERCOT's market temperature in light of expected tight capacity.

Generation Fleet

Of note with the expected loss of 2,127 MW of reserve capacity this summer is the current generation projection showing just a 30-megawatt (MW) capacity difference from last year. As can be seen in Exhibit 1, this change is insignificant. While last year's coal retirements largely drove market excitement, their loss, in large part, did not live up to expectations. This happened because the adjusted capacity figures used to ensure enough reserve to meet summer peak load understate intermittent renewable capacity. Since ERCOT's reserve estimate stresses for conservative and not average or optimal generation levels, it understates intermittent renewable generation. This year the difference between total capacity and total adjusted capacity is again high at over 22,019 MW for the upcoming summer.

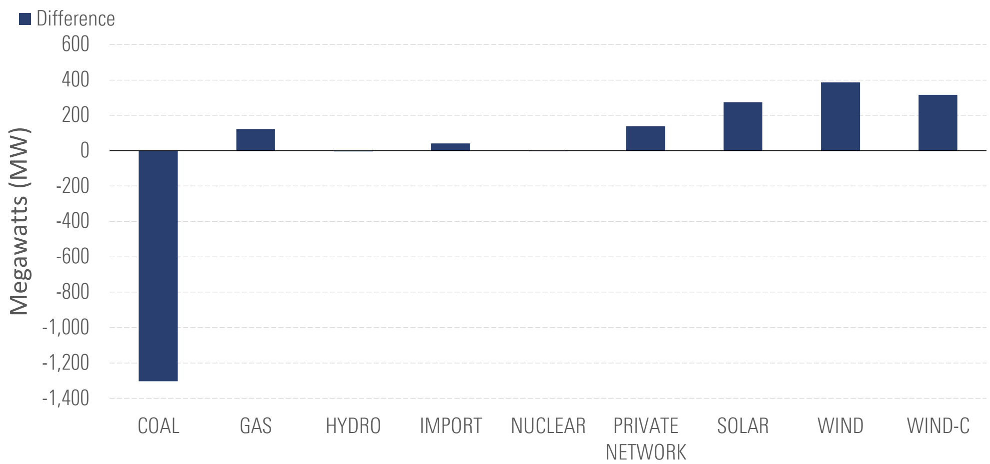
Exhibit 1 2018 vs. 2019 ERCOT Generation Capacity Mix



Source: ERCOT, Morningstar.

While the overall level of MWs is almost unchanged, this upcoming summer sees a change in the generation fleet that has added more renewables and natural gas and reduced coal, as you can see in Exhibit 2. This trend continues in ERCOT as it does in the total U.S. The two plant closures that led to a large coal reduction are J.T. Deely and Gibbons Creek with a combined 1,310 MW capacity. On the gain side, as noted previously, (see ERCOT Solar Set to Climb), not only is wind being built out, but solar is also growing in ERCOT. An expected doubling of solar generation capacity over the next two years will help curtail midday heat when the sun is shining, driving heavy load and low wind conditions. This increases bearish downside possibilities for ERCOT during the upcoming summer months.

Exhibit 2 2018 vs. 2019 Capacity Difference

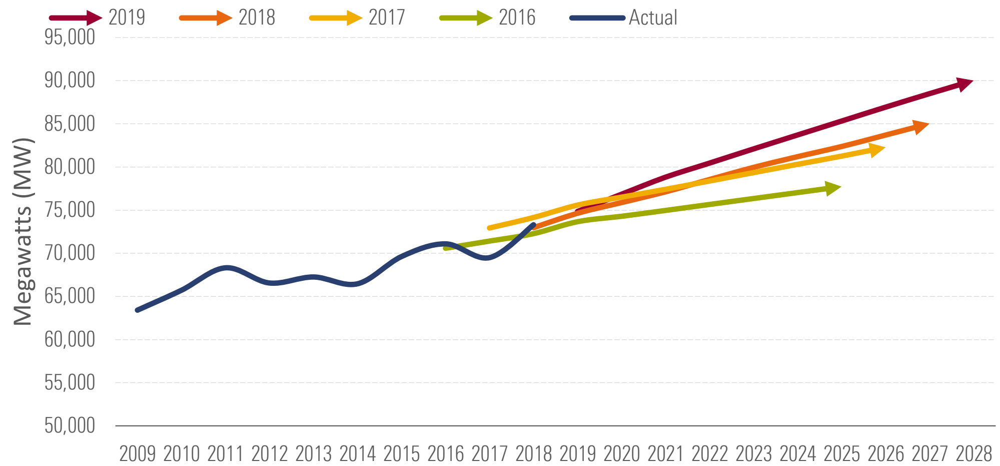


Source: ERCOT, Morningstar.

Load Expectations

ERCOT is projecting a near 2% load increase year on year of 1,879 MW based on recent trajectories. From 2009 to 2018 the historic annual increase was 1.6%. This year's load increase shrinks the reserve margin from last year with the generating stack mostly unchanged. As can be seen below in Exhibit 3 the trajectory of ERCOT's annual long-term forecast keeps revising upward. Two main drivers are pushing this increase—industrial load in West Zone and Houston Zone is growing with LNG terminal buildouts, and Permian oil and gas drilling demand continues to expand. While baseload industrial growth is increasing, added extreme cooling degree day potential over the summer is also driving a higher peak load.

Exhibit 3 ERCOT Long-Term Load Forecasts

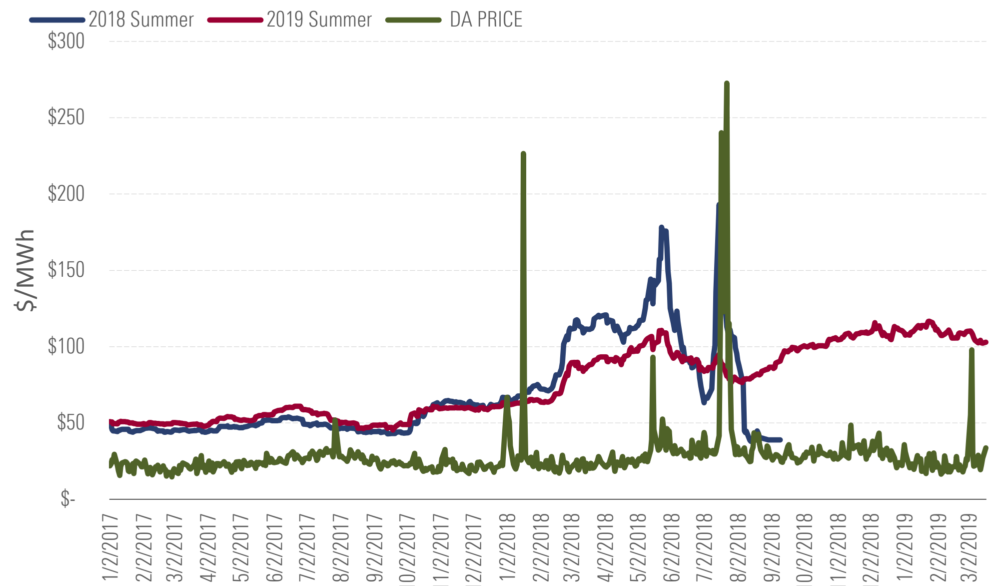


Source: ERCOT, Morningstar

ERCOT Futures

Despite an even smaller projected reserve margin in ERCOT this summer versus last, the market has not seen the added volatility experienced last year. In Exhibit 4 you can see the 2019 summer strip (red line) increase in line with last year's rise (blue line) after an initial price spike in January. Last year, other than January, ERCOT only saw the month of July experience daily price pops that attempted to justify the premium traded into the entire 2018 summer strip. Outside of July, the rest of the summer turned out to be a considerably bearish bust. With cheaper wind and solar in the stack and a few more MW of storage the likely scenario will be the same this year. While some hours or even a handful of days will almost certainly spike toward quadruple-digit prices in high load and low wind days, we expect that the ambient wind and now increasingly solar capacity will weight prices lower over most hours during the summer months and reduce the upside risk that made ERCOT so dangerous in the past.

Exhibit 4 2018 vs. 2019 Summer Strip North Hub

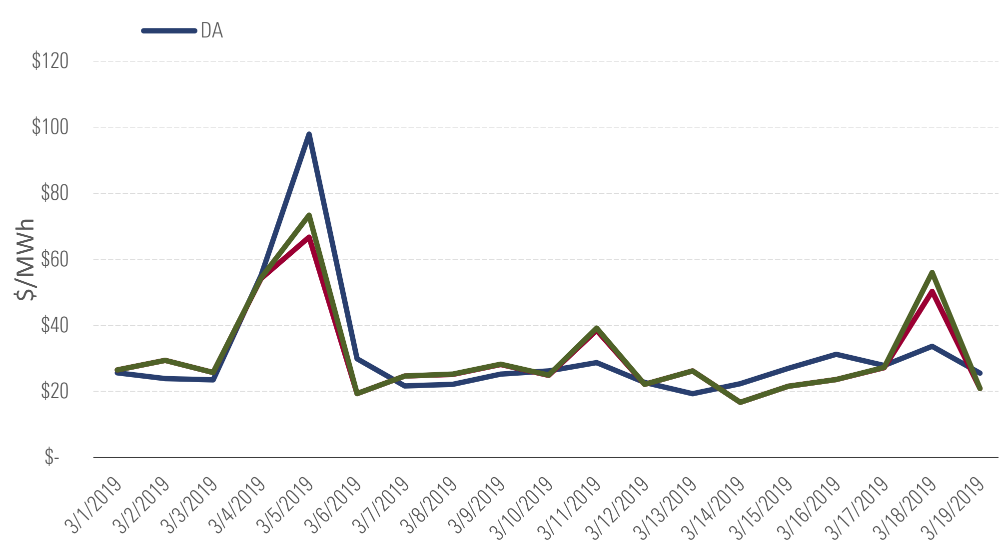


Source: ICE, Morningstar.

Recent Volatility

This month has seen increased volatility in ERCOT. Last year in January the daily volatility was a spark that fueled rampant speculation over the ISO being able to get through summer without some costly emergency actions and tight SCED situations. This year despite recent price spikes, summer futures have continued a slight retreat. With the price hovering a bit over a $100/MWh for the month any premium is largely built in. Last year only July broke the $100 mark with June and August not even able to break $40, indicating that the upside potential this year at $100 is very limited.

Exhibit 5 ERCOT North Hub Price



Source: ERCOT, Morningstar.

ERCOT Expectations

After last year, market expectation is so far more subdued in ERCOT. Futures are still pricing within a tight range around $100/MW, and at that level the risk is mostly built in. The 2 and 3 handles seen last year likely will not reappear without a stronger or sustained indicator. Even with the reserve margin looking tighter, ISO statements expressing greater concern than last year, and RT and DA volatility jumping in before summer gets going, the market remains unphased given the way prices have dropped in the last month.

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