Commentary

Global Utilities & Independent Power Producers 2024 Outlook: A Steady Track to Electrification

Morningstar DBRS
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Key Highlights

- Our outlook for the industry is neutral despite the significant capital expenditures needed for the electrification of the economy – which could pressure balance sheets for the next few years.
- We expect customer bills to remain a top concern but anticipate electricity prices to be more stable this year relative to the past few year.
- Overall, we expect credit ratings to remain stable.

Tom Li
Senior Vice President
Energy & Natural Resources
+1 416 597-7378
tom.li@morningstar.com

Adam Provencher
Vice President
Infrastructure, Power & Utilities
+1 416 597-7476
adam.provencher@morningstar.com

Steven Lin
Assistant Vice President
Energy & Natural Resources
+1 416 597-7596
steven.lin@morningstar.com

2024 Outlook: Neutral

We view the 2024 outlook for utilities and independent power producers (IPP) to be neutral. While we believe the sector continues to face challenges driven by climate change and general affordability concerns, these have been tempered somewhat by interest rates that appear to be stabilizing and lower inflationary pressures (see our Commentary *2024 Sovereign Outlook: Higher Rates and Slowing Economies, but Stable Credit Ratings*, published December 8, 2023). We expect the general trend this year and in the next few years to revolve around electrification and decarbonization of the economy, with the pace of investment likely to quicken in order for the industry to meet government targets to reduce fossil fuel-based power generation.

Credit Ratings to Remain Stable

Overall, we expect rating changes (if any) to be event based and issuer specific, driven by possible mergers, acquisitions, or poor performance. Our sector ratings have been resilient largely because of the stable regulatory frameworks in place for utilities and the high level of contracted or hedged output for IPPs. The significant capital needs for the electrification of the economy could pressure some balance sheets though, so medium-term capital expenditures (capex) plans will be a particular focus for us for the year.

Significant Capital Spending for Electrification

Government-imposed deadlines on climate change-related targets are quickly approaching. These include targets for phasing out coal-fired generation plants or achieving minimum renewable power generation.

Exhibit 1 Coal Phase-Out Targets

Country	Coal Phase-Out Target Year
Canada	2030
Finland	2029
France	2027
Germany	2038
Great Britain	2024
Norway	2025
Spain	2030
U.S.	2035

Significant capital is being invested by sector participants in order to build replacement renewable and clean energy power generation. Additionally, as wind and solar are intermittent sources of energy, new baseload units (such as nuclear) and peaking units (such as natural gas-fired plants) may need to be built—at least until battery storage technology is more advanced. Furthermore, to accommodate the new plants as well as the transition to electric vehicles and electric heating, transmission and distribution networks will also need to be upgraded and extended to handle the expected greater capacity and demand.

We expect the pace of investment to hasten in 2024 as government-mandated deadlines approach. While many of these projects present opportunities for utilities to increase their rate bases and for IPPs to grow their portfolios, their pace and scale could pressure some companies' financial risk profiles. This financial risk is partly offset by government initiatives and subsidies to support electrification and grid upgrades, but there will be a need to closely observe how IPPs and utilities tap these available funds. The higher interest rate environment has also made debt financing of these projects more expensive and, in some cases, has even made some uneconomic. Also, we note that some issuers held off issuing debt with longer-dated maturities in 2023. However, we expect more activity in 2024 as the interest rate environment appears to have stabilized. Nonetheless, we expect utilities and IPPs to be prudent in financing capex plans in order to maintain overall key credit metrics within their current rating thresholds.

Customer Bills Remain Top of Mind

Utility spending for the electrification of the economy will ultimately be borne by ratepayers, which could translate to higher bills for customers. This challenge is compounded by the ongoing cost of living pressures from the high inflationary environment in 2023. While interest rates seem to have stabilized and the rate of inflation has slowed, our macroeconomic outlook for 2024 remains cautious with growth expected to be subdued. Moreover, a mild recession in North America and throughout Europe remains a possibility. We expect pocketbook issues, including utility bills, to remain top of mind in 2024. While we have not seen further material political interference in the regulatory process for utilities in 2023, this will remain a heightened risk at least over the short term.

Wholesale Prices Expected To Be Less Volatile

On the other hand, we generally expect natural gas prices to be less volatile in 2024 because of higher storage in both the U.S. and Europe (see our commentaries *North American Natural Gas Market Outlook: Price Pressures Through Early 2024 Followed by a Recovery* published December 18, 2023, and *European Gas Outlook: Cautious Optimism for the Winter Heating Season But with Prices Subject to Possible High Volatility* published December 21, 2023) although a colder-than-average winter could lead to some price swings.

We cautiously anticipate wholesale electricity prices to be more stable this year relative to the past few years. We note, however, that given the increasing amount of intermittent renewable generation coming into service, there could be additional price volatility in the future. Furthermore, as noted in our commentary *North American Merchant Wholesale Electricity Prices: Overall Subdued, but No Escape From Price Volatility* published December 6, 2023, unpredictable weather patterns as a result of climate change will increasingly lead to electricity price spikes. We expect our issuers to mitigate this risk through their hedging strategies and contracting their generation portfolios.

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