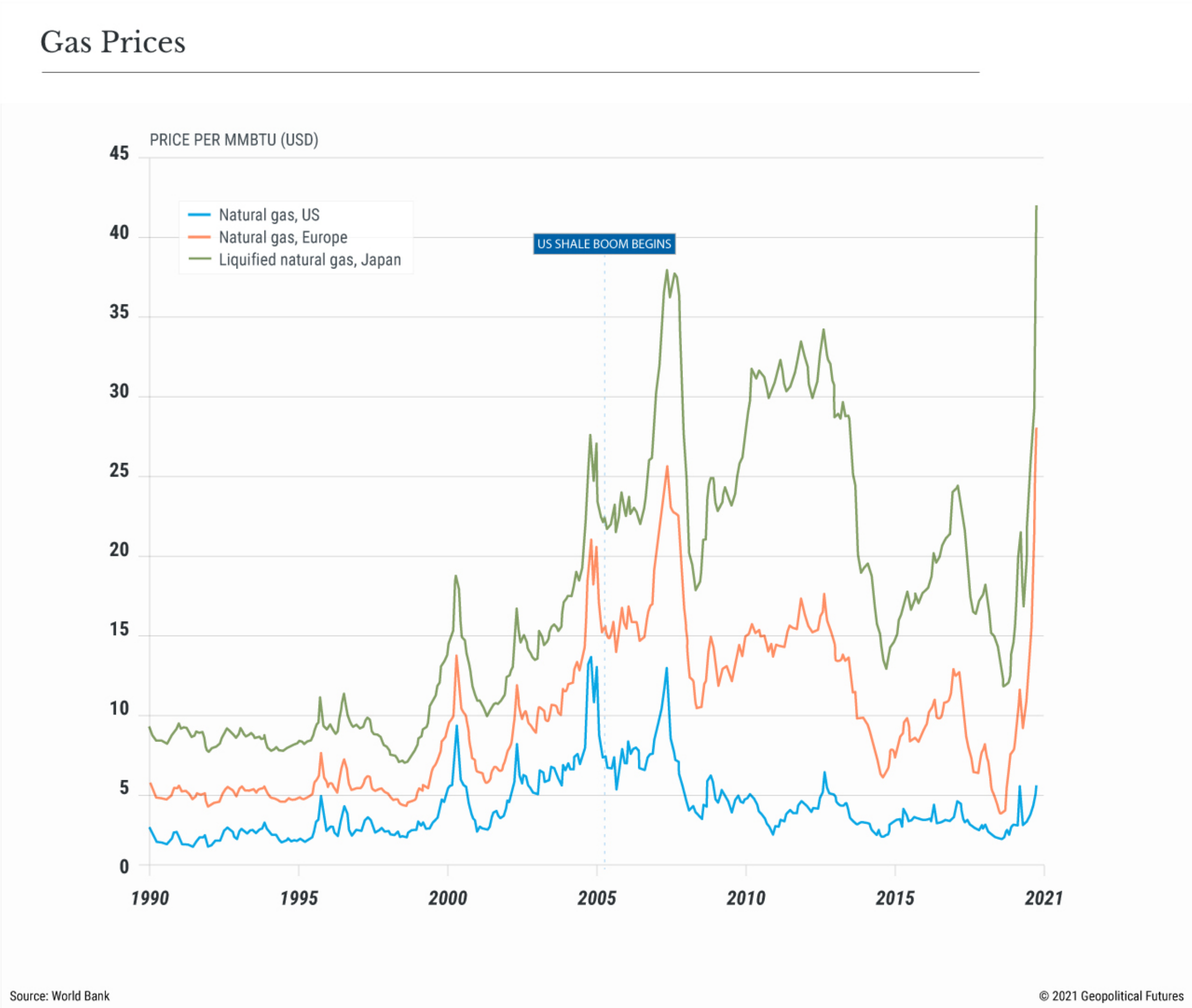
What's Driving the Spike in Energy Prices?

by Antonia Colibasanu - October 12, 2021

Inflation has been a big story around the world for much of 2021. But the spike in prices for consumer goods should have been expected, given that we knew economies and consumer demand would be picking back up after a year of lockdowns. What wasn't expected, however, were the dramatic spikes in the cost of energy, especially natural gas. Indeed, natural gas prices have seen record highs in parts of the Western world in recent months, and that's unlikely to change as winter approaches. While all the data isn't in yet, we can point to some factors that got us to this point.



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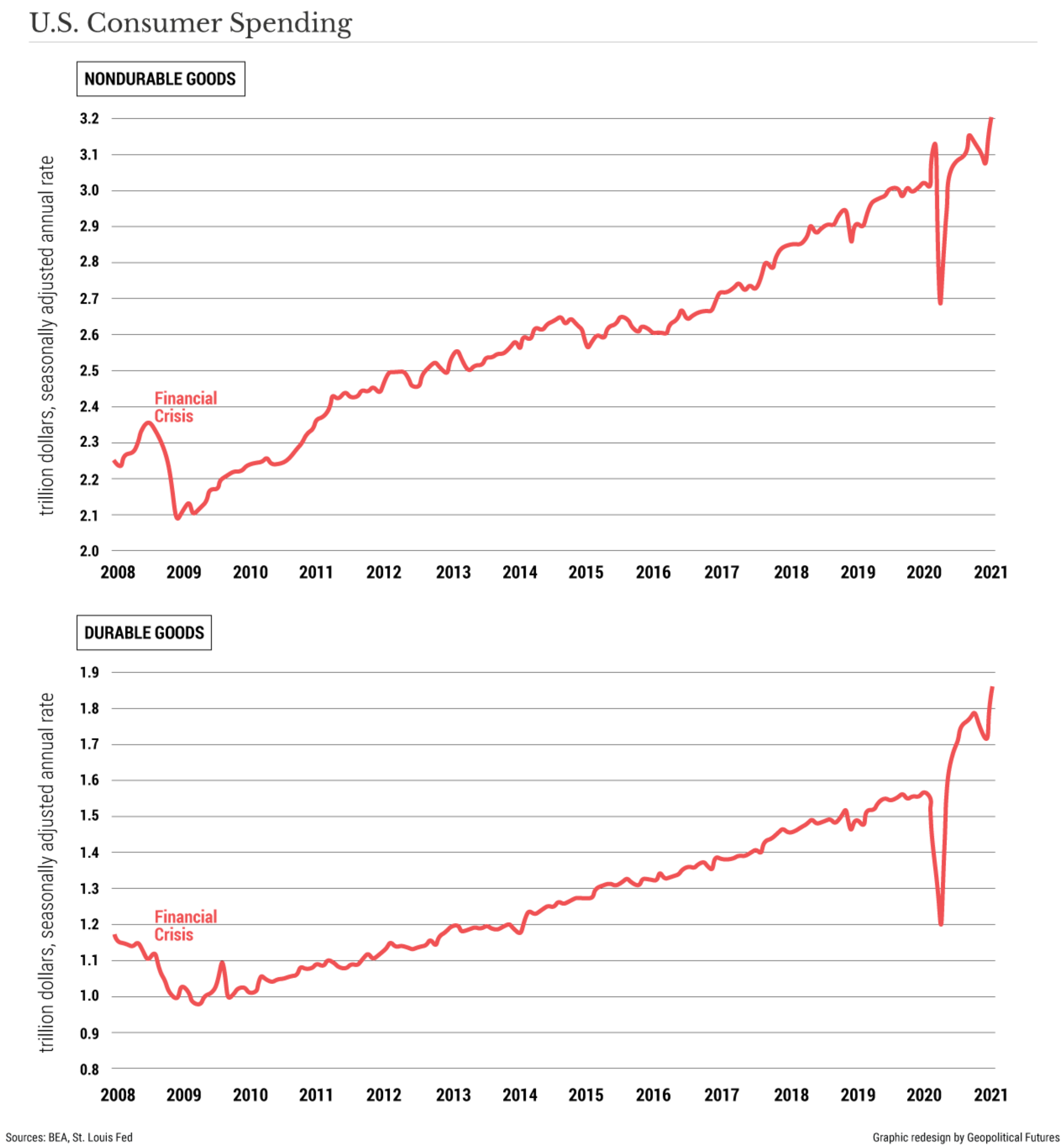
2021 in a Nutshell

Though 2021 began much the way 2020 ended, things gradually began to feel more "normal" as the summer season kicked off, with quarantine measures easing or ending nearly everywhere. But it was a new kind of normal. As restaurants reopened, demand for food supplies increased, causing shortages of certain goods, while other products were in abundant supply – a cycle that forced the food production chain to quickly adapt and led to increased energy consumption, among other things. As people began traveling again, they used their cars more, causing demand for gasoline to soar. And as the fall approached and people prepared for another season of working from home (a reminder that the pandemic is far from over), consumption of pretty much everything manufactured increased as well. Indeed, sales of durable goods – which include things like computers, phones, home appliances and furniture – surged in 2021. But the increase in demand really began in 2020 when, despite the economic pain of the pandemic, many people in developed countries had money to spend and, because of the lockdowns and travel restrictions, nowhere to spend it.



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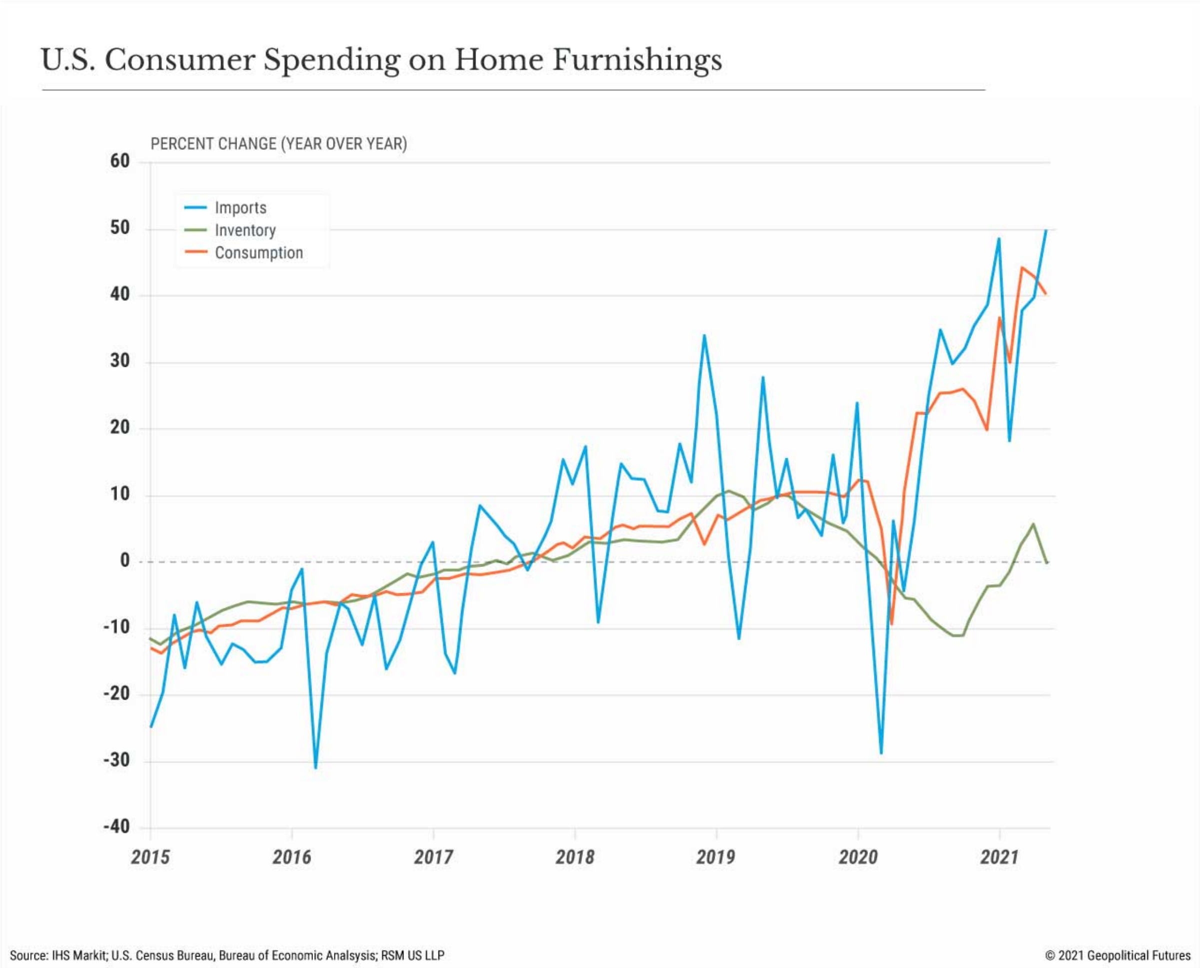

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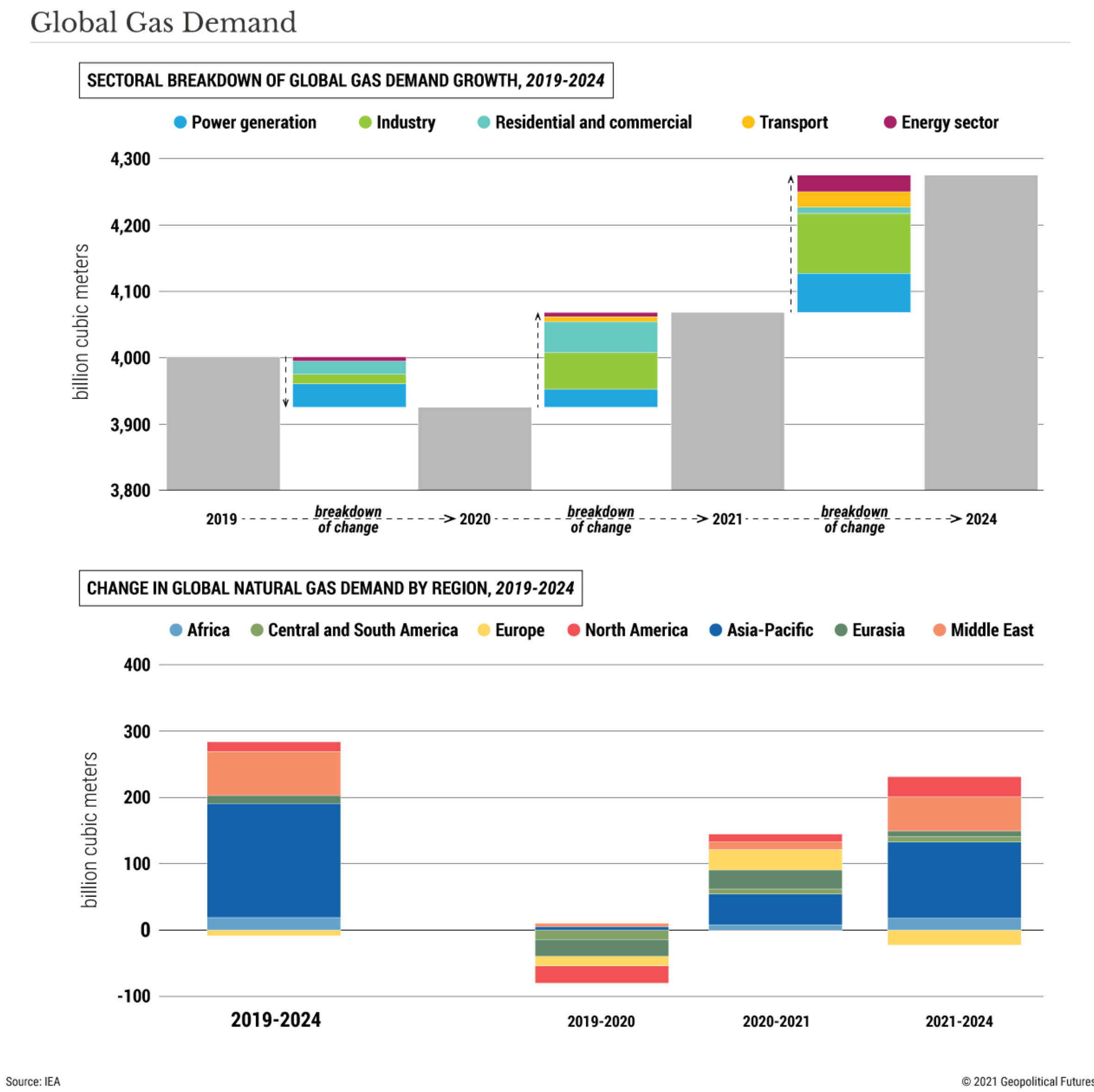
This placed a strain on infrastructure and logistics because the goods had to be delivered, not just to consumers but also to retailers, creating all sorts of other problems. Most consumer products sold in the Western world came from China and other developing countries, but very few went in the other direction, which created an imbalance in delivery patterns. This led to a shipping container shortage and rising shipping costs, which also contributed to the inflation problem. At the same time, global manufacturers were forced to adjust to rising orders, shifting production to meet demand in one area, which led to insufficient supplies in another. For example, surging demand for electronic goods led to a shortage of semiconductors for the automobile industry.

The pandemic also caused changes in social and workplace behaviors. Some are staying away from crowded, enclosed places like buses and subways. Some are still working remotely. This latter trend has enabled people to move away from where their jobs are located to places with more affordable housing. Thus, there's been a noticeable shift away from the cities. Though hard data on the topic isn't available yet, we know anecdotally that a significant portion of the adult population is relocating. Retirees and those close to retirement age have been making the move for some time, but now those in their mid-30s and early 40s are also relocating to places where single-family homes are less expensive. Thus, boomers and millennials (who account for the majority of the population in Europe and the United States) are making similar lifestyle shifts at the same time – which leads to more changes in consumption patterns. This will have consequences not only for the real estate market and construction industry (for which the cost of supplies like lumber was already high) but also for manufacturers of home furnishings and other consumer goods.

Impacts on the Energy Market

All these factors are driving changes in the energy market. Both consumers and industry are responsible for the rising energy demand – which explains why the cost of natural gas, in particular, has spiked considerably over the past few weeks. In much of the developed world, natural gas is the most common fuel used to produce electricity. Along with other petrochemicals, it's also a critical component in the manufacture of virtually everything from lipstick to furniture, to pesticides, to glass, and even diapers and face masks.



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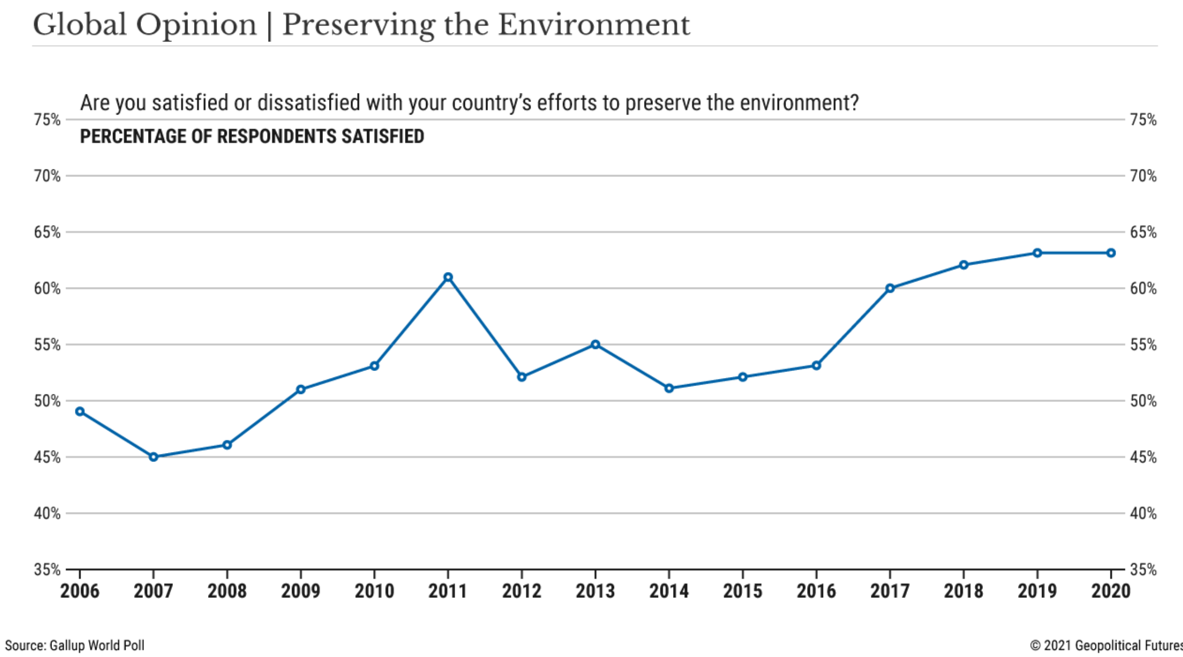
Compounding the problem was an especially cold winter of 2020-21, followed by an extremely hot summer. It left many gas storage facilities worldwide empty or nearly empty. At the same time, with concerns rising about the effects of climate change, policymakers are under pressure to commit to green initiatives – which has led to a steady increase in prices for transitional energy sources like natural gas.



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Other factors also played a role. In March, a container ship ran aground in the Suez Canal, blocking traffic for a week and preventing energy supplies from reaching Europe. (In fact, this was when the first spikes in the price of both oil and natural gas became apparent.) In April, Texas saw record low temperatures that caused disruptions in crude oil production, which pushed 3 million barrels of oil (over 20 percent of U.S. output) offline. This had a spillover effect in Mexico, where industry and at least 5 million consumers were impacted, creating the second shock that jacked up prices. In May, a ransomware attack targeting the Colonial Pipeline blocked gasoline from being delivered to the U.S. Eastern Seaboard for about two weeks. In August, Hurricane Ida forced oil and gas production in the Gulf of Mexico to shut down for a number of weeks, prompting another spike in energy prices. In addition, the surge in COVID-19 cases in India, led by the delta variant, suspended most port operations there, impacting half the country's oil supply.

Now, winter is coming, and we can expect more cold temperatures and erratic consumer behavior. Meanwhile, storage facilities are still running low and manufacturers are consuming more. All this likely means higher prices are here to stay, at least for now.

It's still unclear where we go from here. Some of the explanations above resulted from systemic problems, which one would expect to flare up during a recovery from a significant economic downtown. What we need to understand better is how demographics played into this. Why are people really choosing to relocate and will they come back? What's driving the labor shortages? And how exactly are they related to the energy crunch?

Without more data, we can't answer these questions, and without answers to these questions, we can't create a model for what the future might look like. The pandemic has changed how humans socialize – and that is key to understanding how global markets will behave.

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