ENERGY PRICES: OUTLOOK FOR 2010

In this briefing, EEF looks at the outlook for industrial energy prices in 2010 through three scenarios for the price of oil driven by conditions in the global economy. The scenarios illustrate a range of possible outcomes, but should not be taken as accurate guides to what energy prices will actually be next year.

The past 18 months have been a roller coaster ride for energy prices and those paying them. But what can we expect looking forward? Economic growth, through its impact on demand, is the single most important driver of energy prices. The outlook for the global economy in 2010 remains uncertain. Opinions differ as to whether the tentative signs of recovery will prove ephemeral, are indicative of a gradual recovery or herald a quick return to strong growth next year.

EEF has modelled the impact on industrial energy prices of three different oil price scenarios for 2010 based on the state of the global economy. We look at how a '**double dip recession**', a **gradual recovery** and a **robust recovery** in 2010 might affect oil prices and in turn the energy prices paid by manufacturers. The price of oil, because it is such a widely used and traded commodity, is especially sensitive to the state of the global economy. A dramatic illustration of the strength of this connection was provided by the collapse in the price of oil in the second half of 2008 triggered by the economic downturn. In turn, most industrial and power generation fuel prices are typically closely correlated to trends in oil prices. Although the impact of movements in the price of crude on gas and electricity prices is lagged and smoothed over time because the effect is factored into supply contracts over time.

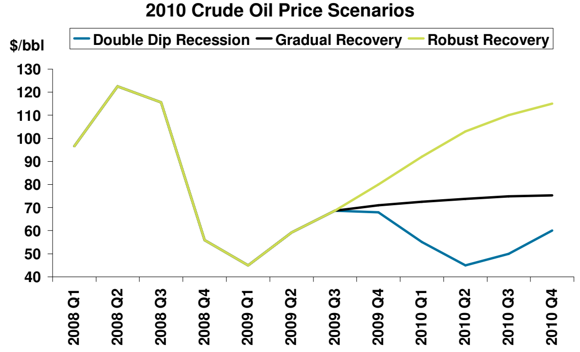
It should be noted that energy prices depend on a wide range of factors of which the state of the global economy is just one, albeit an influential one. For example country-specific factors, such as unforeseen disruptions to key infrastructure (e.g. networks, gas fields and power stations), can have a major impact on local energy prices in the short-run.

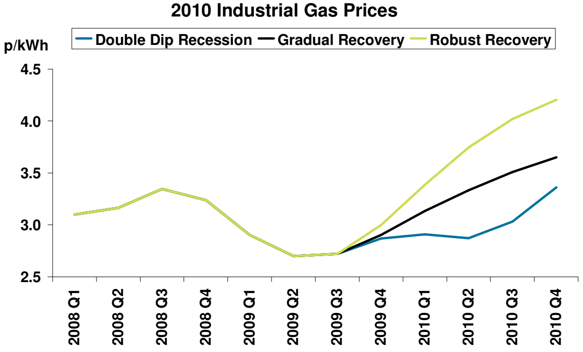
Key Messages

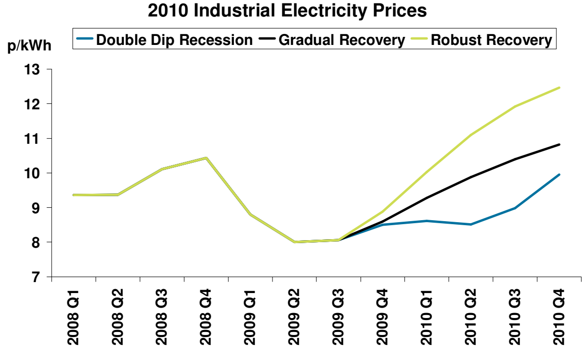
- Under all three scenarios, the energy prices paid by manufacturers increase by the end of 2010
- Under the **Gradual Recovery** and **Robust Recovery** scenarios energy prices end of 2010 33%-50% higher than they are now, surpassing their 2008 peaks
- Even under the **Double Dip Recession** scenario**,** prices rebound sharply to finish 2010 about 20% higher than they are now
- All three scenarios suggest that manufacturers might benefit from contracting or re-contracting for energy as early as possible in 2010

For further information contact EEF's Energy Adviser, Roger Salomone, **rsalomone@eef.org.uk**

ENERGY PRICES: OUTLOOK FOR 2010







1. **Double Dip Recession:** recent signs of recovery prove short-lived and the global economy begins to weaken again from Q4 2009 as the effect of economic stimulus packages wear off, falling back into recession in Q1 and Q2 of 2010. Oil prices drop rapidly in the first half of 2010 as demand collapses, before rebounding in the second half of the year as the economy emerges from recession and demand picks up again. Industrial gas and electricity are relatively stable in the first half of 2010, averaging around 2.9p/kWh and 8.5p/kWh respectively in the run up to the April contracting round. Prices then rebound sharply as the recovering economy stokes demand for energy. The upturn in energy prices is sharp because the low prices earlier in the year freed up cash for households and business to spend in other areas which reinforces the recovery. In the run up to the October contracting round gas and electricity prices could be in the region of 3-4p/kWh and 9-10p/kWh respectively.
2. **Gradual Recovery:** the combination of steady economic growth and the gradual depletion of oil inventories built up during the recession result in modest growth in the price of oil across 2010. Industrial gas and electricity are in the region of 3.1-3.3p/kWh and 9.3-9.6p/kWh respectively in the run up to the April contracting round. By October, the cumulative effect of growing demand and inventory depletion could see gas prices move to around 3.5-3.7p/kWh and electricity prices to 10.4-10.8p/kWh.
3. **Robust Recovery:** the global economy continues to recover in Q4 2009 and grows strongly throughout 2010. Oil prices increase rapidly in Q1 and Q2 of 2010 as the prospect of significant growth in demand is factored into the price by the market. Prices continue to rise in the second half of the year as oil inventories deplete and strong demand begins to expose underlying constraints on production levels resulting from underinvestment in oil fields in some parts of the world. During the April contracting round gas and electricity prices could be in the region of 3.4-3.7p/kWh and 10-11p/kWh respectively. By October gas prices could have risen to around 4.0-4.2p/kWh and electricity prices to somewhere in the region of 11.9-12.5p/kWh.

For further information contact EEF's Energy Adviser, Roger Salomone, **rsalomone@eef.org.uk**