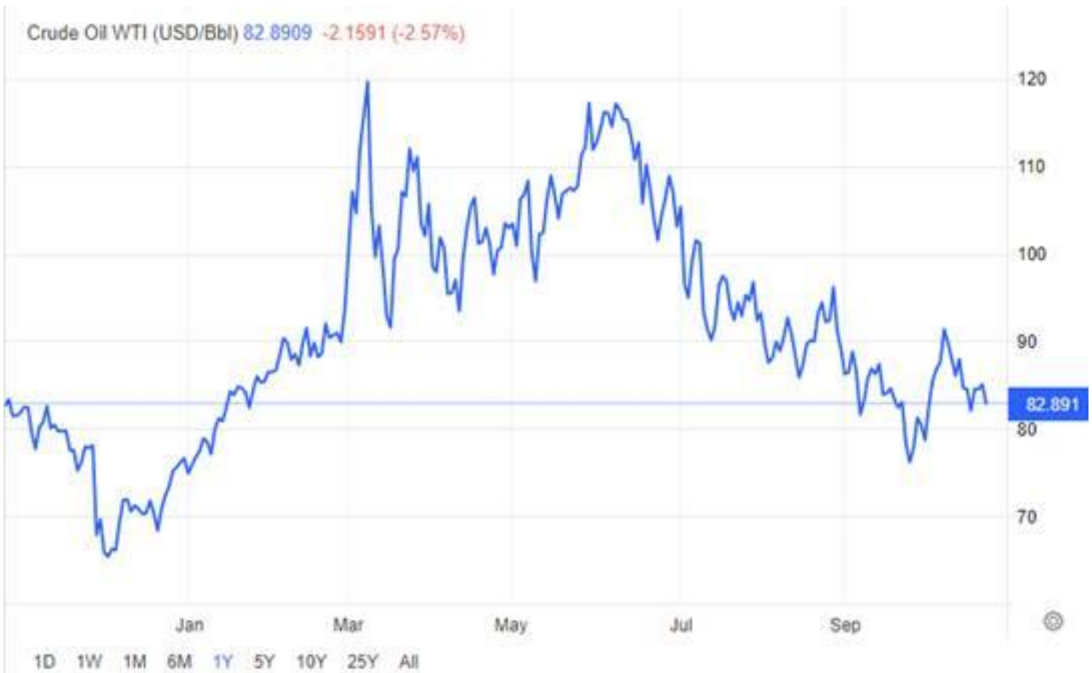
Gas & Oil prices and their impacts on the CPI

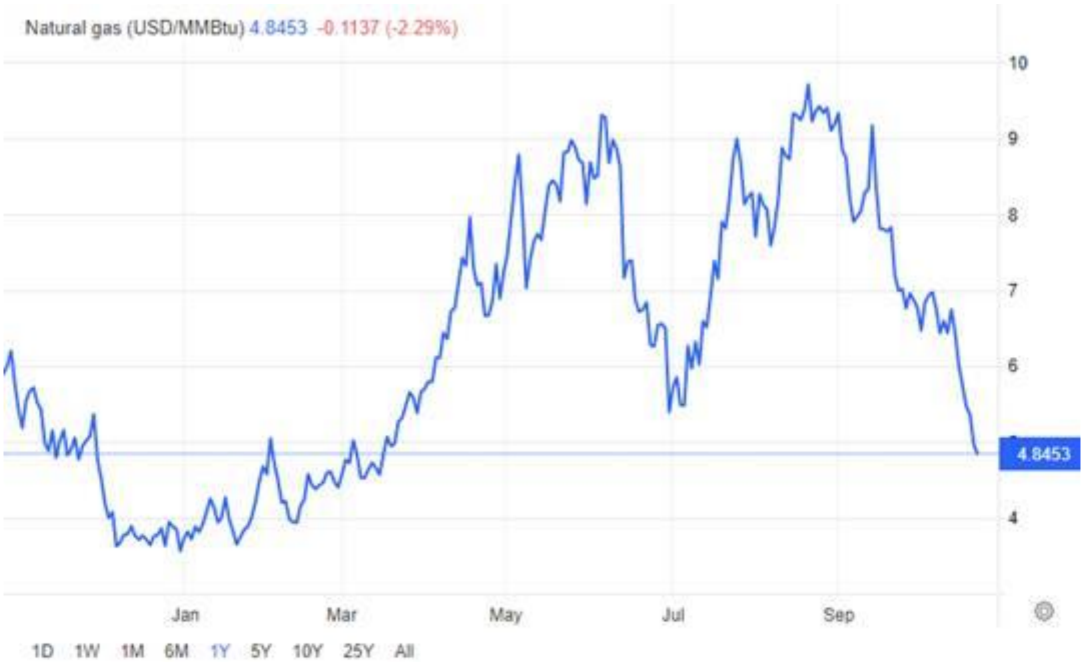
Oil price jumped just after the attempted invasion of Ukraine by Russia. It stayed at a historic high level until the beginning of the Summer. Since then, mainly due to the anticipation of a slowdown of demand in oil in the coming months by the Energy International Agency (EIA), the oil price went down. It has reached a level below USD 80 per barrel, just before OPEC+ set to reduce output from November. The price is not very close to the level observed one year ago. As it can be observed in the graph, **if prices remain in the current range of USD 80-90 per barrel during the first half of 2023, <u>it will have a large deflationary impact</u>.**



More recently**, the focus was on the evolution of the gas price** as European economy remains very dependent on gas import and also due to the impact of the gas price on the electricity pricing. These elements had recently a huge impact on inflation, especially in Europe affecting production industries but also directly consumers. But here again, recent news is rather reassuring.

The US natural gas future continued to fell last week, the 9th consecutive week of falls and the lower level since March. Forecasts of lower weather-driven demand, record US domestic production levels but also reduced liquefied natural gas exports allowed important gas storage. According to the EIA, last week US utilities companies added more than 111 billion cubic feet of natural gas to storage, well above 91 billion cubic feet inject injected during the same week one year ago and well above a five-year average increase of 73 billion cubic feet. At the same time, gas demand is expected to slow down. **Gas prices are now below last year and as for oil, <u>they may have also a clear deflationary impact in 2023 in the US.</u>**

October 2022



In Europe, it is slightly more complicated as both oil and gas prices are denominated in USD and the dollar has been particularly strong vs all major currencies, including the Swiss franc. But the same trend can be observed with the EU Dutch TTF, Europe's wholesale gas price. The price drop accelerated recently due to some announcements like EU join natural gas purchases, gas supply, including LNG, remains high but also thanks to easing demand as temperatures in Europe are still warmer-than-usual. In this positive environment, Europe's gas storages have reached more than 92% (Germany 96%, France 99%). The target of the European commission is still to decorrelate the gas and the electricity prices but **<u>the recent impressive drop of the gas price should also have an immediate positive impact on electricity prices in Europe and of course on the CPI.</u>**

Other positive news on the EU energy front

The scenario of gas shortage in Europe seems to disappear
Norway has become the biggest gas supplier in Europe. Europe is also importing LNG for the US, representing about 20% of the Russian gas supply). Imports from Azerbaijan but especially from Algeria have increased significantly. The first German floating module to get LNG should be ready next Spring. It may deal up to 6% of gas needed in Germany. 5 other modules are under construction. France has also started to export gas to Germany (which is then exporting electricity to France). Note that Russia continues to export some gas to Europe, via the Ukrainian pipelines.

What about a possible blackout?
The situation remains under control but cards have been re-dealt. France is now more the biggest electricity exporter in Europe. During the first 6 months of 2022, Sweden and Germany exported around 16 Tw each. On the opposite, at the end of July, France had to import 2.5 TWh, while during the first part of 2021, the country exported 21.5 TWh ! The closing of about half of the 56 French nuclear reactors explains these figures. This situation should persist in the coming months as the timetable of the reactivation of the nuclear power plants shared by EDF will for sure not be reached. For that reason, Germany decided to maintain in activity its 3 latest nuclear power plants under mid-April.

Note that Europe, including Switzerland, is acting to reduce gas and electricity demand. French Gas or Electricity suppliers like GRTgas or Engie have all announced a drop of demand coming especially from gas intensive industries, reaching up to 30% (steel industry reduced production due to record electricity prices) but also from private consumers. In Switzerland, Swissgrid indicated that in September, electricity demand dropped by 13% vs the average of the last 7 years. However, warmer-than-usual temperatures may also explain a large part of these decreases.

Conclusions

On the positive side:

- The recent drop in oil and gas prices is a very good news in the very short term but also regarding the impact on the 2023 CPI.
- Currently gas supply remains high in Europe and the demand is contained (positive weather conditions + positive impacts of measures to reduce consumption)
- Gas storage at a very high level in Europe

A few uncertainties:

- French nuclear power plants availability still a concern especially in the heart of winter when electricity demand is picking up
- Temperatures as a key metric for demand (again positive impact in October)
- Uncertainties about Russian reactions