

Market Summary

Market prices across the whole energy spectrum have continued to increase sharply throughout the second quarter of 2008; oil has climbed from \$94 / barrel at the beginning of the year to over \$145 in June, although it has since eased back around \$140.

The principal drivers behind the gains in oil appear to be the weakness of the dollar relative to other major currencies prompting investors to seek better returns in commodities, geopolitical tensions – in particular unrest in Nigeria inhibiting production, and Iranian nuclear supply prompting rumours of an Israeli strike. Talk of \$150 a barrel and even \$200 in the near future simply fuel the speculative activity and heighten market pessimism.

Oil prices are heavily influencing gas and power wholesale prices which have increased by 76% and 62% respectively since the beginning of the year. Coal has also been influencing power prices, with spot and forward prices setting almost daily records due to supply concerns.

There have been recent reports that household energy bills will rise by 40% in 2008 which, given the increases in wholesale prices is not unexpected. Increased food and energy costs are now having a visible impact in the economy; increases of this magnitude in domestic energy bills would in turn increase RPI by another 1% - it stood at 4.3% in the year to June.

Note: the difference between the increases in costs passed on to domestic consumers, and those faced by industrial and commercial consumers is due to the breakdown in the delivered costs for each – non energy costs such as metering and use of the transmission and distribution systems account for around half of the domestic energy bill, but only 20% of a typical industrial and commercial consumer's energy bill.

Outlook

There are early signs that demand for oil is weakening due to high prices. However, a significant market correction in the next two months is considered unlikely as the prices of gas and electricity continue to be supported by the strength of fuel input costs in the short term, gas remains attractive relative to coal so demand for gas for power production is likely to be sustained through the summer, and European gas prices are now rising due to the lagged effect of their indexation to oil prices.

For further information check our website for energy updates or contact us: