

Special Commentary – Spike in energy prices won't derail U.S. recovery, different story globally

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What happened

Global energy commodity prices have quickly spiked. Benchmark European natural gas (natgas) prices have spiked more than 180% since early August, while U.S. natgas has jumped over 60% (slide 3). Crude oil prices jumped as well, albeit not to the same magnitude (slide 4).

The widely-held narrative is global natgas supplies will be inadequate for the colder winter months, particularly in Europe, where natgas fuels roughly 20% of electric power generation. The United Kingdom (U.K.) is the epicenter of the natgas supply/power generation fears after Britain's main undersea electricity cable connected to France burned, knocking out capacity until March 2022.

Although the U.S. does not have power generation issues, natgas supplies are roughly 7% below the five-year average, while Gulf of Mexico production has been hampered by Hurricane Ida, with more than 70% still not back on line.

China is having its own electricity generation issues due to a lack of coal, mostly due to issues at China's three largest mines along with an ongoing trade spat with Australia, which had been its largest external coal source. This has caused widespread power outages in China, especially in the northeastern industrial hubs.

China's electricity shortage has increased prices for industrial users during peak times. Government officials have ordered state-owned energy companies to secure coal supplies for this winter at all costs.

Commodity	Price change since August 1, 2021
U.S. natural gas ¹	61.3%
U.S. crude oil ²	6.7%
Brent crude oil ³	9.5%
U.K. natural gas ⁴	183.3%

Data Source: Truist IAG, Bloomberg; percentage price change from July 30, 2021 to October 5, 2021. ¹NYMEX Henry Hub natural gas. ²West Texas Intermediate crude oil. ³ICE Brent crude oil. ⁴ICE U.K. natural gas.

Coal fuels about 70% of Chinese electricity production. In response, the country's big coal miners are now pledging to boost output as winter approaches. The power outages also have global speculators believing China will use more natgas to make up the difference.

India is also experiencing electricity outages due to inadequate supplies of coal, which fuels more than 70% of its power generation (slide 5). Monsoon rains, which stop coal production in India, lasted longer than usual. Power outages cripple India's high-tech companies, which depend on stable electricity.

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Special Commentary – our take and the bottom line

Our take

In the near term, natgas prices appear to be unhinged from fundamentals. This is especially true in the U.S., where supplies are lower than normal but do not justify a 60% jump in prices. Despite the weather-related shortage, the U.S. has ample natgas supplies and should be able to ramp up production. That said, **extreme price dislocations happen, but tend to be brief spasms rather than permanent shifts** (slide 4).

The economic impact of higher energy prices is very different for the U.S. compared to the rest of the world.

U.S. economic impact – likely minimal

In our view, the direct impact on the U.S. economy should be minimal. U.S. consumers spend just 4% of after-tax income on energy goods and services (slide 6). The strain on consumers is further limited since most are sitting on a lot of cash, providing a sizable buffer for most Americans (slide 7). That said, higher gasoline prices disproportionately squeeze low-income Americans (slide 6).

Indirectly, we could see some higher prices from foreign-made goods due to increased shipping costs and lower production if power outages linger, particularly in China. This is a negative.

Yet, **the U.S. economic impact could prove to be positive.** For instance, increased energy spending stays in the U.S. since much of it is domestically produced. Thus, the increased cost to one person is higher income to another. Additionally, higher energy prices could lead to increased U.S. energy capital spending. Also, since the U.S. is a net energy exporter, including natgas (LNG) and coal, higher prices could help reduce the trade deficit. Furthermore, higher prices boost cash flows for the energy industry, helping debt servicing for bondholders and U.S. banks with loan exposure in the energy sector.

Global economic impact – exposes vulnerabilities

The economic impact globally is much more complicated. Most of Europe is clearly vulnerable to higher energy costs since it is a net importer of energy commodities. Aside from accidents (such as the U.K. fire), decarbonization and climate change have also made electricity generation in Europe more prone to power outages. For instance, wind and solar are seasonal, while droughts reduce output from hydro-electric plants. Moreover, Europe has underinvested in fossil fuel power generation.

China's power outages might exacerbate numerous production and supply chain delays. However, it is unlikely that China will turn to natgas as an alternative. Alas, higher energy costs will most certainly slow China's economic growth. Similarly, power outages and higher energy costs in India will bite into its growth.

Bottom line

The U.S. economic impact due to the recent spike in energy prices will likely be minimal and should not derail the current recovery. Modest, near-term inflation is possible as a result of the energy ripple, especially if it persists. Conversely, the U.S. could see economic benefits that offset some of the downside in the longer term.

The impact on the global economy, though, is more complicated. **It is a negative economically to net energy importers, including most of Europe, China, and India.** Additionally, power outages in China might exacerbate production and supply chain delays and could further dent growth in the second largest economy.

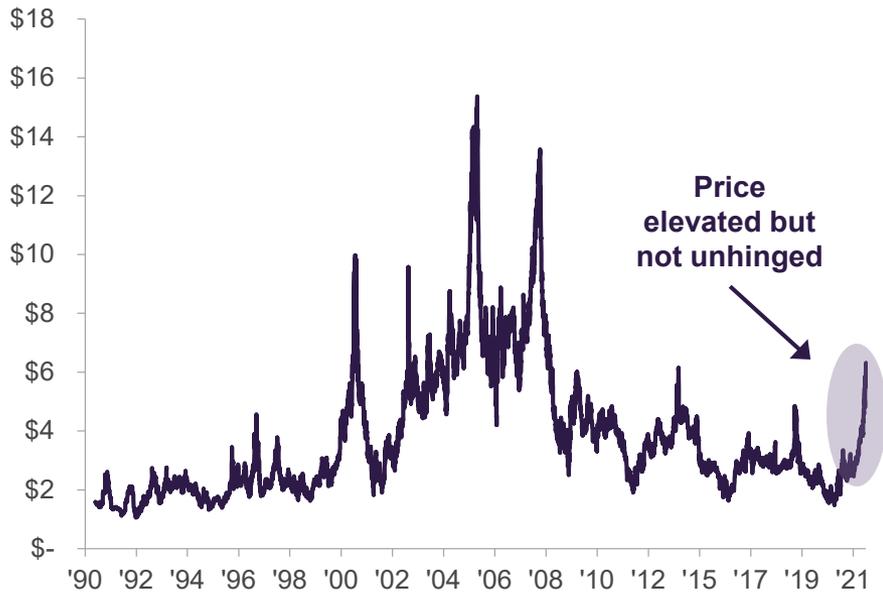


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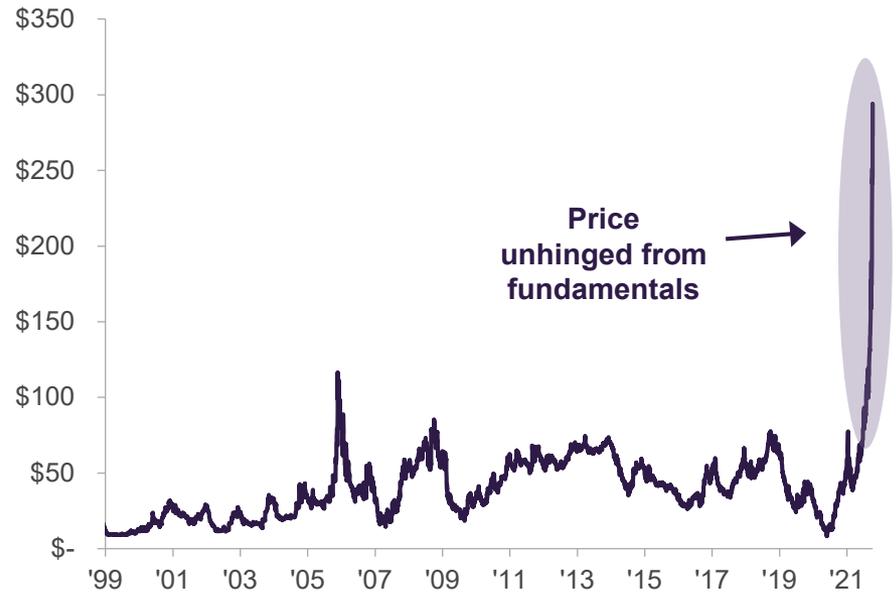
Winter is coming – U.S. natgas prices elevated, European prices unhinged

There's concern global natural gas (natgas) supplies will be inadequate for the colder winter months. In the U.S., natgas supply is mostly domestic. However, the U.S. is now the third largest natgas exporter. Europe's domestic production is insufficient, making it dependent on natgas imports via pipeline from Russia and Ukraine to cover the shortfall. Also, the new Nordstream 2 pipeline linking Russia to Europe is bogged down in the European permitting process. These concerns have caused global natgas prices to spike with European prices seemingly unhinged from fundamentals on speculation.

U.S. natural gas price (\$ per MMBTU)



U.K. natural gas (£/BTU)

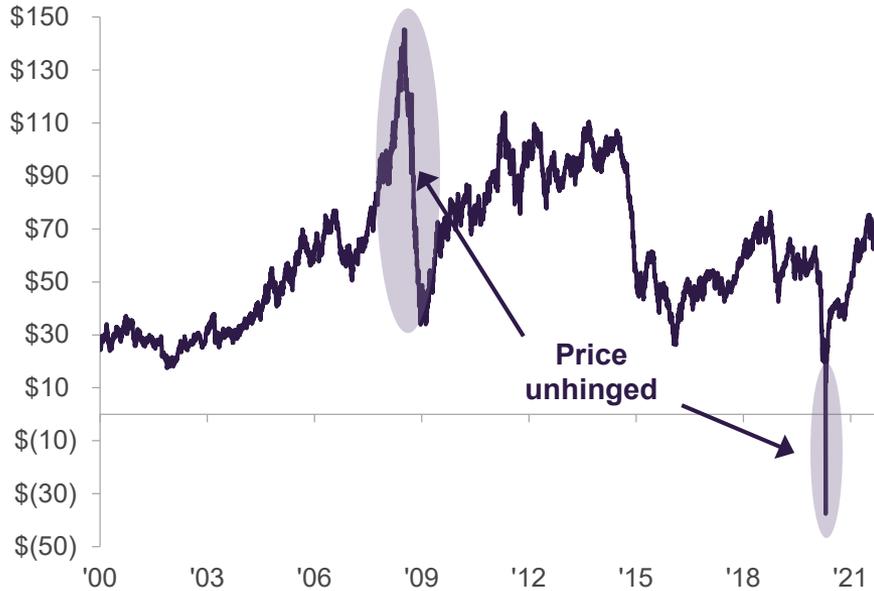


Data Sources: Truist IAG, Bloomberg; daily price data through October 6, 2021.

Crude oil prices elevated in U.S. and Europe; unhinged prices don't last

Crude oil prices are elevated and will likely persist due to stronger demand and tight global supply. Extreme price dislocations, when prices are unhinged from fundamentals, certainly occur, such as when U.S. crude oil prices went negative during the 2020 lockdown period. However, those extreme price dislocations are typically brief spasms rather than permanent shifts.

U.S. crude oil price (\$ per barrel)



Brent crude oil price (\$ per barrel)

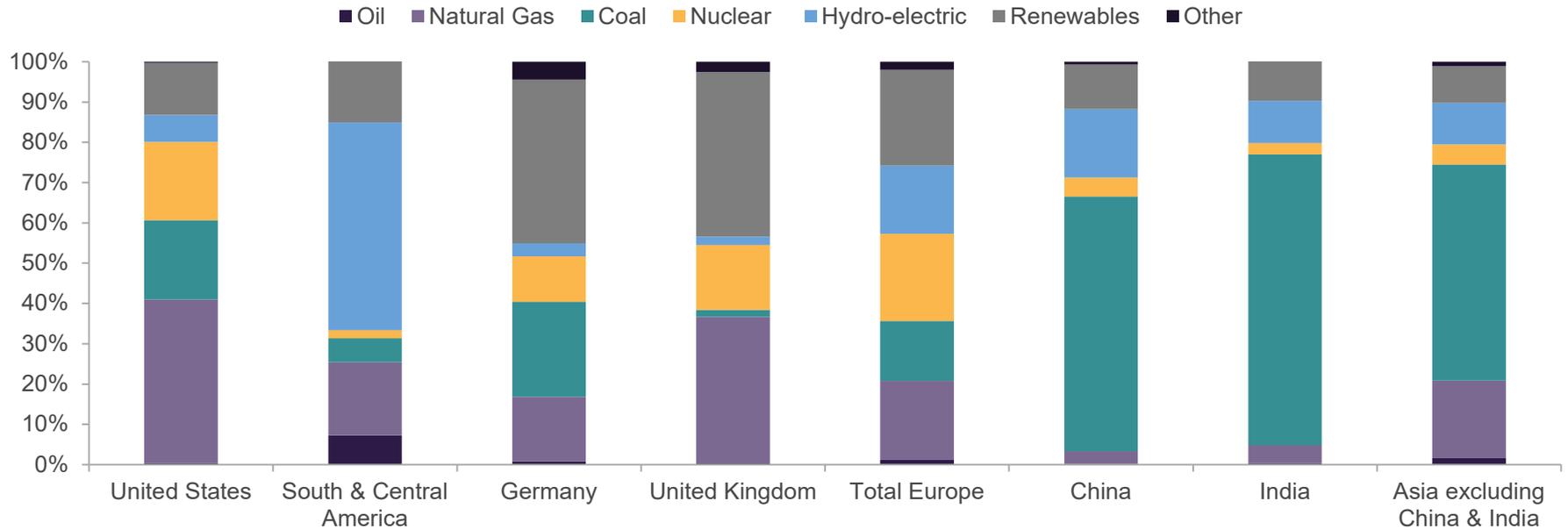


Data Sources: Truist IAG, Bloomberg, Bureau of Labor Statistics; monthly data through July 2021.

Fuel mix used for electricity varies greatly by country

Over 40% of power generation in the U.S. is fueled by natural gas, compared to 20% for all of Europe, with another 24% from renewables. Yet, power generation from renewables is inconsistent due to seasonality and other issues, including droughts impacting hydro-electric power. Meanwhile, coal accounts for 63% and 72% of the total in China and India, respectively.

Electricity generation by fuel

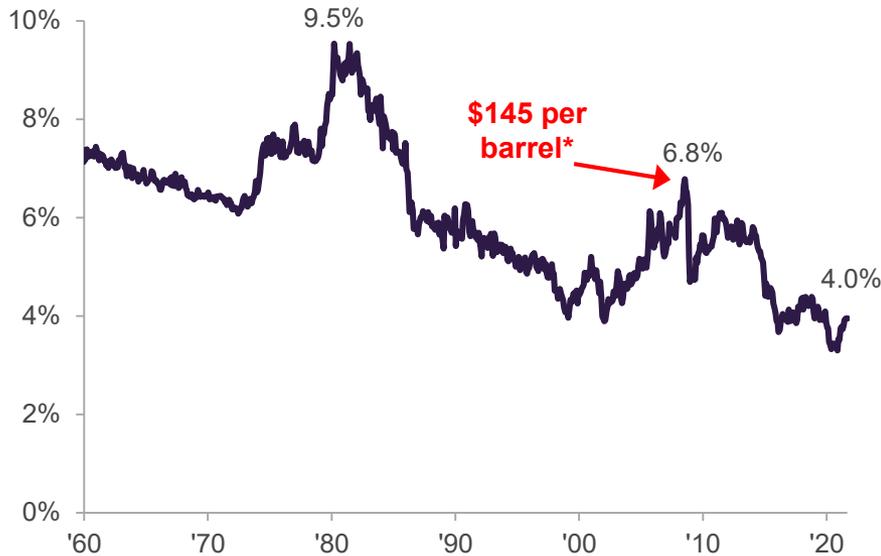


Data Sources: Truist IAG, BP Statistical Review of World Energy, 2021; 2020 annual data based on gross output.

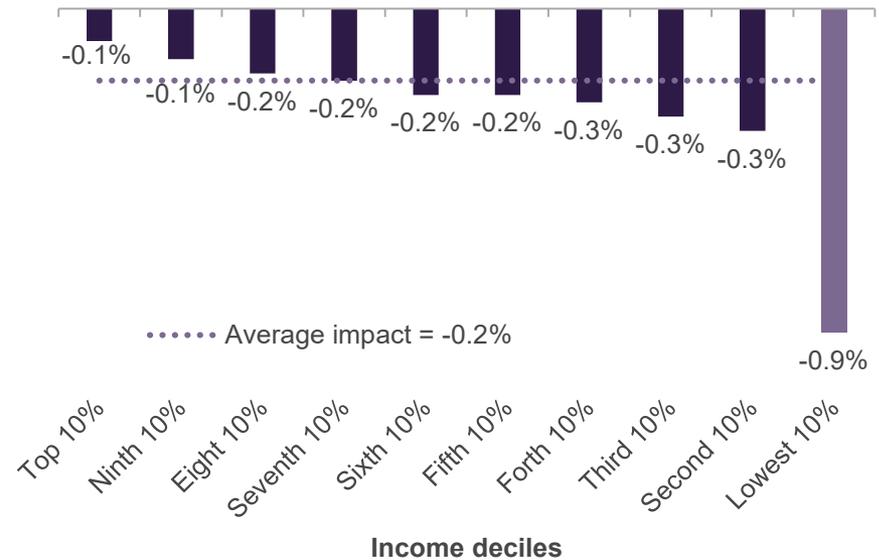
Consumers don't spend much on energy compared to the past, but higher prices greatly impact lower income Americans

U.S. consumers spend just 4% of after-tax income on energy goods and services—even when crude oil hit \$145 per barrel, it was less than 7%. If gasoline prices increased 10%, it would shave off just 0.2% from overall consumer spending. However, higher gasoline prices disproportionately impact Americans in the lowest income decile.

U.S. spending on energy (gasoline+electricity+natgas) as a percentage of consumer spending



Impact of a 10% gasoline price hike on consumer spending

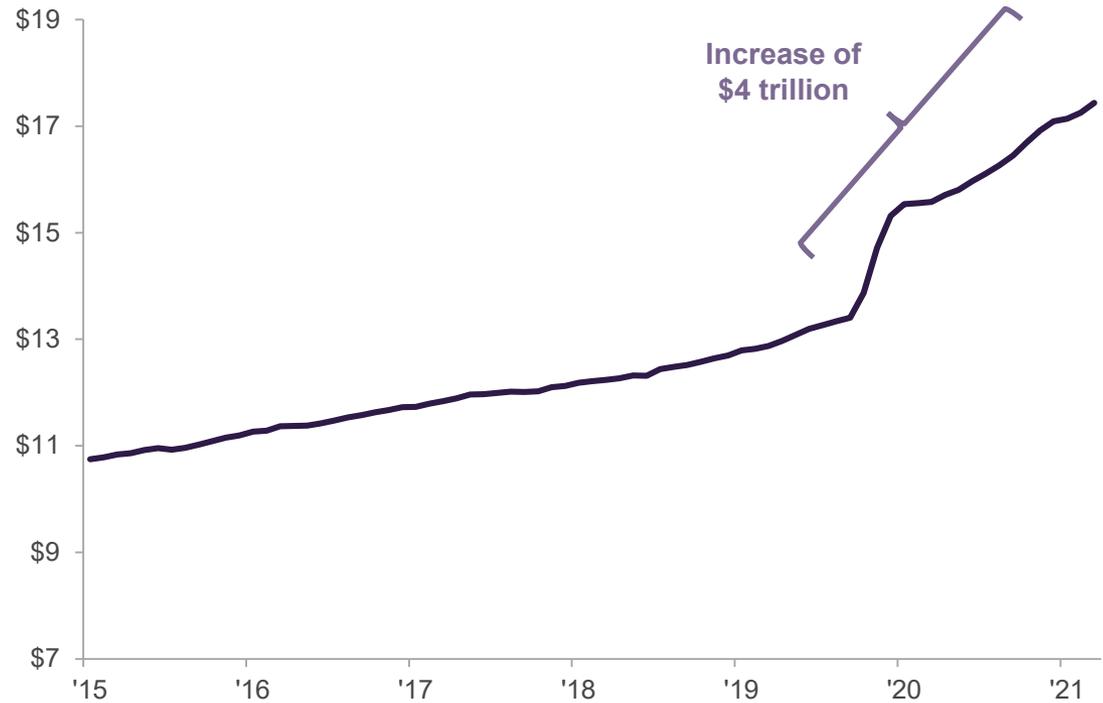


Data Sources: left chart: Truist IAG, Bloomberg; energy spending consists of gasoline and other energy goods and of electricity and natural gas services used for household utilities; spending as percentage of disposable personal income; monthly data through July 2021 (latest data). *West Texas Intermediate crude oil price was \$145 per barrel in July 2008. Right chart: Truist IAG, Cornerstone Macro.

Americans have substantial cash hoard to buffer higher energy prices

Most Americans are sitting on a lot of cash as a result of the pandemic assistance including the CARES Act and American Rescue Plan checks, higher wages and incomes, as well as decreased spending due to the pandemic. This provides most Americans with a sizable amount of cash to deal with potentially higher energy prices.

Weekly bank deposits & savings in U.S. commercial banks (in \$trillions)



Data Sources: Truist IAG, Bloomberg, Federal Reserve Board; weekly data through September 22, 2021. Weekly bank deposits include checking, savings, and time deposits.

Disclosures

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