

# Impact of Financial Market Turmoil on Energy Markets—

Why Energy Prices have Fallen while  
Electricity Prices have not...

# Turmoil in Financial Markets

## *Linked to Energy Pricing*

- ✧ There are Concerns Regarding Credit Worthiness of both Energy Suppliers and Customers
- ✧ Some may be surprised to know large Role of Financial Houses in Energy Markets
- ✧ Expansion of Energy Supplies Dependent On Large Commitments of Capital – ***Without access to capital many projects may be delayed, for example:***
  - Oil & Gas Drilling and Development of New Fields
  - Construction of New Electric Generation
  - New and Expanded Transmission Facilities
  - Advanced Metering & “Smart” Grids
  - Upgrading Other Existing Infrastructure

# Credit Concerns Impede Energy Transactions

- ✧ Meanwhile, the number of credit worthy wholesale energy suppliers has shrunk. For example:
  - Constellation Energy - Financial Trouble and Pending Sale
  - Post-Bankruptcy Mirant
  - Merrill-Lynch takeover by Bank of America
  - Lehman Brothers Bankruptcy
  
- ✧ Wholesale suppliers are becoming less willing to extend credit to retail energy marketers without collateral
  
- ✧ New collateral requirements **raise retail costs of energy supplies**, even though energy commodity costs have declined

# Financial Houses Have Played Key Role in Energy Markets

- ✦ **Several investment firms assumed roles as wholesale energy suppliers**
  - **Since 2004, financial firms have become increasingly active in energy markets**
    - ✓ In 2004, **None** were in the Top 25 U.S. Gas Marketers
    - ✓ By the 2<sup>nd</sup> Quarter of 2008, **Four** were among Top 15 U.S. Gas Marketers
- ✦ **Some were key facilitators of hedging transactions for energy suppliers**
- ✦ **Some were providers of asset management services**

# Influences of Financial Markets on Energy Pricing

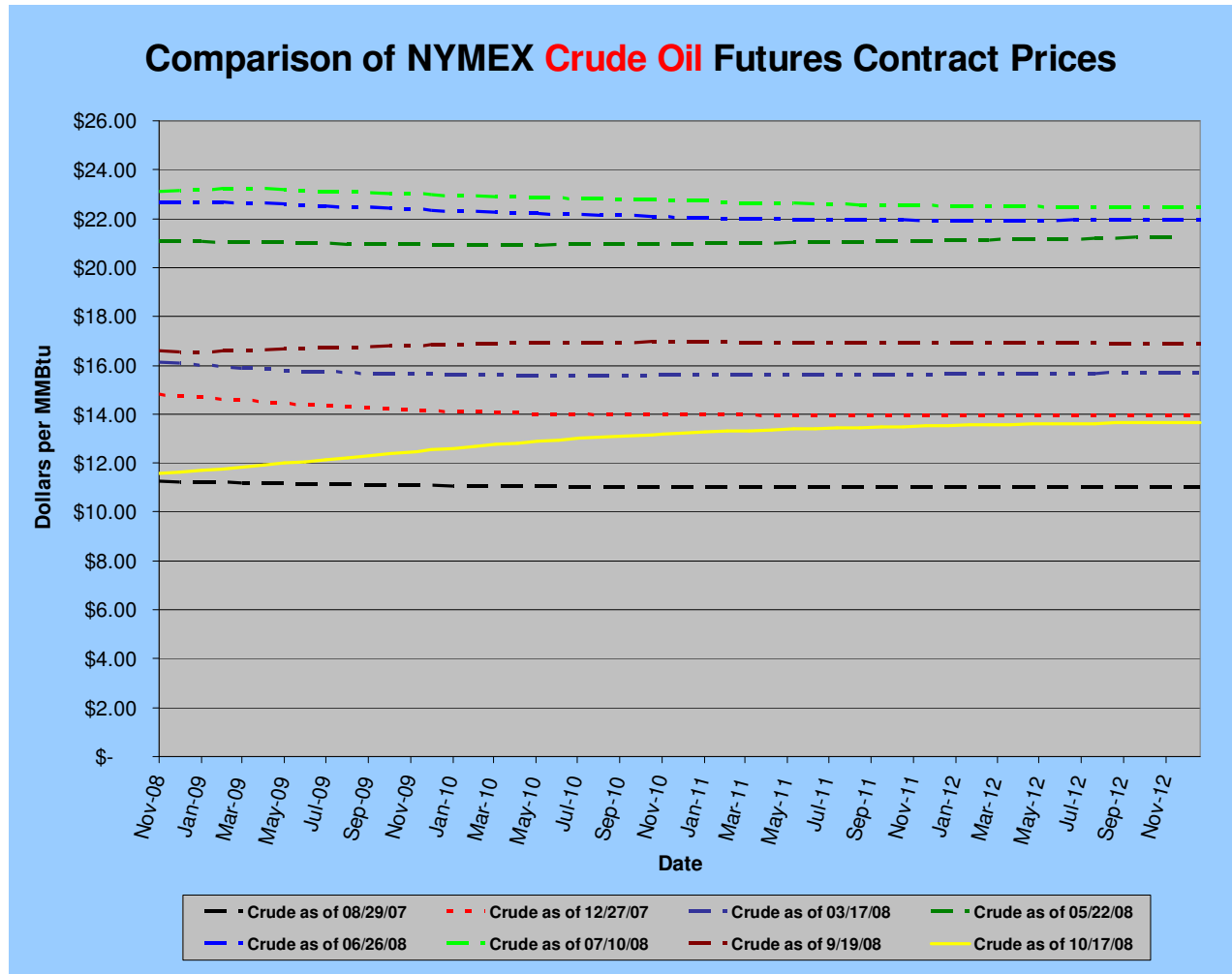
- ✦ Energy pricing problems have been fueled by Speculative Trading of Energy Futures
- ✦ Declining Value of the US Dollar contributed to rising energy prices
- ✦ Turmoil in Financial Markets Slows Economic Activity and Makes Energy Trading More Difficult

# Speculative Trading Fuels Energy Market Price Volatility

- ✧ Declining Returns on Equity Investments Fostered A Large Short-term Migration of Investment Funds into Commodity Futures
- ✧ Current surge in Energy Prices Cannot Be Sustained...Why?
  - Rapidly Rising Energy Costs Quickly Impact Economic Activity
  - Adverse Economic Impacts of Higher Energy Prices Reduce Energy Demand
  - Prices Decline in the Face of Substantial Price Increases

# Crude Oil Goes “Contango”

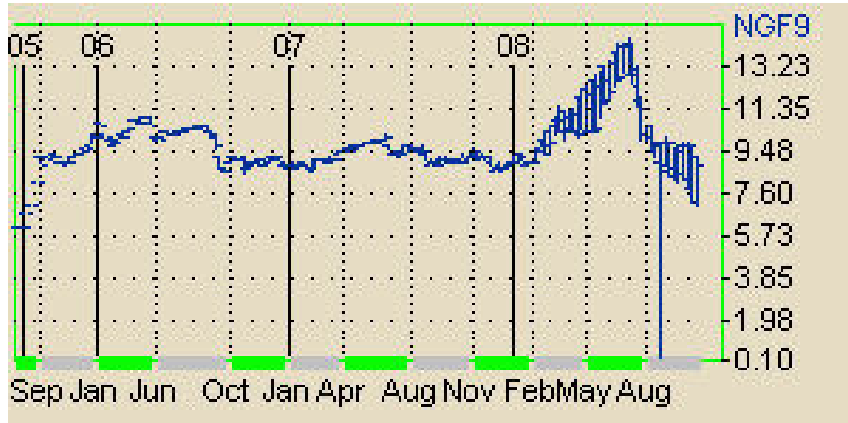
*Futures Prices Are Now Higher for More Distant Time Periods*



# Examples of Natural Gas Price Volatility

*Jan 2009, Jul 2009, Sep 2009 & Dec 2009*

January 2009



July 2009



September 2009



December 2009

