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Drilling Into Soaring Energy Prices

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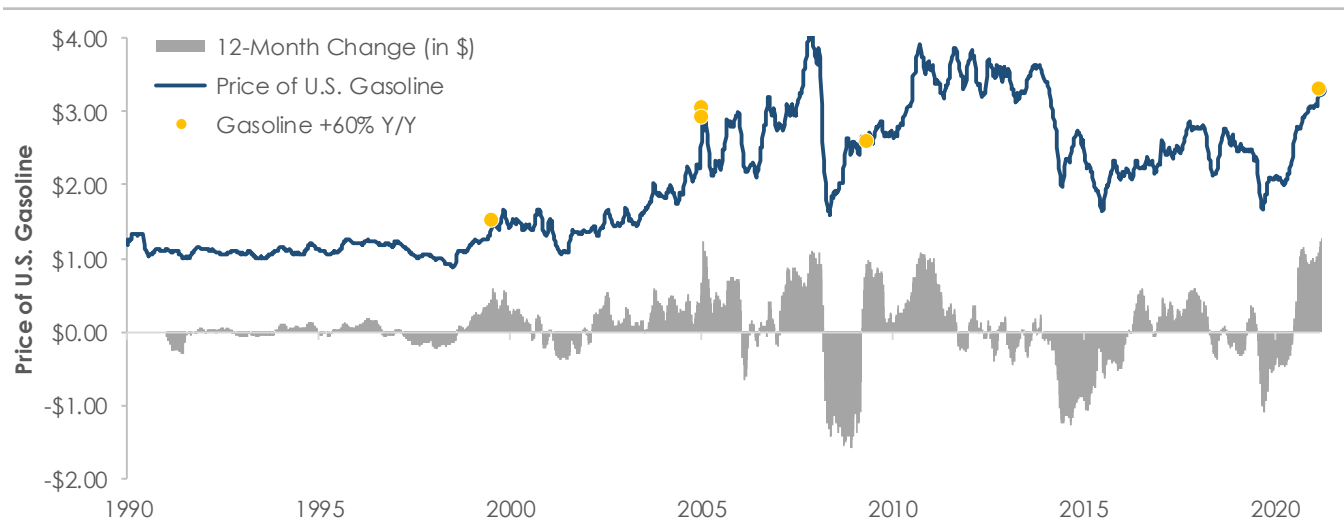
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If you gassed up your vehicle or paid your energy bill recently, you probably noticed energy prices are soaring. AAA reported the national average for a gallon of regular gasoline was \$3.41 on November 14th, up 60% from \$2.13 one-year ago. Natural gas cost \$4.79 per million British thermal units on November 12th, up 70% from \$2.82 one-year ago. Soaring energy prices are starting to impact the economy. U.S. consumer prices rose +6.2% year-over-year during October, the fastest pace since late 1990. In turn, rising inflation pushed consumer confidence to a decade low.

Why are energy prices soaring? Current prices are not the result of a single demand or supply shock but rather the result of a combination of supply and demand factors converging. On the supply side, oil and natural gas investments declined after energy prices collapsed during 2014 and 2015. Since then, investors have pushed oil drillers to return capital to shareholders rather than reinvest in new energy production. Reduced oil and gas drilling capacity has left supply vulnerable to demand shocks like we are seeing today as demand recovers quicker than expected after the pandemic.

Where do energy prices trade from here? Forecasting energy prices is a difficult task, which is why we looked back at prior periods of soaring energy prices to understand what may happen next. Using weekly prices since 1990, gasoline prices fell by an average of -3% over the next 12 months after rising more than 60% year-over-year. Likewise, natural gas prices fell by an average of -24% over the next 12 months after rising more than 70% year-over-year. This does not mean energy prices cannot go higher, because they certainly can. However, it does suggest the worst may be behind us if energy supply and demand can move back toward equilibrium.

FIGURE 1 — Historical U.S. Gasoline Prices



Source: MarketDesk, U.S. Energy Information Administration

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