

What is behind the rising gas prices

October 1 2021, by Hamish Armstrong



Credit: CC0 Public Domain

The rising price of gas has caused widespread concern across the country over how many consumers will afford to heat their homes this winter. The hike in costs has also seen many providers go under as the costs of supplying fuel becomes overbearing.

Professor Michael Tamvakis, professor of commodity economics and finance at Bayes Business School (formerly Cass), comments on the causes of this rise and what can be done to alleviate the situation to return to a sustainable model for both companies and customers.

"The UK generates between 35 and 40 percent of its [energy demand](#) from [wind turbines](#)," Professor Tamvakis said.

"Despite this, gas (CCGT) still accounts for a large proportion of electrical generation, and has had to fill a void left by the effective shutdown of coal and the slow progress in replacing or expanding nuclear.

"As such, it is very useful at mitigating wind generation volatility but it can also be expensive, particularly since the UK is a net gas importer. Recent months have not seen the usual levels of wind, which have increased dependence on other, costlier, energy sources.

"The price also isn't helped by Russia refilling stocks 'less energetically,' possibly with a view to leveraging a dominant position in opening up [gas flow](#) through the controversial Nord Stream 2. This squeeze in supply, as well as increased demand in Asian economies both in terms of electricity generation and industrial processes has contributed to the rises in gas prices.

"Furthermore, high oil prices in the Far East have led to higher gas prices because gas is priced on an oil-indexed basis in that market.

"The UK largely relies on Norway for its [gas imports](#) via pipeline, but in 2020 15 percent of UK imports were from Russia, 17 percent from Qatar and 11 percent from the Americas. There is no shortage of gas import options, especially as the UK is open to more flexible imports in the form of Liquefied Natural Gas (LNG), but it still can't avoid world

market prices."

With gas providers struggling for supply amidst the need to provide competitive pricing, there are fears that it could be left to just a handful of suppliers to power the UK's homes and businesses this winter. Professor Tamvakis says companies should be looking at [financial instruments](#) to protect themselves against the [worst-case scenario](#), but there are limits on what the Government can provide.

"The gas pricing system in the UK and most of the EU is determined by market forces, so it is difficult to provide a concrete long-term solution to the problem," Professor Tamvakis continued.

"The Government could impose a cap on how much gas companies can raise customer bills, but this would ultimately be detrimental to the profitability of the gas industry and is not sustainable. If the Government chooses to protect consumers in the short run, it may be forced to bail out gas companies in the longer run.

"Companies can protect themselves using market instruments such as derivatives—most already do. For the next three to six months and possibly up to two years, I expect most gas companies will have done this and are already offering fixed price contracts to consumers.

"With the petrol supply shortage, we have seen the Government suspend competition laws to allow coordination in delivery—we might see the same sort of thing with gas before too long.

"Overall, I do not foresee a new era of permanently higher prices although the situation could become worse before it gets better. More gas will be required to heat homes during colder and darker months, resulting in higher costs for industries which use gas as a fuel for chemicals and electricity generation.

"In the longer term we also need to seriously consider our use of nuclear. If we want to reduce emissions and still have reliable baseload capacity, we need nuclear energy.

"Oil prices are driven by rather different demand and supply fundamentals and it is really oil prices which drive [gas prices](#), at least in some parts of the world. The more expensive gas is, the more likely electricity generators are to switch from gas to coal-fired generation to control costs. The more coal is then in demand, the higher its own price will rise. Coal burning is by far the 'dirtiest' generation of electricity, so this is not a desirable outcome."

Professor Tamvakis also has a word of advice for consumers.

"People need to be sensible and time their use of energy," he said.

"Insulate your house if you can, and use daylight as much as possible. Also look carefully at and consider fixed price electricity and gas contracts—but enter these cautiously at this time as [prices](#) could be higher in the current situation and you will end up paying more over the long term."

Provided by City University London

Citation: What is behind the rising gas prices (2021, October 1) retrieved 29 April 2024 from <https://techxplore.com/news/2021-10-gas-prices.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.