## Ferguson: Energy Matters

February 1, 2008

## Midwinter Update

As the daily dose of rain here in Boonville reminds me, it's the middle of winter. Time to paU.S.e my fretting over skyrocketing propane bills and look at the bigger picture.

As you may have surmised from pictures in the news, this has been a rather cold winter in the U.S.. In the past eight weeks, withdrawals of natural gas from storage have been among the largest for comparable periods in this century. The U.S. Energy Information Agency reported that withdrawals for the week ending January 25 were a whopping 274 billion cubic feet, the biggest weekly draw on storage in records dating back to 1994.

Despite the large heating demand, storage levels remain 200 bcf above the 5-year average for the date, reflecting the near record gas storage levels in place when the heating season began. Surprisingly, natural gas prices have not softened. The average NYMEX futures contract for delivery in the next 12 months remains around $8.00 per million BTU. What is supporting gas prices?

U.S. gas production increased somewhat last year, but by less than 2 percent. Meanwhile, gas consumption increased about 4 percent, putting upward pressure on prices. Perhaps a bigger factor is the continuing decline in the value of the dollar. The U.S. relies on imported gas for about 17 percent of its supplies, much of it from Canada, and a weaker dollar increases the price of imports.

Today the U.S. dollar is about at parity with the Canadian dollar. Relative to Canadian currency the U.S. dollar has fallen 8 percent lower from the 2007 average, 14 percent from the 2006 average, and 22 percent from the 2005 average.

The declining dollar also makes liquefied natural gas imports more expensive as we compete with Europe for gas supplies. The drop in value of the dollar compared to the euro has also been dramatic.

Given the weakened U.S. economy and persistent budget deficits, the dollar is projected to continue its swoon. The growing U.S. dependence on imports and falling dollar provide fodder for those bullish on natural gas prices, of which I am one.

The crude oil situation is no better. As you know, early this year a few crude contracts traded above $100 per barrel for the first time ever. Since then the U.S. has been preoccupied with the prospect of recession and the possibility that a slowing world economy will reduce demand has driven crude oil prices down to the $90 range.

The weak dollar is certainly an important factor supporting oil prices in the U.S., since the country is even more dependent on imported oil than on imported gas. Global oil production has apparently increased recently, but remains sluggish. The latest data from EIA for October 2007 show world output up 1.6 million barrels per day from AugU.S.t levels, but still a bit under the peak production reached in April 2005. Since these estimates are based on unverifiable reports from producing countries, they should always be taken with a grain or two of salt.

More reliable domestic data show U.S. stocks of crude oil at the lowest levels in over two years, perhaps due to record high prices. As the summer driving season approaches, purchases of crude in global markets are expected to increase, providing support for oil prices.

Offsetting this support is the potential for slower U.S. economic growth and perhaps recession. If U.S. oil demand were to decrease markedly as a result, prices would be expected to sag as well. U.S. consumption of petroleum products has remained remarkably flat for the last four years even though crude oil prices have tripled in the same time. The run-up in prices evidently kept consumption from increasing, but no significant decrease occurred. How much the U.S. economic woes might depress world consumption and thU.S. world prices remains unclear.

As regular readers know, I have been bullish on oil and gas prices for several years and evidently have guessed correctly. I continue to see little likelihood of lower prices, and there appears to be considerable upside potential.

Global crude oil production from mature regions like Mexico and the North Sea will continue to fall, and Middle Eastern production mU.S.t increase merely to maintain totals at today’s levels. Increases to meet rapidly increasing Asian consumption will be problematical. In addition, the expected continued fall of the dollar makes further increases in prices seem likely. New record highs are certainly not out of the question.

U.S. production of natural gas continues to struggle, making the country increasingly dependent on world markets. Global natural gas production continues to increase, unlike crude. However, the pace of construction of facilities to import LNG into the U.S. has been slower than expected and the decline in the dollar has increased gas costs. Moreover, the international price of gas remains coupled to oil prices, albeit not as tightly as a few years ago. It is difficult to see gas prices falling any time soon barring global economic collapse.

We Californians should be thankful for the rain Mother Nature is giving to U.S. generoU.S.ly this winter, filling our reservoirs with free energy.

——*Dr. Rich Ferguson, Research Director, CEERT,* rich@ceert.org.

*Opinions expressed by DrF are not necessarily those of any organization with which he is affiliated.*