

# Ferguson: Energy Matters

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## Natural Gas Update – Hedge Your Bearish Bets

The heating season has begun with the first withdrawals of gas from storage in response to falling temperatures around the country. Official gas data for twelve full months following the 2005 hurricanes is also available, making it a good time to reflect on the numbers.

Natural gas in storage reached record levels this fall as expected, peaking at 3,461 billion cubic feet. But despite earlier concerns, we did not run out of storage space.

Gas futures contracts hit a low of \$4.48/MMBtu in September amid talk that the U.S. would be awash in unwanted gas. Since then prices have rebounded dramatically, trading at \$8.10/MMBtu.

So, what does the future look like and why have prices nearly doubled since mid-September?

In response to the drop in prices following the post-hurricane peak and the threat of excess gas in storage, the trade press reported that some producers were cutting back production. This appears to be happening to some extent and may be the reason the record amount in storage wasn't even higher.

Since mid-summer, supplies have dropped markedly relative to consumption. Until more data are available, we won't know whether supplies have decreased or consumption has increased. However, my computer model shows that since July the amount of gas available for heating/cooling and storage is significantly less than in the first two quarters of the year. This apparent shortfall isn't a problem in the short term—there is plenty of gas in storage for the winter. But it does help explain why prices have rebounded.

I do not expect this trend to be able to continue through the next year, however. The current apparent shortfall is around 75 bcf per month. If it were to continue for 12 months, we would enter next winter with storage levels well below average. Long before that happens, prices would climb, supplies would increase, and consumption would decrease, bringing supplies and consumption into better balance.

We have weathered hurricanes, and we enter the heating season with more gas in storage than ever before. But otherwise the supply/demand picture looks surprisingly similar to the outlook before Katrina. Despite record drilling and attractive prices, natural gas production continues to sag as mature gas fields are depleted. Higher prices are needed to keep production from falling even faster. I see nothing in the near future that promises to change this situation.

The latest data available from the U.S. Energy Information Administration is for August, one full year after Hurricane Katrina. It shows clearly why gas storage peaked this year 300 bcf higher than last. Yes, the storms did put a dent in supplies.

For the 12 months ending in August, US gas production fell 470 bcf compared to the same period a year earlier. Increased imports from Canada compensated somewhat, but total supplies fell 400 bcf.

The thing is, consumption fell even farther, dropping 700 bcf and thereby increasing amounts going into storage by 300 bcf. Only a small fraction of the decline in consumption was due to mild weather. Weather-related consumption fell less than 200 bcf. The surprise was that industrial consumption fell more than 500 bcf in the first months after the hurricanes.

Consumption rebounded, however, reaching pre-storm levels in June of 2006 as infrastructure was repaired and prices declined. All in all, Katrina and Rita created little more than a temporary blip in the natural gas statistics.

Despite the record amount of gas in storage, the most recent data continues to be bullish. If you're betting that gas prices will drop, I'd hedge those bets if I were you.

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