

Ferguson: Energy Matters

September 14, 2007

End of Summer Update: Lots of Gas, Not So Plentiful Oil

On September 12 crude oil prices reached a record high of \$80 per barrel and are going higher as I write this on September 13. Even adjusting previous records for inflation, \$80/bbl stands as the all-time high price. More about this later, but in the meantime, what's happening with natural gas?

For the second year in a row, the U.S. ended the summer with plenty of gas in storage, over 3,000 billion cubic feet—slightly more than last year. 3,000 bcf is considered ample for the winter heating season. And, we have two more months to go before we start using it for the season. Historically, gas storage increases 500 bcf in September and October.

There will be no shortage of gas this winter.

Not surprisingly, gas prices have been soft since the beginning of summer. Prices dropped to a low of \$5.50/MMBtu last week before climbing a bit. Stormy weather in the Gulf of Mexico and the sabotage of major gas lines in Mexico conspired to boost prices back above \$6/MMBtu this week. Nevertheless, prices remain lower than they have been since 2004.

The market evidently does not expect the current surfeit of gas to continue. The 12-month NYMEX strip remains well above \$7/MMBtu. However, with near month and spot prices weak, there have been reports that gas is now being shut in, i.e. kept in the ground rather than being put into the system. Between March and June of this year there was an unusually large amount of gas coming into the system. In July and August, this flow was reduced considerably. With next year's prices well above current levels, it makes good sense to keep the gas in the ground for another year.

According to EIA, gas consumption in the 12 months ending in June increased nearly 4 percent over calendar year 2006 (about 800 bcf.) Supplies increased by only 300 bcf over 2006, however, about 1.4 percent. Liquefied natural gas imports provided 3 percent of U.S. supplies, up slightly from the previous year. The number of gas wells drilled increased 3 percent but managed to increase production by less than one percent, reflecting the continuing depletion of U.S. gas

resources. The rate of drilling can be expected to decrease unless prices increase, however, which can be expected to lower production.

The big news is oil.

With the price of crude oil around \$80 per barrel, energy from oil costs almost \$14/MMBtu, more than twice as much as natural gas today. Needless to say, no one is in a hurry to switch from gas to oil at these prices.

OPEC promised last week to increase production, but the market ignored the announcement, as did I. You may recall a chart I included a few months ago that illustrated how oil prices have been rising since 2004 without being able to increase production. I remarked that the markets appeared to be challenging OPEC to “show us the oil,” and that prices are likely to keep rising until substantially more oil shows up. My opinion has not changed.

Today’s oil price is *double* the price in 2004, but production has not budged.

Perhaps OPEC could flood the world with oil tomorrow and is just too busy hauling money to the bank to bother pumping more. On the other hand, perhaps there is no spare capacity left anywhere—as the “peak oil” theorists claim—even though government agencies continue to profess that there are millions of barrels per day of spare capacity sitting around unused.

In years past, every price spike has been caused by revolutions and wars when oil was removed from the market for political reasons. For the first time in history, we are seeing limited production and resulting record prices with no explanation in sight except the possibility that world oil resources are being depleted faster than new sources can replace them.

It is probably too early to say definitively that the world is running out of oil. But I’m hard pressed to explain the combination of current record prices and stagnant production any other way.

Are we watching history in the making, the end of the oil era? Only time will tell. In the meantime, enjoy cheap natural gas while you can.

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