Ferguson: Energy Matters

January 12, 2007

Balmy Weather Cools Energy Prices

Back East, the crocuses are blooming and the fruit trees are budding. Must be spring. But wait - it's January! What's going on? Maybe there's something to this global warming stuff after all.

The U.S. entered the heating season with more natural gas stored than ever before. We were ready for a killer winter, subzero temperatures, and Jack Frost nipping at noses. What did we get instead? The warmest December in New Jersey since they began keeping records. Boston saw a total of four days in which the average temperature dropped below freezing. New York had five.

Winter demand for natural gas is largest in the populous and usually cold states in the East and upper Midwest. The warm weather reduced the use of gas for heating nationwide in December by about 200 billion cubic feet, 16 percent below average. Gas consumption was the lowest in the 10 years for which I have records. Demand for heating oil is off, too.

Needless to say, there is a lot of gas remaining in storage. Storage levels remain above 3,000 bcf, a value that is considered ample for the entire heating season. We have only a couple of months left to go.

Prices have responded by falling as well. Natural gas prices have fallen more than 30 percent in the last two months. Crude oil trading closed yesterday below $52 per barrel, a level not seen since mid-2005, helped by the fact that Europe has had exceptionally mild weather, too.

Yes, I know that a cold snap can begin any day and turn things around. Cooler weather is headed East this week. January is usually the coldest month, and February is cold, too.

With all the natural gas remaining in storage and more mild weather forecast, why are gas prices as high as they are? Gas for February delivery was still trading yesterday above $6/MMBtu. Only a few years ago, $6/MMBtu was considered a very high price.

My guess is that the cost of production has risen to the point at which $6/MMBtu is near the floor price for firm natural gas. I expect that if the price continues to fall, investment will fall and drilling will slow.

Gas prices are also held up by the price of crude. Although oil prices have fallen dramatically, on an energy basis, oil is still selling around $9/MMBtu, 50 percent higher than natural gas. Nobody is going to switch from gas to oil anytime soon.

The gas price outlook for 2007 is an excellent one for consumers. Unless the weather soon turns bitterly cold, we will end the heating season with record amounts remaining in storage. Additional gas will be added over the summer, and we should enter next winter's heating season with plenty. Prices should stay depressed through the year unless something unusual happens.

This is not good news for suppliers, especially those investing in liquefied natural gas import terminals. World liquefied natural gas prices got a boost recently when China declared that it would tie the price it is willing to pay to the price of oil. With China hungry for energy and the U.S. having plenty of gas in storage, LNG is increasingly going to go to Asia.

LNG contributes only about 3 percent to U.S. gas supplies. However, the Energy Information Administration expects a surge in imports in the next two years. It will be interesting to see whether the agency is correct. With gas prices and consumption down, it's difficult to believe that the U.S. will need to - or be able to - compete internationally for supplies.

Meanwhile, enjoy the balmy weather and cheap fuel.

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