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## The Coming Natural Gas Crisis

A new study by EnergyBusinessWatch suggests that, after three years of unprecedented turmoil, the U.S. energy industry is about to face a new and potentially severe crisis: a sharp upward shift in natural gas prices that could permanently change the competitive positioning of many energy companies and persist for at least the next 5-7 years.

These conclusions already have been partially confirmed by the stunning events of the past few days – including an all-time record comparable-week withdrawal from storage during the first week in December and a 25% increase in the NYMEX January (i.e., “near month”) contract in a single 5 day period, to levels well above \$ 5/ MMBTU.

The EBW study, to be released next week, concludes that if recent proprietary forecasts of a colder-than-normal next 30 days prove to be correct, the amount of natural gas in storage could easily drop below 800 BCf by the end of the winter heating season, with natural gas prices potentially soaring to a level between \$ 6 and \$ 8 /MMBTU in as little as three weeks.

Further, while natural gas prices may soften slightly during the spring, injection into storage during the '03 injection season is likely to be at least 35 -- 40% *below* historical norms.

As a result, by the end of the injection season next fall, storage may still be below 2,000 BCf (i.e., on a seasonally adjusted basis, an all time low). If so, natural gas prices could remain well above \$ 6/ MMBTU during much of next year and the upward pressure on natural gas prices in the winter of '03/'04 could be just as severe as it is likely to be this year.

Further, by April or May of next year, electricity prices could begin to increase rapidly in every region of the country in which natural gas-fired generation is the marginal source of supply – with peak prices during the summer months rising 50% or more compared to last summer even in regions in which there is substantial excess generating capacity.

Nor is this upward shift in the price curve for both electricity and natural gas likely to be short-lived. Instead, it marks the earliest stage of a transition period that may last for much of the rest of this decade in which the U.S. must shift to new, less conventional sources of supply to meet the rapidly growing demand for natural gas as a fuel to generate electricity (i.e., massive increases in imports of LNG, imports of natural gas from the Arctic Circle in Canada through the MacKenzie Delta Pipeline, massive expansive in ultra-deepwater drilling in the Gulf, etc.) but cannot bring these new sources of supply on rapidly enough to avoid a near-term short-fall in supply of up to 1.5 –2.0 Tcf/year.

For some well-positioned energy companies, these price increases could provide much-needed financial relief at a time of great stress. For many others, however, and for the U.S. economy as a whole, the negative repercussions could be severe – with the potential to nip the current economic recovery in the bud, pushing the U.S. economy into a “double dip” recession in the first or second quarter of next year.

## Causes and Consequences

Unlike some prior market dislocations, there is no reason to expect that this price increase will be the product of market manipulation or other illegal conduct. Instead, it results from a fundamental imbalance that has been developing throughout the course of this year between supplies available to the North American market and the level of demand that would occur if prices were to remain at or near the \$ 4 /MMBTU level.

As a result of this rapidly-growing imbalance, supplies of natural gas available to the U.S. market are virtually certain to fall at least 1.5 TCf *below* EIA's most recent (12/9/02) '03 consumption forecast of 23.11 TCf, forcing sharp price increases to drive out-of-the market at least 5-7% of expected '03 demand.

This imbalance in turn is the direct of result of a head-on collision of two "tectonic plates" set in motion long ago:

1. The rapid decline, after more than three decades of development, of almost every major conventional source of natural gas supply in the U.S. and the Albertan fields in Canada.
2. The rapid shift, as a result of the long-delayed impact of Clean Air Act requirements enacted in the early 1990's, to natural gas-fired generating units as the marginal source of supply to serve virtually all of the incremental electricity needs of the U.S. economy (by far the most electricity-intensive economy in the world) for many years to come.

These two drivers will be examined in greater detail in subsequent articles and in the study to be released next week.

For any questions, comments or reactions, please don't hesitate to contact Andy Weissman directly at [aweissman@energyvg.com](mailto:aweissman@energyvg.com) or 202/944-4141.

Energy Ventures Group, L.L.C. is the parent of EnergyBusinessWatch.com, which originally published this article.