

Natural Gas Market Indicators



August 28, 2015



Reported Prices – West Texas Intermediate crude oil prices dipped to as low as \$39 per barrel the second half of August while natural gas prices at Henry Hub slipped to below \$2.70 per MMBtu with expectations of moderating temperatures in September. Gas demand for power generation is the elephant in the room right now and, as it moderates with the coming of fall, marginal demand is not expected to force prices up – not until there are winter heating season influences anyway.

Weather – despite strong storm activity in the Pacific, the Atlantic has been relatively quiet this year. It's been three months since the first Atlantic low pressure system developed into a named tropical storm. Since then, only two others have materialized, both of which never graded any higher. That said, on August 20 Hurricane Danny became the first storm upgraded to a Category 1. Having since dissipated southwest of Guadeloupe, on the heels of Danny comes Erika, currently designated a Tropical Storm. As of this writing, it's too early to evaluate any potential impacts to the US. Meanwhile, NOAA data on temperatures remains persistently warmer than normal. The past six weeks have shown electric air conditioning-weighted cooling degree days above the thirty year average. Cumulatively the US lower-48 is 12.6 percent warmer than normal and nearly 11 percent ahead of last year. One can find more normal temperatures in the middle of the country. The East North Central division has been 4.9 percent cooler than normal while the West North Central has been about 2.4 percent cooler from normal conditions in aggregate since May 1.

Working Gas in Underground Storage – storage gained 53 for the week ending August 14, bringing total stocks above 3 Tcf for the first time since January, then added another 69 Bcf the week ending August 21. Even assuming a moderate injection pace for the balance of the season puts storage volumes at 3.8 Tcf before withdrawals occur. If the pace of injections is more aggressive, exceeding 3.9 Tcf by the fall turnaround to winter is entirely plausible.

Natural Gas Production – the Environmental Protection Agency (EPA) released its new methane reduction rules aimed at limiting emissions from oil and gas operations from the wellhead to the distribution city gate. The rule includes elements targeting hydraulically fractured oil wells—something the New Source Performance Standards did not cover in 2012. The new standards would be expected to cost industry about \$370 million dollars to implement annually by 2025 but bring between \$460 to \$550 million dollars in benefits. It is not expected (at least by EPA) to be a limiting factor for domestic production. US production averaged 72 Bcf per day in August. An extended maintenance season this summer has moderated some production growth in all areas of the country. Still, current average daily production year to date has been 4.0 Bcf higher than the same period in 2014.

Shale Gas – efficiency and technology account, at least in part, for continued growth in US shale gas production in 2015, even with relatively low natural gas prices at Henry Hub. In fact, there are numerous reasons that affect the annual production calculus, particularly in low price environments, not the least of which is whether a given producer hedges future natural gas production or not; when

the hedge went on; and, how soon it is expected to come off. Barclays Capital has surveyed 43 large-cap and mid-cap producers regarding production expectations and hedging practices to see if there is a link to production growth and gas sales price hedging. Overall, the group of 43 expects their production to grow 3.1 Bcf per day in aggregate for 2016 compared to 2015. However, half of the companies have placed no hedges on 2016 production because they see prices at near bottom and hedging now would mean locking in at relatively low prices thus missing possible upside developments in the market next year. For the large-cap producers only seven percent of 2016 production is hedged, while for the 22 mid-cap producers surveyed about 46 percent of 2016 gas production is hedged at an average of \$3.99 per MMBtu. Only time will tell whether that strategy was appropriate given actual market conditions. That is, however, the essence of a hedging strategy, managing the unknown.

Rig Counts – despite the drop in petroleum prices, drilling activity is slowly climbing, indicating a bottom may have been reached (for now). From July 17 to August 14, west Texas crude oil prices dropped by 17 percent. During that time, oil rigs in operation gained 5 percent, a somewhat counterintuitive result. What’s driving this relationship is not quite clear, though it’s important to recognize that decisions whether to drill operate on different time schedules and speeds than the markets that price crude oil. Nevertheless, the short-term dynamics do seem to defy common wisdom to some degree. Meanwhile, natural gas rigs in operation currently total 211, down 5 rigs during the same period. Adding gas rigs in operation to the oil rig count of 672 brings total activity to 884.

Pipeline Imports and Exports – exports to Mexico have slowed slightly to below 3 Bcf per day for much of the past two weeks, yet remain 0.7 Bcf per day higher this month than in August 2014 and 0.6 Bcf higher year to date. Additionally, US imports from Canada at 5.6 Bcf per day (year to date) are 0.5 Bcf per day higher than last year.

LNG Markets – LNG import facility sendout volumes to the pipeline grid have been in the range of 0.2 to 0.3 Bcf per day during the past week. That said, we will take the opportunity at this point to blatantly name drop in this LNG space—something we rarely do. With an 8.18 percent share in Cheniere Energy Inc., Carl Icahn’s Icahn Capital LP has acquired two seats on the Cheniere board of directors. Icahn has, of course, been historically known for enhancement of shareholder value in the companies they own or own in part. What this means for Cheniere or LNG more broadly we haven’t a clue but thought it was interesting nonetheless.

Natural Gas Market Summary – those items noted above are our story and we’re sticking to them.

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