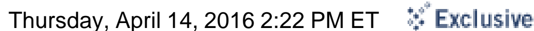
Thursday, April 14, 2016 2:22 PM ET 

Low crude oil price could support natural gas back to $6/MMBtu by 2019, analyst says

By Jodi Shafto

If crude oil prices stay below $50/bbl for the next three years, natural gas prices could recover back above $6/MMBtu, Macquarie Group's global oil and gas strategist Vikas Dwivedi said.

"Crude oil is so important to what happens to natural gas as you think about gas risks and opportunities," Dwivedi said during a presentation at the LDC Gas Forum Southeast in Atlanta on April 12.

At the lower crude oil price, associated natural gas production is not growing, and without the free gas from oil production, the natural gas market will turn bullish as the market faces challenges on the supply side from accelerated legacy gas declines, the extreme drop in the gas rig count and the lack of demand pull from the Northeast, which should result in lower Utica/Marcellus production.

The oil market will likely rebalance and prices could get back to $70/bbl, which will produce growth and reproduce associated gas and drive NGL wet-gas economics. "But if we can see it stay in the $70 range, maybe go below $70, that is still very positive for natural gas prices because previously we have had gas production grow 5 Bcf [per day] to 6 Bcf per day while rig counts and prices were falling," the strategist said.

Natural gas production became "an independent variable that didn't care about anything else, it was just going to grow," Dwivedi said. "That is a great recipe to have low prices."

But that may be changing. Natural gas production remains resilient, hovering around 71 Bcf/d, but after the February surge in production, dry gas production is slowing and legacy gas production is expected to continue to decline due to an exceptionally low number of rigs, he said.

"Marcellus/Utica has been the monster, it was 0 Bcf/d a few years ago and is now about 22 [Bcf/d] to 25 Bcf/d," Dwivedi said. "If we didn't have this in gas, the price wouldn't be at $2/MMBtu; it would be much higher," he said.

Although the takeaway capacity from the plays is still pretty big and there is still more room to grow, Dwivedi questioned whether there will be enough interstate pipeline capacity to take it away and be able to grow production. "That is getting more and more challenging as pipeline projects are getting delayed, cancelled or deferred," he said.

Natural gas volatility has been very low, but going forward a lot is changing, Dwivedi said.

From the demand perspective, coal-fired power plants are retiring in a massive way because of legislation and economics. Macquarie anticipates power burn to increase year on year at the high end from 2.0 Bcf/d currently to 3.0 Bcf/d.

"There is renewables growth because of subsidies, but it is getting more economic on a standalone basis and the amount of solar on the way is just massive, so that hurts gas demand as a daytime source, but more gas fired generation will be needed to back solar up," Dwivedi said.

Additionally, pipeline exports to Mexico are seen growing year on year from 1.8 Bcf/d to 2.5 Bcf/d, and could be near 4 Bcf/d further out, the strategist said. Exports will be accelerated by delays on the Mexican side with getting plants built and with production slowing.

LNG exports from Sabine Pass will add to the demand-side challenges as they are on the way from 0.2 Bcf/d to 1 Bcf/d this year. "Through 2020, LNG export demand will be big," Dwivedi said. The economics work to send LNG to global markets because of the nature of contracts and Macquarie sees exports climbing to 6 Bcf/d at least.

Macquarie also expects improvement in industrial demand, which should rise 250 MMcf/d year over year in 2016, but manufacturing indices are worrisome, Dwivedi said.

"So be ready for a more volatile gas world than we have gotten used to in the last few years. It doesn't anymore have to be just from weather," he said.

In terms of weather, last winter destroyed about 1,000 Bcf of demand. "A mild winter should not destroy more demand than a cold winter would have generated," Dwivedi said. The "freakishly mild" winter leaves a lot of demand built into next winter, he said, which could catch the market napping.

"There is a lot of complacency since we finished March with such a high inventory level. But if demand numbers prove right and the supply doesn't grow, the day-to-day market will be much tighter and this massive amount of inventory may not do a lot to keep prices from surging. "

Natural gas storage will also be a risk factor with no new additions to storage capacity. There will be as much storage capacity in five years as there was three years ago and over that time we have added about 20-25 Bcf/d production in the end. "When we look at that we see a lot of volatility," Dwivedi said.

Going forward, Dwivedi sees natural gas prices rising to the high to the low $3s on average, but the real story is the volatility. "Natural gas will be the most volatile commodity in the market," he said. "The range is massive from $1.50 to $6.50."