When it Comes to the North American Gas Market, 'COVID is the Boss'

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Written by John Egan for Industrial Info Resources (Sugar Land, Texas) — Uncertainties created by the COVID-19 pandemic are weighing heavily on the North American gas market, according to several speakers at a recent Natural Gas Forum 2020 hybrid conference. The event, sponsored by Access Intelligence LLC (Rockville, Maryland), came as a major pharmaceutical company announced a vaccine with more than 90% effectiveness. But no speaker predicted that that vaccine would rejuvenate natural gas markets over the near term — say, the next few quarters.

“COVID is the boss,” said one speaker at the event, which took place November 9-11.

Average U.S. natural gas production is expected to fall to about 86.3 billion cubic feet per day (Bcf/d) this year, down from about 95.1 billion cubic feet per day (Bcf/d) in 2019, Sam Andrus, executive director of North American Gas at IHS Markit Limited (NYSE:INFO) (London, England). In 2021, he projected, production will average about 88.5 Bcf/d. Other speakers had essentially the same viewpoint about production in this year and 2021.

He didn't specifically address how soaring U.S. COVID-19 infection rates, which are triggering various levels of restrictions and shutdowns in different states, could affect gas demand.

But he did say gas prices, which averaged about $2.50 per million British thermal units (MMBtu) going into the winter heating season, would end the season at about $3.50, or even as high as $4.25, per MMBtu if the U.S. experiences a colder-than-average winter.

Orlando Alvarez, president and chief executive at BP Energy Company (Houston, Texas), the U.S. unit of BP plc (NYSE:BP) (London, England), cautioned attendees that “we're not through the pandemic yet, and that's driving uncertainty and volatility.”

He noted that associated natural gas, which is produced when oil is extracted from reservoirs, accounts for 35% to 40% of all gas produced, a percentage that has doubled over the last 12 years. So the slowdown in crude oil production also cuts associated natural gas production.

Alvarez said he does not expect natural gas production to return to its pre-COVID-19 levels until 2022, “but all projections for 2021 and beyond are tied to COVID.”

He noted this was particularly true for exports of liquefied natural gas (LNG), which fell sharply during the summer as overseas buyers cancelled more than 150 tanker shipments. “The U.S. natural gas business has become increasingly dependent on overseas demand,” he said.

The event had several break-out sessions on North America's regional gas markets.

Northwest U.S.

This region has an interesting push-pull dynamic, where coal plants are retiring and new-build renewables are squeezing out gas-fired generation in California, speakers told conference attendees.

Roughly 2,194 megawatts (MW) of coal-fired generation is scheduled to be retired by the end of 2020, and an additional 4,790 MW of coal generation in the region is slated to be shut down by 2028, according to Gary Venz, a director of commercial services for the Northwest Pipeline, which is owned by the Williams Companies (NYSE:WMB) (Tulsa, Oklahoma).

“The energy transformation is under way,” he said. “Renewables are changing the region's fuel mix as states seek to decarbonize their electricity.”

But there's a downside to a heavy reliance on the wind and the sun, Venz said. During a cold snap in February and March 2019, which cut into renewable electricity production in the region, power prices in the region rose to $1,000 per megawatt-hour and gas prices soared to $160 per MMBtu.

More recently, on August 14, as California was wracked by a heat wave and wildfires, electric generation from renewable resources fell sharply: wind power output plummeted 58% and solar output dropped 25%, according to Will Brown, vice president-commercial for Kinder Morgan Incorporated (NYSE:KMI) (Houston, Texas).

Wind power output declines during high temperatures, and smoke from the wildfires

impaired solar generation. The lights stayed on and the air conditioners kept humming in the Golden State this past summer only because it had access to gas-fired generation, Brown said.

Williams' Venz predicted that as demand for gas in the region rises throughout this decade, it would bump up against the available infrastructure. “As the region transforms and you remove coal from the resource mix, you will need to rely on gas to back up renewable generation,” he told the Natural Gas Forum 2020 attendees.

Southeast U.S.

For nearly five years, ever since the U.S. began exporting liquefied natural gas (LNG) in early 2016, demand for LNG terminal feed gas has been a critical driver for demand and prices in this area. That was good news a few years ago, when overseas prices for LNG were high. But as those prices have steadily fallen in recent years, and as COVID-19 has cut into overseas demand, LNG exporters are facing a different — and more difficult — market, where supply is spiking at the same time that demand is falling, speakers told event attendees.

“The competitiveness of U.S. LNG is in question,” said Jamison Cocklin, senior editor at National Gas Intelligence's *LNG Insight*. As recently as early 2018, he said, U.S. exporters enjoyed a $4 to $8 per MMBtu premium over gas shipped from other areas, but that spread has now narrowed to about $1 per MMBtu. "International prices have converged around Henry Hub prices," Cocklin said.

He noted that further LNG cargo cancellations could be forthcoming from European buyers, who have full storage and weak demand, caused by the COVID-19 pandemic.

Another speaker, an LNG developer, said the current supply overhang could cause under-investment in LNG terminals over 2020-2022, which should drive LNG prices higher during 2024-2026, which could then trigger another round of construction and another glut by the end of this decade.

In short: The U.S. LNG market is in the “bust” phase of a boom-and-bust cycle.

Mexico

Recent gas trends in Mexico — rising demand, falling domestic supply and a commitment to opening up the state-owned energy industry — were in recent years welcomed by U.S. gas producers looking to export their product, either via pipelines or LNG shipments. But COVID-19, and a president who appears to want to reverse the opening of Mexico's energy markets, have taken the shine off the Mexican market,

speakers at the event said.

Mexico's domestic gas production has declined to about 2.5 Bcf/d, down from about 4.5 Bcf/d in 2015, according to Ryan Ouwerkerk, manager of Americas natural gas pricing at S&P Global Platts, a unit of S&P Global Incorporated (NYSE:SPGI) (New York, New York). Right now, he said, Mexico is importing about 6 Bcf/d from the U.S. via pipelines, a 6% increase compared to 2019. However, LNG imports have dropped about 55% year-over-year, he added.

Over the summer, Mexico's president, Andrés Manuel Lopez Obrador, issued a memorandum calling into question the liberalization of the country's energy markets, a process that began in 2014. Speakers at the event suggested this could be the first step to securing an anti-liberalization bloc in the Mexican Congress when elections are held next year. The president would need a two-thirds vote in the Congress to reverse the country's move to open its energy markets.

Gas imports from the U.S. have helped lower Mexico's gas prices, to about $2.75 to $3 per MMBtu, from about $4.25 to $4.50 per MMBtu at the start of 2018.

But speakers noted the still-nascent gas infrastructure in the country — the entire country's pipeline network is about one-third the size of Texas' system — limits the nation's ability to increase its use of gas. And speakers said there were legal and regulatory issues that must be addressed if the energy market is to become fully transparent.

“In terms of developing a transparent energy market, we're in the first quarter of a four-quarter game,” said Jeff Welch, president of NAmerico Energy Holdings LLC (The Woodlands, Texas). “There remains great potential for U.S. exports, but there are also practical matters that affect investment and doing business in Mexico.”

Northeastern U.S.

Although there was no sustained discussion of supply and demand trends in the Northeastern U.S., one speaker, Stuart Saulters, vice president of government relations at the American Public Gas Association (Washington, D.C.), said some locally owned gas utilities in the region have had to suspend new residential gas hookups because there is insufficient supply and inbound pipeline capacity to meet new demand.

Saulters went on to decry the growing national movement toward “building electrification,” chiefly achieved by changing local building codes in ways that prohibit direct use of natural gas in new homes and buildings.

“It's becoming increasingly apparent that there is significant opposition to direct use of natural gas,” he said. “Policies are being enacted across the country to limit fuel choice and mandate only one form of energy can be delivered to a customer — electricity.”

“Although building electrification started on the coasts, it is moving inland,” he said. “No state, city or town is insulated from the challenge to direct use of natural gas. One hundred-percent electrification of buildings is not appropriate.”

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