

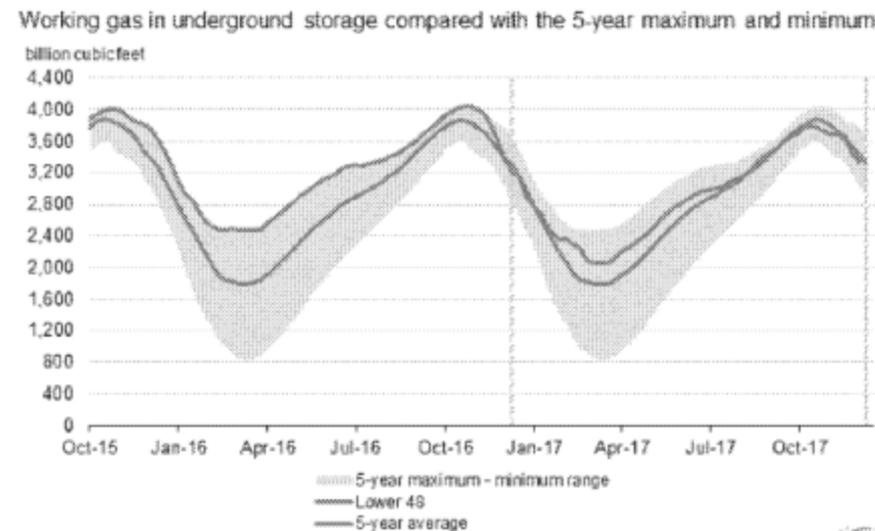


Natural Gas – normal winter key to absorb coming production surge

Flat production and exports supported gas prices in 2017

After two consecutive years of gas prices well below \$3, the US gas market is set to end 2017 above the \$3 mark, but just barely. Despite a second consecutive mild winter for the record books, S/D dynamics have turned more supportive, steadily whittling down an inventory surplus through most of 2016 and ultimately turning it into a modest deficit by mid-November '17. At the start of the 2016 injection season, working gas storage stood at 2.5 Tcf, 874 Bcf higher (or 54% higher) than the 5-year average. A year later, the inventory levels had come down to 2.1 Tcf, only 265 Bcf or 15% higher than the 5-year. By mid-November, inventory levels had turned into a deficit of 121 Bcf (or 3% lower). Two factors have driven this turnaround. First, production has been largely flattish over the last two years – EIA estimates that dry gas production in FY 17E would grow by just 1% YoY despite weak 2016 comps (-2% YoY). Second, export growth has been impressive at +2.3 Bcf/d YoY, taking out an additional ~840 Bcf of supply for the year. The pipeline exports have seen a robust increase in recent years, but more notable in 2017 was the sharp ramp up in the LNG export market (+1.4 Bcf/d YoY).

Figure 14: US working natural gas storage



Source: U.S. Energy Information Administration



Source: EIA

A mixed start to 2017-18 winter season drives a volatile gas market

Since the start of the year, the outlook for 2018 gas price has been constructive – in the very relative sense of a \$3 gas world – with the 2018 gas strip trading in a narrow range of \$2.90-\$3.10 until early December. Two factors have contributed to this. First is the prospect of the markets getting back to balance in 2H 17 due to reasons discussed above. Second, the expectation for a relatively normal winter during 2017-18 after 2 consecutive years of very mild winters. However, weather since mid-November has been mixed – weather was warmer-than-usual during the three weeks ending December 8th, reversing 94 Bcf of the inventory deficit (121 Bcf as of mid-November). Considering that 2018 is expected to see a robust resurgence in