

## HIGH NATURAL GAS PRICES: **THE BASICS**



“Given weather conditions this winter, supply overall appears to be adequate for U.S. needs through the winter, though prices could still spike on cold weather and local deliveries could be affected by local prices.”

Winter 2005-2006 Natural Gas Market Update

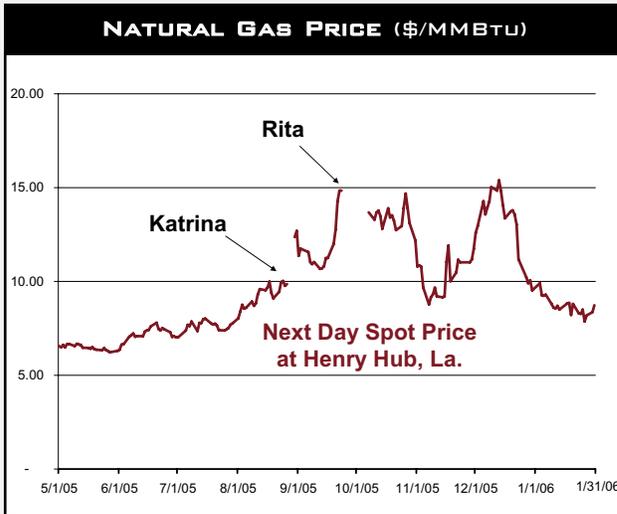
January 19, 2006





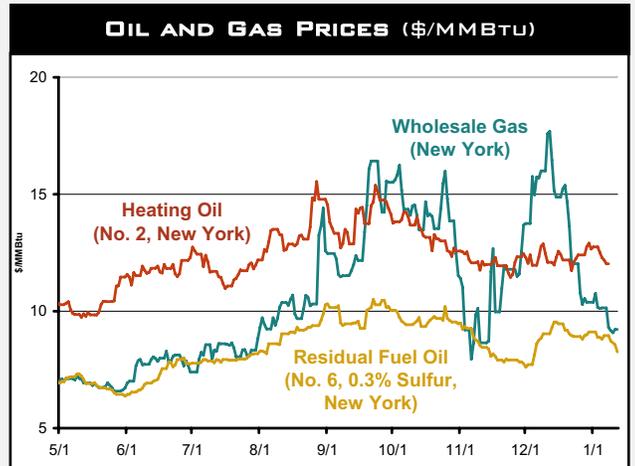
### Natural gas prices have fallen in recent weeks.

Natural gas prices rose significantly in 2005, trading for as much as \$16.00 per MMBtu in national production-area spot markets after hurricanes Rita and Katrina. Since then, prices have fluctuated with changing weather - lower during a warm November, higher during cold weather in early December and lower again during mild weather through January. As of January 23, prices were at \$8.25 per MMBtu at the Henry Hub, slightly higher in consuming areas of the East and lower in the rest of the country. These prices are much lower than peak prices in 2005, but still high by historical standards.



DERIVED FROM INTERCONTINENTAL EXCHANGE.

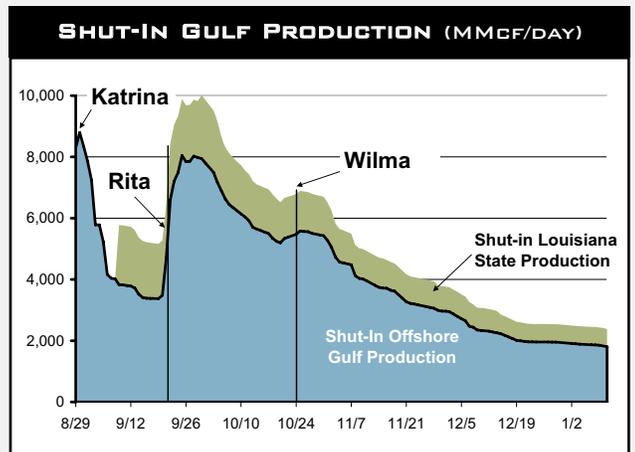
Natural gas prices have fallen to the point where oil prices appear to be holding them up. Except during weather-driven periods, gas prices normally fall between those for residual fuel oil (as a low) and heating oil (as a high). After the hurricanes, and again during cold weather in December 2005, gas prices rose above that range. Recently, however, the gas price has fallen near the bottom of that range and may not fall much further at current oil prices. In New York, for example, the gas price has not dropped far below residual fuel oil for any significant length of time in years.



DERIVED FROM INTERCONTINENTAL EXCHANGE.

### Production recovery in the Gulf of Mexico is strong.

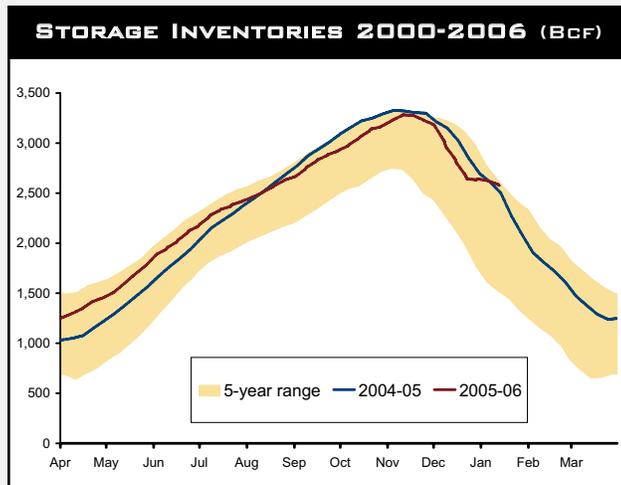
Recovery efforts in the Gulf of Mexico have returned almost three-quarters of the supplies shut in by storm damage, both offshore and onshore, in Louisiana. Today, about 2.4 billion cubic feet (Bcf) remains shut-in, 1.8 Bcf offshore and 0.6 Bcf onshore in Louisiana. Combined with lower consumption because of weather, this recovery has alleviated most of the immediate supply concerns for the winter of 2005-2006.



DERIVED FROM MINERALS MANAGEMENT SERVICE (MMS) AND THE LOUISIANA DEPARTMENT OF NATURAL RESOURCES.



The natural gas industry entered the winter with high levels of gas storage, despite the supply interruptions from the hurricanes. This was a sensible insurance policy against the possibility of a cold winter. As weather has remained warm in January, storage levels have remained high (near the top of the five-year range). Withdrawals from storage have been relatively low – consistent with warm weather and high prices. As a result, storage inventories are as high as they have been at this time of the year in any of the last five years.



DERIVED FROM ENERGY INFORMATION ADMINISTRATION THROUGH 1/20/06.

## What is the Commission doing to respond to high gas prices?

The Commission is acting to make sure that natural gas prices reflect the true balance between supply and demand, and not artificial constraints in the system or the exercise of market power. It has:

- Strengthened its enforcement policy, adopting new market manipulation rules and implementing its new civil penalty authority (up to \$1 million per day, per violation) in a manner to encourage a strong compliance program.
- Improved its ability to detect new market manipulation by implementing a Memorandum of Understanding with the Commodity Futures Trading Commission.
- Established a strong monitoring system for the market to make sure that the Commission detects any market manipulation that might arise during this time of high prices.
- Issued orders immediately after the hurricanes that let market participants move gas in new ways that avoided bottlenecks caused by the hurricane damage.
- Approved applications for a substantial expansion of the Nation's LNG terminals for receipt of imported gas.
- Shown a strong record of approving applications for new pipelines in a swift and environmentally responsible way.
- Approved changes to pipeline tariffs to help pipelines force compliance with operational flow orders to maintain system reliability.

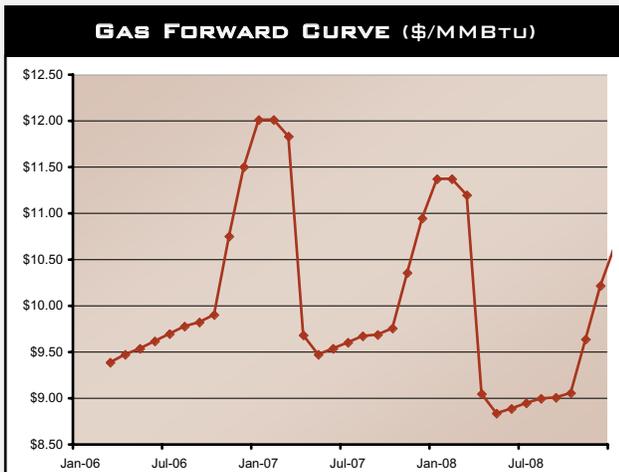
It is important to remember that the Commission does not directly regulate most wholesale natural gas prices, which were decontrolled in 1989 to prevent the severe inefficiencies and shortages of the 1970s from recurring. It has no jurisdiction over retail gas prices.



FEDERAL ENERGY REGULATORY COMMISSION

### Where are gas prices headed from here?

Before the hurricanes, natural gas prices had reached levels that reflected an ongoing tightness between supply and demand. Despite the warm weather this winter, markets appear to expect natural gas prices to remain high in historical terms for some years to come.



DERIVED FROM NYMEX DATA FROM 1/30/06.

In the near term, the best guess from the market is that prices will probably remain near current levels for the next month or two and then trend higher through the summer as the electric power load picks up. The relatively low price for the rest of this winter reflects high gas storage inventories resulting from warm weather so far. Forward prices for next winter are 30 percent to 40 percent higher than current prices. In future years, forward prices anticipate slightly lower prices each year, with recurring peaks in the winter.

These forward prices are not price predictions - only what the market is willing to trade at now for the future. In practice, weather will continue to be the most important factor in determining prices. A very hot summer or cold winter would tend to increase gas prices, while mild weather would do the opposite.

### How will imports affect the American market?

The United States produces 84 percent of the natural gas it consumes. The United States imports the remainder from Canada and from overseas as liquefied natural gas (LNG). Canada is part of the same basic market with the United States and sees the same tightness between demand and supply that we do. For overseas shipments, the United States competes with other consuming countries in Europe and Asia. Even where spot markets are active (for example, in the United Kingdom), prices can be higher than in North America. This winter, Europe has seen very cold weather and much higher prices than the United States. As a result, where contracts permit, gas sellers have diverted LNG deliveries to Europe to take advantage of the high prices, and deliveries to the United States have been lower than last year.

In the future, more natural gas producing countries will be building plants to liquefy natural gas, increasing overall supply. As a result, LNG is likely to be an increasing part of natural gas supply in the United States.

### What can you as a customer do about high natural gas prices?

You can cut your own natural gas bill through conservation - see (for example) the Department of Energy's website <http://energysavers.gov> for practical suggestions on conservation. When you conserve, you also help everyone else, since reduced consumption lowers stress on the whole gas industry and tends to lower prices.

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For further information on natural gas:  
[WWW.FERC.GOV/INDUSTRIES/GAS.ASP](http://www.ferc.gov/industries/gas.asp)

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