

Why natural gas prices are high

Since natural gas can often be a substitute for oil, and frequently is a byproduct of oil production, gas prices (in terms of dollars per million cubic feet) closely track oil prices (in dollars per barrel), as shown in Figure 3. Weak natural gas production, high demand and rising oil prices are the main drivers of high natural gas prices. Because some large volume customers, primarily industrial consumers and electricity generators, have the ability to switch between natural gas and petroleum products, natural gas will correlate closely with crude oil. However, with increased environmental concerns, more and more large-scale users require substantial price differential before switching to the high emission petroleum products. As a result, this will cause natural gas and crude oil price decoupling. Weather related events such as lack of rainfall in hydroelectric generation regions, hurricane impacts on Gulf of Mexico production and pipeline capacity limitations will create price spikes any given year.

Figure 3. The relationship between the price of crude oil and natural gas

Source: Energy Information Agency⁷



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Beginning in the winter of 2000-01, which was colder and drier than normal, cold weather drove up heating demand, and dry weather reduced the availability of hydropower, increasing the demand for gas-fired electricity. U.S. gas prices that had remained in the range of \$1.40 to \$2.40 per million British thermal units (MMBTU) for 95% percent of the 1990s spiked to over \$6.00 per MMBTU in late 2000.⁸

12 LNG and the Northwest Forward Observer

Futures markets suggest that prices will remain near or above \$7.00 per MMBtu for the foreseeable future.⁹ In fact, as of June 11, 2007, the NYMEX future prices for January 2012 (the first full year of Bradwood Landing's operation) settled recently at \$8.66 per MMBTU.