

June 23, 2008

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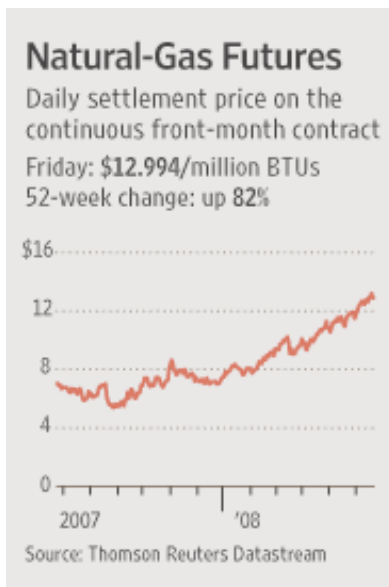
Weather May Ping Natural Gas

Prices Could Climb If Summertime Heat Is Worse Than Usual

By BEN CASSELMAN
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Natural-gas prices, up 74% since the year began, could be headed higher amid predictions of an unusually hot summer in parts of the nation. If those forecasts play out, air-conditioner use will rise -- and with it, demand for electricity production fueled by natural gas, possibly driving futures prices to records.

In Washington and Saudi Arabia, where world leaders gathered during the weekend to discuss high energy prices, much of the focus was on the price of oil, which remains near its highest closing on record. Natural-gas prices have been soaring despite increased domestic production.



Natural-gas futures settled Friday at \$12.994 a million British thermal units, up 11% in June and up more than 82% from 52 weeks ago. Prices are off about 16% from the record close of \$15.378 a million BTUs set Dec. 13, 2005, in the wake of hurricanes Katrina and Rita, which disrupted natural-gas production in the Gulf of Mexico.

Many experts say that record could soon fall -- and it may not take a hurricane to break it. "We could see \$15 gas this summer. All the elements are there," said Jefferies & Co. analyst Subash Chandra. Experts attribute high oil prices to a blend of factors: foreign turmoil, increased speculation, industrialization in India and China, and the weak dollar. Explaining the rise in natural-gas prices is relatively simple: It's the weather.

An unexpectedly cold winter increased demand for natural gas, which heats about half of U.S. homes. That left spring storage levels unusually low -- down 14% in the first week of March, compared with a year earlier, according to government data.

Storage levels made up some ground in April and May, but a hot June eroded those gains as consumers turned on air conditioners, increasing electricity use. Natural gas generates as much as 30% of U.S. electricity during peak summer periods, according to the research firm Genscape Inc.

The heat is likely to continue. Weather 2000 Chief Meteorologist Michael Schlacter predicts an unusually hot summer in the heavily populated South and East, which could drive up natural-gas demand, and prices, even further. If a hurricane strikes gas-producing areas in the Gulf of Mexico, it

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could lead prices to rally as high as \$20 a million BTUs, some experts estimate.

"God forbid you see a hurricane this summer," said Wachovia analyst David Tameron, who sees prices approaching \$16 a million BTUs even without a major storm.

A hurricane would have a bigger impact on natural-gas prices than on oil prices because the U.S. is far more dependent on domestic supplies for its natural gas. The U.S. imports roughly two-thirds of its oil, but less than 20% of its natural gas, mostly from Canada. Only about 3% comes from overseas in the more easily transportable form of liquefied natural gas.

LNG imports have been especially low this year because of high demand in Europe and Asia. LNG imports in the U.S. are down more than 70% from last year, according to federal data. "All that LNG that was supposed to come here is more likely to find a higher price in those other markets," said Credit Suisse analyst Jon Wolff.

The long-term outlook for U.S. natural-gas prices is less clear. Demand for natural gas for power generation is rising as utilities look for a cleaner alternative to coal. But supply is rising as well, thanks to a drilling boom driven by higher prices. U.S. natural-gas production was up 7.7% in March compared to the previous year, according to the Energy Information Administration

If LNG imports also rise -- a possibility because several LNG projects are set to go online next year -- the increased supplies could drive down prices. Mr. Wolff is among those predicting prices will fall next year, possibly below \$10 a million BTUs, he says.

Some analysts expect the drop sooner. They argue the market has overcompensated for a hotter summer and lower storage levels; if the market's worst fears don't materialize, they say, prices will fall. "I would be surprised if we held these prices all summer," said Jeff Hayden, an analyst with Pritchard Capital Partners, who expects prices to slip to \$10 or less by fall.

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