

Natural Gas Outlook: On the Road to Recovery

A Publication of BMO Capital Markets Economic Research · Douglas Porter, CFA, Chief Economist, BMO Financial Group

The prospects for natural gas have improved, especially compared to the depressed prices witnessed over the past year. The increased optimism over natural gas is reflected in the futures market, which suggests that Henry Hub—North America's benchmark price—could be significantly higher in 2021. Of course, a futures price is not a forecast, so higher futures prices may not necessarily translate into higher actual Henry Hub spot prices. The futures market is currently indicating that a producer could theoretically sell all of its natural gas production in 2021 at around US\$3/mmbtu. In contrast, Henry Hub has averaged \$1.80 over the past month.

The optimism is largely based on two key developments. First, U.S. natural gas production is expected to decline significantly due to weaker associated gas production from lower shale oil output. The U.S. Energy Information Administration forecasts output to contract 3.8% to 94.4 bcf/d in 2021 (vs an estimate of -1.9% in 2020). Second, U.S. exports of LNG are expected to accelerate on the back of the recent surge in benchmark prices in Europe (Title Transfer Facility-TTF) and Asia (Japan-Korea-Marker-JKM). TTF is now trading close to EUR14.00/MWh (up ~165% since the beginning of August), while JKM is hovering just over US\$5.00/mmbtu (up ~90% in the same period). Both have reached levels that make them attractive for U.S. producers to export to these markets, when accounting for liquefaction and shipping costs. In contrast, natural gas prices in the spring had sunk to levels that compelled many buyers to cancel LNG contracts and opt to pay a penalty, rather than take delivery.

These two factors, coupled with the typical seasonal pick-up in natural gas consumption during the winter, are expected to lead to a drawdown in inventories and a tighter market. Consequently, we revised up our forecast for Henry Hub to US\$2.50/mmbtu in 2021 (previously \$2.25), compared to an estimate of \$1.95 for the whole of 2020. Meantime, the price of AECO—Western Canada's natural gas benchmark—should be able to piggyback on higher Henry Hub in the coming quarters. As a result, we are projecting AECO to average US\$1.75/mmbtu in 2021, up from \$1.60 in 2020.

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