

Running out of gas: Soaring demand outpaces production

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USA. - The natural gas industry faces a year of conflicting extremes in 2004.

Houston-based and multinational energy companies will pursue a number of extremely huge exploration and production projects in the Gulf of Mexico

But the amount of natural gas they supply, although substantial, will be woefully inadequate to offset a U.S. production rate that continues to dwindle at an extremely rapid pace.

And events like the freezing cold snap that hit much of the country in December and caused gas prices to spike 50 percent only represent the tip of the iceberg.

This bleak assessment of the disparity between expanding production and shrinking supply comes from Houston energy guru Matthew Simmons.

The president of Simmons & Co. International, an energy investment bank, believes the United States faces a serious natural gas crisis that could have a devastating impact on the national economy.

And Simmons is not alone...

In October, the National Petroleum Council (NPC) revised its official natural gas outlook with a 180-degree turn.

Four years ago, the council was projecting a bright future for the fuel, with ample supplies and prices averaging under \$3 through 2015.

Now the NPC is saying that, "there has been a fundamental shift in natural gas supply/demand

balance that has resulted in higher prices and volatility."

As a result, the NPC has lowered gas production estimates for North America by 22 percent, or 7.5 trillion cubic feet per year ## more than 16 billion cubic feet a day.

Deep thinking

The dramatic turnaround has a lot of industry experts scrambling to explain what happened and why.

Part of the answer relates to the huge number of gas-fired electric power plants that were built in the late 1990s. Instead of adding 144 gigawatts by 2015 as the NPC had assumed, actual capacity will exceed 220 gigawatts by 2005.

Simmons also points to the ongoing, accelerating decline in natural gas production in North America, and the reality that even technologically innovative drilling booms in the deep waters of the Gulf of Mexico and in Canada have failed to plug the hole.

Deep-water Gulf production is an important natural gas source ## about 3 billion to 4 billion cubic feet per day. But Americans now consume about 65 billion cubic feet of gas per day.

The Falcon gas field, a major new production area developed by Dallas-based Pioneer Natural Resources Co. in 2003, is expected to produce 400 million cubic feet of gas a day this year. And Shell/BP's Na Kika project is projected to provide similar output.

Houston-based Anadarko Petroleum Corp., ConocoPhillips Co. and Murphy Oil Co. will all be starting up new deep-water fields this year. And BP's huge Thunder Horse field is slated to start up in 2005.

But Simmons points out that deep-water production peaks quickly and declines just as fast.

Deep-water gas production in the Gulf is expected to increase about 4 percent in 2004, a slower growth rate than in recent years. But this won't overcome a projected 3 percent overall drop in Gulf gas production due to steep declines in shallow water.

In a survey of 26 key natural gas producers ## constituting 55 percent of the U.S. supply ## Simmons found that production in the third quarter of 2003 was on average 4.8 percent less than a year earlier, with 70 percent of the companies producing 5 percent to 15 percent less than the previous year.

Declining U.S. gas production and growing demand has spurred many producers to explore for gas in other parts of the world.

And the need to transport that foreign gas to the United States has spawned proposals for numerous liquefied natural gas (LNG) projects.

"LNG has become the 'flavor of the month,'" Simmons says. "It has ended up as a vital component to our gas supply, even though just three or four years ago people would have said that's crazy."

While LNG can add critical incremental supplies of natural gas, it would require 10 billion to 20 billion cubic feet of LNG to fill the gap.

Michelle Foss, director of the Institute for Energy, Law & Enterprise at the University of Houston, says part of the answer to alleviate the gas production problem could lie as near as south of the border.

"A really good thing would be for Mexico to do a better job of developing their domestic natural gas supplies," Foss says

This could help ease some of the pressure since LNG imports to the United States equal roughly the same amount of natural gas the country exports to Mexico.

Lift the bans

Foss, Simmons and a growing chorus of other industry leaders say the most logical solution would be the lifting of U.S. bans on drilling for natural gas offshore along the Atlantic and Pacific coasts and in the eastern Gulf of Mexico.

"One of the sillier things we're doing is the bans on offshore drilling," says Foss. "We should be able to develop natural gas offshore. Keeping it off the table for discussion and resource development is ridiculous."

But Simmons notes that even if the ban on drilling in waters off the Outer Continental Shelf were lifted tomorrow, it would take at least a decade and a lot of investment to develop those sources of gas.

With dwindling supply, no immediate solutions and growing demand, Simmons believes some type of government regulation needs to be reimposed on natural gas markets, which were deregulated in the 1980s.

"If it is important to regulate banking and the financial markets, it is infinitely important to have some oversight regulation on something as complicated as natural gas," he says.

But Foss thinks "people will try market-based solutions first."

The best way is for people to see the price signals and respond with more efficient use of natural gas, she says.

But Foss also acknowledges that there is disagreement on how much room for adjustment

exists on the demand side.

Says Simmons: "You can't just let residential consumers duke it out with industry and power plants to see who gets gas and electricity."

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