By: Alex Mills **March 24, 2016**

Oil, Natural Gas Prices Remain Low On News Of Large Supplies

While the big news last week pointed to another historic increase in crude oil supplies, natural gas received news that it is now the major energy source for electricity generation in the U.S. The abundant supply of oil and natural gas in the U.S. continues to keep prices low.

The Energy Information Administration reported March 23 crude stocks in the U.S. rose by 9.4 million barrels to a record total of 532.5 million barrels. The news of increased oil supplies caused oil futures for May delivery on the NYMEX to close down $1.66 (4%) to settle at $39.79 per barrel on March 23. The decline in price reversed a two-month rally from a low of $26 per barrel to a high of $41 earlier in the week.

On the other hand, there were reports that oil supplies in a major trading area declined, and there was a decrease in gasoline supplies. EIA reported that gasoline stocks fell 4.6 million barrels, and demand for gasoline over the past four weeks rose 7 percent year-on-year. Also, crude stockpiles at the Cushing, Oklahoma, delivery hub fell 1.3 million barrels, declining for the first time in seven weeks.

Another event impacting oil prices is the anticipated meeting of oil exporting countries next month in an effort to limit more production. Qatar has invited all 13 OPEC members to Doha on April 17th for another round of talks to widen the production deal. Libya and Iran have snubbed the initiative, arguing that they will need to boost their crude output further before considering joining any caps on production. Iran's oil production has been reported at about 300,000 barrels per day currently with expectations to increase.

Increased hedging volume is evident in Commodities Futures Trading Commission (CFTC) data as well as anecdotal evidence from commodities trading desk, and it's not confined to distressed producers, according to a report from Morgan Stanley. "IG Permian producers are actively willing to hedge at $45- 50 in 2017, which should cap the potential upside in prices," the report stated. Hedging is a financial tool that can be used to reduce risk associated with volatile price swings.

Regarding natural gas, EIA expects that the combination of market forces and government policies will continue to stimulate the use of natural gas to provide 33 percent of generation in 2016 while coal's share falls to 32 percent. The expected share of nonhydro renewables (wind and solar) increases to 8 percent in 2016, with hydropower's share at 6 percent.

Coal and natural gas generation shares over the past decade have been responsive to changes in relation to fuel prices. For example, particularly low natural gas prices throughout much of 2012 following an extremely mild 2011–12 winter led to a significant rise in the natural gas generation share between 2011 and 2012, often displacing coal-fired generation. With higher natural gas prices in 2013 and 2014, coal regained some of its generation share. However, with a return to lower natural gas prices in 2015 favoring increased natural gas-fired generation, coal's generation share dropped again, EIA stated.

Environmental regulations affecting power plants have played a role in driving coal's declining generation share over the past decade, although plant owners in some states have made investments to shift generation toward natural gas at least partly for environmental reasons. Environmental regulations may play a larger role in conjunction with market forces. Owners of some coal plants will face decisions to either retire units or reduce their utilization rate to comply with requirements to reduce carbon dioxide emissions from existing fossil fuel-fired power plants under the Clean Power Plan, which is scheduled to take effect in 2022 but has recently been stayed by the Supreme Court pending the outcome of ongoing litigation.

Beyond the growing market share for natural gas-fired generation over the past decade, coal's generation share has also been reduced by the growing market share of wind and solar. Unlike the growth of natural gas-fired generation, which has largely been market-driven, increased use of wind and solar has largely been driven by a combination of state and federal policies.

Natural gas closed on NYMEX at $1.794 on March 23.

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