



## Fuel Prices As We Go over the Top...?

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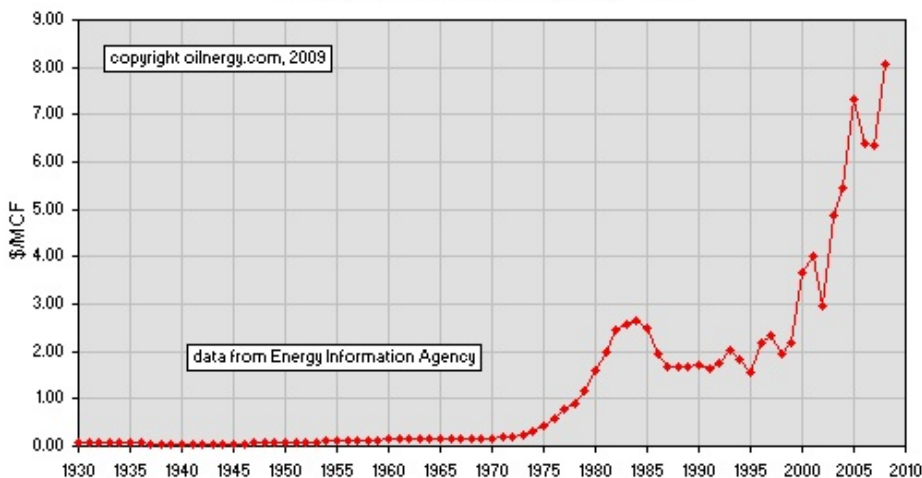
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The first question asked by those hearing about fuel depletion is usually: "How high will prices go?". The attitude is almost always that one will just have to pay up, as the fuel is essential. This is of course a recipe for extremely high prices, but just how prices will vary as the depletion process unfolds remains to be seen.

We already have an example of a (nearly) isolated market that has definitely gone over the top of production, and that is the North American natural gas market. Production peaked several years ago, and a slow decline has begun, in spite of record drilling. This phenomenon has occurred at very close to the same time for almost all the major basins on the continent. If we look at the NYMEX wellhead gas price for the last 75 years, we can see that the price was very low indeed until about the time of the first production peak in 1970, and then rose to a reasonably steady \$2US per thousand cubic feet, which held until about 1999. During this period, it was relatively easy to meet any production shortfall by drilling new deposits. (One thousand cubic feet of gas has very close to one million BTU of heating energy, which is also close to one gigaJoule.)

Since 1999, the price has risen by a factor of about four. It should come as no surprise that this has occurred as the limits to gas production became impossible to ignore. Drilling rates rose dramatically, while production reached a plateau and began to decline slowly.

U. S. Wellhead Natural Gas Price



What the year-by-year graph does not show is the shorter-term variation, which has been extreme over the last year. The all-time (so far) maximum of over \$15US per million BTU, achieved in December 2005, has been followed by a minimum of barely over \$4 in September of this year, and some [large players paid dearly](#) for betting on high prices. This has led some people to think that the "crisis" is over.

**NYMEX Henry-Hub Natural Gas - 12 previous months**



Nevertheless, the president of the American Chemistry Council said recently: "[Make no mistake, the natural gas crisis hasn't gone anywhere.](#)", and the bets are on [increasing prices](#) once again.

The question that arises is why the price has fallen so far in an era of dwindling supply. The answer lies partly in the mild winter of 2005/6 and moderate summer of 2006, but the steady shutting down of industry has a large and on-going influence on consumption and on price. Industrial users of gas pay the lowest prices, and are the first to shut down or move their production facilities overseas as the price rises. This acts as a brake on the rise. U.S. industrial consumption of gas fell 22% [between 1997 and 2005](#), and the U.S. has lost [three million manufacturing jobs](#) since 2000. Canada will not have been immune to this type of change. The deindustrialisation of North America is already under way, even though "Peak Oil" (and gas) is only just beginning to enter mainstream public debate.

Industrial consumption is still very large, so there yet remains a considerable fraction of the gas demand that can gradually be destroyed at relatively low prices. Will this allow production to decline by say twenty per cent without the price going any higher than it already has? Adding to this effect may be a decrease in gas consumed to make electricity, as deindustrialisation destroys electricity demand too. Will the result be that gas depletion remains partially hidden from public view by the economic downturn that it has helped cause? A collapse of the debt bubble and hence of the US dollar would no doubt cause a major reduction of consumption by all sectors. It is not too difficult to envisage a situation in which real prices do not rise much, or even fall, while a major decline in gas production is officially explained by economic factors, rather than depletion.



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