In 2020, gas glut will push prices down to 1970s lows, research firm forecasts

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Natural gas prices are likely to slump in 2020 to adjusted levels not seen since the 1970s, pressured by surging supply from western Texas that will heap pain on gas drillers and force companies to pull back on spending, according to a forecast by industry research firm IHS Markit.

Henry Hub gas prices will average under $2/MMBtu in 2020, marking the first time since 1995 that the benchmark contract will have dropped below the $2 level in nominal terms and threatening to set the lowest annual inflation-adjusted average in decades, IHS Markit said in a report. The London-based firm sees prices then rebounding slightly in 2021, averaging $2.25/MMBtu, lower than its previous estimate.

A massive increase in associated gas plumbed from the Permian Basin during oil production underpins the firm's forecast. That growth in gas production will combine with new gas pipeline capacity in the Permian, the nation's top shale oil field, to contribute to oversupply that will force gas-focused drillers to pump the brakes across North America, IHS Markit said.

Gas production hit a new monthly record at 91 Bcf/d in August, according to the U.S. Energy Information Administration. Output hit a daily record of 92.8 Bcf/d on Aug. 19, the EIA said, citing IHS Markit data.

"We need about 90 Bcf/d in 2020, and we're at 92 and still growing, so you can see we've got a reckoning that we're going to have to deal with in 2020," IHS Markit Executive Director Samuel Andrus said during a Sept. 10 panel at the LDC Gas Forum in Chicago.

"What we expect from all of this is some serious cash flow challenges in 2020, and that ... outside of Appalachia — in the smaller producers — there's going to be a lot of struggle," Andrus said. "It's going to be a rough year for the industry."

Associated gas hammers Henry Hub prices

Direct Energy market analyst Kiran Sidhu agreed that U.S. production needs to back off. He warned that current market dynamics could force some dry gas producers into bankruptcy or consolidation with more diversified competitors, such as ConocoPhillips

"The debt is still not that high in the producer community," Sidhu said at the LDC Gas Forum. "However, the fear is very high because the debt will increase many-fold if you don't have other projects. So you need to be multicommodity producer, not a pure gas producer."

IHS Markit sees output of U.S. associated gas rising to about 30 Bcf/d in 2021 and catching up with production from the Marcellus and Utica, the nation's top gas shale regions, the following year. As this happens, drillers that focus on gas will have to throttle back output, leading to a reduction in capital expenditures of about 30% in 2020, Andrus said.

Canadian producers will find it increasingly difficult to find a home for their supplies south of the border in this environment, Andrus said. Output is also likely to drop in the Haynesville Shale in Louisiana, Arkansas and eastern Texas, where producers will struggle to send gas east, Andrus said.

Even the Marcellus Shale, the Appalachian engine of U.S. output growth, will see gas production flatten in 2020, Andrus added.

Goldman Sachs Group Inc. recently echoed that sentiment when it lowered its 2020 and 2021 gas price forecasts to

$2.50/MMBtu and $2.75/MMBtu, respectively. The investment bank pointed to robust U.S. supply growth in August and lower expectations for industrial demand.

"Rising associated gas production and a slowdown in demand growth lead us to believe U.S. natural gas prices will need to remain low enough to moderate production growth, especially in Appalachia, in order to keep storage levels in check," Goldman analysts said in a Sept. 2 research note.

LNG exports, storage influence market

IHS Markit projects that U.S. gas storage will exit winter about 263 Bcf above the rolling five-year average and head toward all-time highs around 4 Tcf in October 2020.

"That will signal to the market that we need to pull back," Andrus said. "Right now, the market is protecting for the winter, but once we see the injections in October, we'll know that we don't need to protect quite as hard."

Andrus expects Appalachian output to begin ticking up again as the market, particularly the one for liquefied natural gas, expands to absorb more supply.

The U.S. is expected to increase LNG exports by an additional 3 Bcf/d in 2020, creating more domestic demand for feedgas, according to IHS Markit. But the amount of new capacity, as indicated by final investment decisions on export terminals, means LNG supply will continue to outstrip global demand, Andrus said.

IHS Markit believes that this will create seasonal swings in which LNG export terminals will either see "very opportunistic" maintenance or simply take units offline coming out of the winter into the second quarter.

"All of the [final investment decisions] that you're seeing are adding capacity to a market that already can't absorb all of the capacity we have," Andrus said. "The timing of the extra capacity may increase ... the cyclicality, or the seasonality, of this even out into 2022, '23 and '24."

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