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# NATURAL GAS & POWER MARKET REPORT FOR OCTOBER 26, 2010

## NATURAL GAS MARKET NEWS

**The NRC reported today that some 79,495 Mw of generating capacity was online today, down 0.3% from yesterday, but some 8.6% higher than the same day a year ago.**

The National Weather Service as expected this morning down graded Tropical Storm/Depression Richard to a remnant low-pressure system and saw no threat for intensification given that it will be moving through an area of dry mid-level air and moderate to strong wind shear. Forecasters continue look for a tropical system to spring to life in the Caribbean by early next week coming from a area of disturbed weather currently moving west ward located currently in the eastern Atlantic. Several computer models have this system becoming a named storm as it moves near Aruba then heading northward and then up along the east coast as it is absorbed into an intense coastal storm later next week.

Pennsylvania Governor Rendell today halted further leasing of state land for natural gas drilling, as he signed an executive order imposing a "strategic moratorium" on future drilling operations on state lands. The state has already leased about one third of its two million acres of state forests for gas drilling.

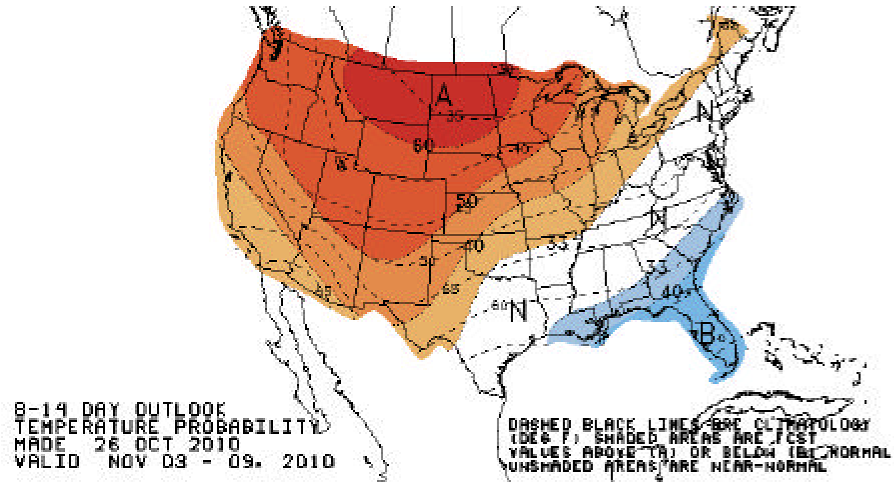
The Canadian Association of Oil well Drilling Contractors said today that they expect just a 2% increase in Western Canadian wells drilled in 2011 as natural gas prices remain weak. They look for the focus to be on oil drilling. The group based their outlook on crude oil prices averaging $80 per barrel and natural gas prices averaging C$4 per mcf.

A research report from Bank of America Merrill Lynch today estimated that the LNG market will tighten further next year and spot prices will rise as demand picks up across Asia, Europe and South America. The group sees global imports will increase by 3.8 bcf/d or 13% to 33.8 bcf/d, while production capacity increases by 4.7 bcf/d or 16% reaching 33.9 bcf/d. The research note looks for Europe to continue to be the prominent destination for LNG given the wide price differential between oil and gas prices and the reluctance of Gazprom to reduce contract prices.

Natural Gas Cash Market
ICE Next Day Cash Market

| Location | Volume Traded | Avg Price | Change | Basis (As of 12:30 PM) | Change | Basis 5-Day Moving Avg |
|---|---|---|---|---|---|---|
| Henry Hub | 571,100 | $3.277 | $0.101 | ($0.067) | $0.080 | ($0.059) |
| Chicago City Gate | 515,700 | $3.503 | $0.194 | $0.159 | $0.140 | $0.094 |
| NGPL- TX/OK | 755,900 | $3.213 | $0.157 | ($0.131) | $0.103 | ($0.163) |
| SoCal | 307,800 | $3.151 | $0.135 | ($0.193) | $0.081 | ($0.160) |
| PG&E Citygate | 922,800 | $3.933 | $0.061 | $0.589 | $0.007 | $0.499 |
| Dominion-South | 535,100 | $3.413 | $0.164 | $0.069 | $0.110 | $0.025 |
| USTrade Weighted | 19,898,500 | $3.302 | $0.134 | ($0.042) | $0.08 | ($0.059) |

The head of power and gas trading for Barclays Capital said today that natural gas prices could drop below the seven year low they recorded last September if expectations for a mild winter, high inventories and growing domestic production are realized. He noted that prices could drop even below $2 per Mmbtu by the second quarter of next year and could challenge the $1.85 per Mmbtu level recorded in 2002. He noted the stubborn production growth coming into an over supplied market will be the primary force. He noted that some producers are drilling to be paid for production they hedged at higher levels while others are producing to hold onto leases. He noted though there is little gas that can be produced at $3.50 or below that is economical to produce. He looked for the U.S. to see record inventory levels at the end of this winter heating season. The bank earlier this month lowered their price forecast for 2012 from $5.25 to $4.50.




Algeria's finance minister today said that Algeria should see its energy production and exports shrink in 2011, with oil and gas sales expected to be a combined $2 billion lower next year. The ministry declined to give specifics and some market observers were speculating that Algeria could cut gas and LNG exports in response to low global demand and prices and a desire to hold onto its reserves until prices recover. Algerian LNG production capacity was cut this year by 20% due to an accident and is not expect4ed to return to normal for a few more months.

Lithuania's prime minister said today that Western Europe needs to break its dependence on Russian energy by improving its internal gas market.

BP reportedly is considering shutting down the Rhum natural gas field in the North Sea that it holds a 50% stake in along with state owned National Iranian Oil Company, as a result of its management looking to be in compliance with new European sanction on Iran. The field holds 800 bcf of gas reserves.

The Swiss energy ministry reported today that the Swiss-Italian Transitgas pipeline which has been shut since July 23rd will resume operations provisionally by the end of the year.

Reuters reported that the Qatari Al Huwaila LNG tanker is expected to arrive at the Isle of grain LNG terminal on October 31st. The vessel holds 216,000 cubic meters of gas. National Grid reported that the Fraiha LNG tanker berthed at the Isle of Grain terminal today with another cargo expected before Sunday to arrive as well.

The joint venture between Saudi Aramco and Royal Dutch Shell has begun drilling the first of three wells as part of a second phase of gas exploration in Saudi Arabia. The drilling began a few weeks ago. The first phase of drilling failed to discover sufficient commercial quantities of gas.

A member of Russia's Audit Chamber said today that ExxonMobil may be replaced by a Russian company as operator of the Sakhalin-1 gas project, but at this time that action is not being directly considered.

## ECONOMIC NEWS

The CME Group reported that algorithmic or automated trading systems have increasingly been used in CME Group markets. It reported that during the third quarter of 2010, automated trading in its markets totaled 45.61% of the total electronic volume, with message traffic of 66.06%. Foreign exchange traders accounted for 67.73% of the volume and 85% of the message traffic generated. Energy traders accounted for 33.77% of the electronic volume traded, with 59.7% of the message traffic generated. Crude futures and options traders accounted for 34% of the volume and 59% of the traffic message.

The Standard & Poor's/Case-Shiller 20 city home price index fell 0.2% in August from July. Fifteen of the cities showed monthly price declines. US home prices fell 2.4% in the 12 months through August.

State Street said confidence among institutional investors fell in October as flows into emerging markets were offset by a flight from developed economies. Its global investor confidence index fell to 86.2 from a downwardly revised 88.1 in September. Its North America index fell to 84.9 in October from 88.1 in September. European investors' confidence also fell to 96.4 from 97 in September. Asian investors' confidence fell to 103.3 from 107.7.

Britain's economy grew twice as fast as expected in the third quarter. The Office for National Statistics said Britain's economy grew 0.8% between July and September, down from a nine-year high of 1.2% in the second quarter but twice the 0.4% most economists had expected. In annual terms, Britain's economy grew by 2.8% in the third quarter, the fastest rate in three years and up from 1.7% in the previous quarter.

Under newly proposed rules, the CFTC's anti-fraud and anti-manipulation power would increase. It would implement provisions in the Dodd-Frank financial law, with expands the CFTC's authority and allows it to regulate the $615 trillion over-the-counter derivatives market. The CFTC however does not propose specific bans on high frequency trading practices and is seeking more public comment. A CFTC official said the new anti-manipulation powers, position limits will help improve the metals market.

## MARKET COMMENTARY

The bears in the natural gas market today never really mounted a serious challenge to the support at $3.25 in an attempt to flush weak shorts in the expiring November $3.25 puts to cover their positions. The relative strength of the cash market at many locations appeared to keep the bears at bay. Instead trading spent much of the day contained within a 10 cent trading between $3.30-$3.40. With the expiration of the November contract tomorrow we expect to see a relatively modest price impact for expiration, as open interest in the expiring contract is relatively modest. Some 22,167 contracts as of Monday were still open in the contract, some 4,000 lots less than the October contract had at the same stage of the month and some 10,000 lots less than the November 2009 had left open prior to expiration.

We would look for the futures market to remain relatively stable tomorrow if the underlying cash markets hold onto the gains they posted today. We would look for the November contract to have potential significant downside support at $3.25 and $3.20, with resistance at $3.40 and $3.468, but feel that the end of the day prices should settle out between $3.25-$3.35.