



# Annual Energy Industry Review

## Snapshot of the fundamentals

Factors that shaped the natural gas market in 2011.

### Demand:

- Wintry start to the year
- Blistering summer
- Return of pre-recession industrial demand levels
- Lackluster year-end with unseasonably mild weather

### Supply:

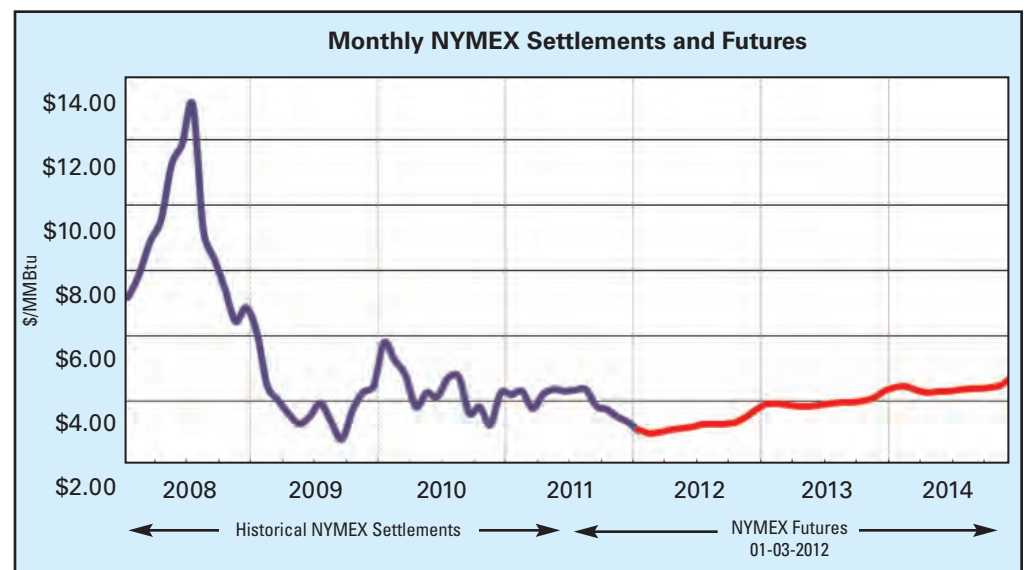
- Continued production growth
- New pipeline infrastructure
- LNG market gets flipped upside-down
- Storage level reaches new peak

This annual market review from CenterPoint Energy Services (CES) provides our customers with the most current information on the fundamental factors affecting energy prices.

This report, as well as our company profile, may be found at [CenterPointEnergy.com/ces](http://CenterPointEnergy.com/ces).

## 2011 Natural Gas Markets: Year in Review

Throughout the first 10 months of the year, monthly NYMEX natural gas prices remained within a \$0.60 range until finally breaking to the downside as cold weather failed to materialize at the onset of winter. To close out the year, the January natural gas futures contract settled at \$3.08/MMBtu – the lowest monthly settlement since September 2009 and the lowest January settlement since 2002. The 2011 NYMEX monthly prices averaged \$4.04/MMBtu, markedly below the \$4.39/MMBtu average in 2010.



Arguably, the unprecedented growth in production was the most important feature of the natural gas industry in 2011. Dry production increased by 5 billion cubic feet per day (Bcf/d) last year – the biggest annual increase on record that spans back to the 1930s. Driving the resurgence of domestic production was the abundance of shale, a porous rock that contains vast resources of natural gas. Shale production has increased twelvefold in the last decade and proved reserves have nearly tripled in the last three years.

Growth in production also brought growth in infrastructure investments. The EIA estimates there were more than \$12 billion worth of natural gas infrastructure investments made in 2011, adding 3,800 miles of pipeline assets. Projects ranged from small gathering systems and capacity expansions in the Marcellus to giant projects like the 1.8 Bcf/d Acadian Pipeline in the Haynesville and the 1.5 Bcf/d Ruby Pipeline out of the Rockies.

Demand growth counterbalanced the increase in supply as colder-than-normal temperatures at the start of the year pushed storage inventories below the five-year average.

As 2011 progressed, however, weather continued to play a key role for natural gas demand. Extreme heat spread over the country to produce the second hottest summer on record, with the average temperature only one-tenth of a degree away from the all-time high set in 1936.

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Demand from power generators edged up 1 percent from the summer of 2010 – a considerable feat considering that 2010 levels were 13 percent higher than the previous summer.

The summer of 2011 was also notable for the industrial sector. On the back of economic gains and growth in manufacturing output, industrial gas demand returned to pre-recession levels. With natural gas prices in the U.S. not just lower than crude oil prices but lower than global natural gas prices as well, domestic manufacturers were presented with a competitive advantage. As a result, 2011 saw a stream of headlines announcing plans for world-scale petrochemical plants to be built in the U.S.

Forecasts for an active hurricane season were validated. None of the 18 named storms, seven hurricanes and three major hurricanes made a significant impact on Gulf of Mexico production, but Hurricane Irene tore through the eastern seaboard producing an estimated \$4 billion in damages.

Natural gas balances took a decisively bearish turn as the summer drew to a close. After sinking below the five-year average at the start of the year, gas storage levels remained there until the end of September. When the summer heat receded, gains in production overwhelmed demand. Spare natural gas made its way into storage, and it did so at a very rapid pace. Inventories swelled, going from 60 Bcf below the five-year average to 460 Bcf above it in just four months and setting a new record-high storage level of 3,852 Bcf.








### Looking Forward

It is difficult to ignore the storage glut. Thus far, mild winter temperatures have created a scenario where the end of the withdrawal season will likely transpire with storage levels above 2,000 Bcf. That, in turn, could lead gas in storage to reach maximum operable limits before the end of the summer and force some producers to shut-in their wells. Under this scenario, marketers would be left scrambling to find a home for supply and prices could tank.

Alternatively, there are a number of factors that could point to higher prices in 2012. On the demand side, the new air quality standards from the EPA may allow gas-fired electric generators to increase market share at the expense of coal. Similarly, the disparity between crude oil and natural gas prices is fueling a shift towards natural gas consumption in the petrochemical and transportation industries. Interest in natural gas vehicles (NGVs) has surged recently. Announcements include fleet expansions, commercial production of natural gas trucks and school buses and development of compressed natural gas (CNG) and liquefied natural gas (LNG) fueling stations.

On the supply side, increasing controversy about hydraulic fracturing (“fracking”), a process instrumental in extracting natural gas from shale rock, may lead to disruptions in recent supply growth. An outright ban on fracking could send prices skyrocketing.

Looking ahead, it is easy to imagine how fracking may represent a major crossroad in the natural gas market this year. Regardless of how things play out, we don’t expect 2012 to be a dull year in the energy markets.

Major themes for 2012		
<b>Gas Production</b>		<ul style="list-style-type: none"> <li>• Current forecasts show production leveling off in 2012</li> <li>• Regulatory environment tightening around hydraulic fracturing (“fracking”)</li> </ul>
<b>Storage</b>		<ul style="list-style-type: none"> <li>• Storage levels have been at record highs this winter</li> <li>• Production shut-ins are a possibility in September and October if storage reaches operational limits</li> </ul>
<b>Industrial Gas Demand</b>		<ul style="list-style-type: none"> <li>• Rebounding economy should continue to propel industrial demand growth</li> <li>• European debt crisis could limit demand for industrial goods overseas</li> </ul>
<b>Residential and Commercial Demand</b>		<ul style="list-style-type: none"> <li>• Mild winter weather causing drastic reductions in demand from last year</li> <li>• Commercial demand poised to benefit from NGVs</li> </ul>
<b>Electric Generation Demand</b>		<ul style="list-style-type: none"> <li>• New emission rules are favorable for electricity generated with natural gas</li> <li>• Natural gas may continue to overtake coal-fired generation</li> </ul>
<b>Competing Fuels</b>		<ul style="list-style-type: none"> <li>• Historical crude oil to natural gas price relationship has tripled in the last year</li> <li>• Coal prices have stayed aloft due to global demand growth</li> </ul>
<b>Liquefied Natural Gas</b>		<ul style="list-style-type: none"> <li>• Imports remain at contractual lows</li> <li>• Several LNG facilities have used their storage tanks to hold and re-export cargos instead of selling them at U.S. market rates</li> </ul>

At CenterPoint Energy Services, our business is helping our customers effectively manage their natural gas purchases in terms of cost, reliability and predictability. It is our hope that our customers take advantage of the experience and expertise of their CenterPoint Energy Services account executive to develop and implement an energy management strategy that performs successfully, regardless of fluctuations in market conditions.

*We thank you for your business in 2011 and look forward to serving you with continued success in 2012 and beyond. Please feel free to contact your account executive if you have any questions or need additional information.*

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