US NATURAL GAS: TWO EASTERN REGION PRODUCING LOCATIONS
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OVERVIEW AND CONCLUSION

The growing natural gas production from the United States Eastern region over the past couple of years has played a key bearish role within the overall American natural gas theater.

The Eastern territory contains numerous important pricing locations. Although the various hubs offer spot pricing information, not all of them provide substantial forward month pricing (and forward trading). The Leidy and Zone 4 Marcellus hubs represent notable natural gas output centers within the East. Algonquin City Gate, in contrast, is a widely-watched Eastern delivery point.

Focusing on the Leidy and Zone 4 Marcellus Hub spot marketplaces together offers insight into Eastern region price trends. The first attached chart averages the Leidy and Zone 4 Marcellus spot prices (individual series from Bloomberg; daily settlements) since mid-November 2011).

The general price trends for this Leidy/Z4Marcellus benchmark over the past two years (see the solid black line on Chart 1) generally parallels those of NYMEX nearest futures continuation (Henry Hub/Louisiana, which rests within the EIA's "Producing Region". The chart also shows that many key price turning points for the Leidy/Z4 Marcellus spot combination have occurred around the same time as those in the NYMEX first futures continuation contract. The handwritten Leidy/Z4Marcellus prices are in blue ink, the NYMEX handwritten ones in black, Thus this Eastern price behavior frequently tends to confirm (intertwine with) notable NYMEX natural gas price trends.

NYMEX nearest futures over the past couple of years admittedly has not cratered to under 150, whereas this Eastern region output benchmark has (6/15/12 at 1.425; 7/3/13 at 1.290 and 8/8/13 at 1.245). Yet extreme price declines in Leidy/Z4Marcellus to levels under 200 arguably help to encourage further sharp price drops in the NYMEX natural gas complex. If a shortage in available storage capacity and related containment threats develop around these Eastern hubs, that situation probably helps to induce these relatively greater Eastern collapses.

For the past couple of years, a Leidy/Z4Marcellus price around 300 looks like a so-called equilibrium price. In this context, think of natural gas drilling production costs and the potential for coal/gas switching. In any event, if prices fall under around 200 (or 250) for spot Leidy/Z4Marcellus, will production be shut in? And how quickly? Will Eastern region output (increased drilling or at least plans for it) jump if prices sustain levels around or above 375/425? At what prices will Eastern region producers elect to short hedge (perhaps choosing to do so via NYMEX rather than Eastern forward marketplaces)?

Chart 2 displays the spot marketplace basis between the Leidy/Z4Marcellus spot price and the spot Henry Hub price (not the NYMEX nearest futures price).

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