

## Crude, Natural Gas Link Examined

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A top industry analyst has been taking a look at the much discussed price correlations between natural gas and crude oil futures. Up until relatively recently that relationship has not had much statistical validity, but what seems to be emerging is a new dynamic between the two.

“What I have been examining for the last couple of weeks is that natural gas prices have become increasingly correlated with crude oil. The impact of one of the regression coefficients I follow has doubled since 2000,” said Bill O’Grady, senior analyst, AG Edwards, St. Louis.

He noted that what is happening over time is that the influence of crude oil is increasing to the point where the correlation between natural gas inventories and price has become positive, and that isn’t correct. “Statistically the impact of storage on natural gas prices has become overwhelmed by the effect of crude oil. From a futures perspective natural gas has turned into crude oil on steroids,” he mused.

According to O’Grady the explanation is that natural gas fundamentals are becoming less important and those of crude oil are gaining importance. “That makes it really tough, for all the seasonal patterns that characterize natural gas and that are useful for trading are now becoming less reliable,” he said.

“I’m not sure why that is happening, for it could be that the influx of hedge fund money which is essentially buying energy rather than trading the intricacies of natural gas are part of this or what”.

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## IMGA Lowers Cost With Innovative Idea

At the October 1, 2004 Board of Directors meeting, the IMGA Directors voted to offer the purchasing members the option of amending Section 4 of their gas supply contracts. This amendment allows participating members the opportunity of lowering gas prices thru financial trades.

As of the date of this publication, eighty percent (80%) of the IMGA purchasing members had taken advantage of this offer. By doing so, these members have realized an average savings of \$0.09 per dekatherm.

The IMGA is encouraged by the success of this newest opportunity for its members. This is only one of many innovative ideas the IMGA is initiating to keep up with the ever changing natural gas industry. ♦

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## Information Wanted

An IMGA member has requested information on promoting the use of natural gas within their community. The IMGA is asking any members with programs that promote the use of natural gas over other utilities, to share the information with the IMGA staff. The staff will pass the information on to the member requesting it and any other members interested. Working together the member of the IMGA can help each other succeed. ♦

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## Changes to OPS Annual Reports Take Effect Soon

Last year the Office of Pipeline Safety (OPS) made several changes to both incident and annual reporting forms. The biggest change in the annual reports is that it will now ask for the miles of main and number of services by the decade of installation.

APGA’s comments on the proposed rule points out that many operators do not have this data readily available and urges OPS not to require operators to take extraordinary steps to complete these news data fields. Some effort will be expected, however, and since the reports will be due in April, 2005, it makes sense for operators to begin examining what records are available now, if you have not already done so. ♦

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## Link...

He went on to say that the correlation has been growing to the point where crude oil is overwhelming storage numbers. Other analysts continually argue that natural gas prices are too high. They say that storage levels are high, and argue that prices can't hold up here. "If storage doesn't matter, then prices certainly can stay at these elevated levels," he cautiously suggested.

"That's kind of where we are, and I can't explain why and I don't know if this relationship will continue. What could be happening is that a new price plateau could be in the works and storage will eventually become more important again".

O'Grady suggests that at this point it can be argued that storage doesn't matter very much. The story Thursday, for example, was crude oil, and it's not the only thing that drives the market but it seems to be very important, he said.

It looks like the technicians who follow natural gas are now going to have to start paying more attention to things like support, resistance, and trends in crude oil. For what used to be a nice isolated North American market things are now more difficult.

"As an analyst you develop a hypothesis and try to find data and evidence that your hypothesis is correct. As others from engineering and other quantitative disciplines have begun looking at energy markets, they just try to mine the data for relationships. The relationships might work with past data, but if they don't stand the test of theory, then you run the risk of nothing more than spurious correlations," he posited. The demand factors for crude and natural gas are somewhat similar and economic growth and weather should have an impact on natural gas prices. "Beyond that they are not substitutable," he pointed out.

"I'm looking at this from the standpoint of this is what is happening, but I'm not sure it is going to continue," he said.