Looking Ahead to 2019
U.S. Power and Gas Weekly

Morningstar Commodities Research
9 January 2019

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Data Sources Used in This Publication
Intercontinental Exchange
PJM
EIA
EOX Live

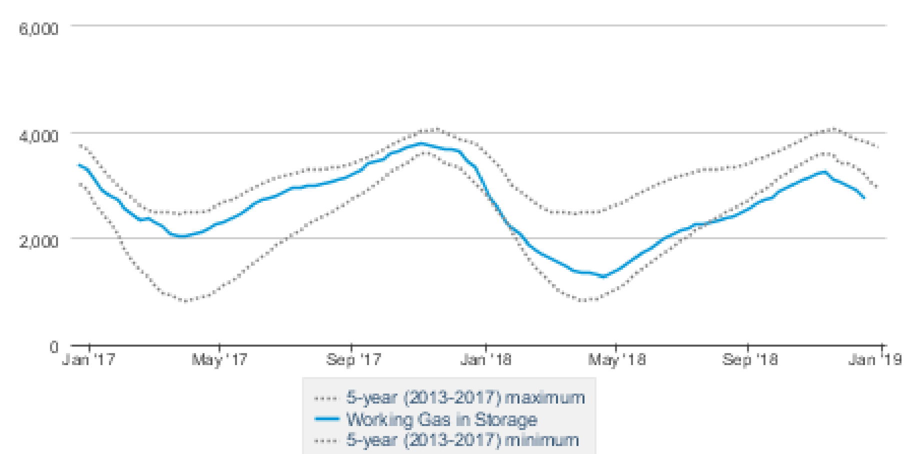
Turbulent Year Ahead

At the end of 2018, power and gas markets continued to see significant changes (2018 in Review). Natural gas production hit new highs, demand growth continued, and pipeline takeaway capacity out of the Marcellus/Utica Basin expanded significantly. Three new liquefied natural gas export trains came on line in Cove Point, Corpus Christi, and Sabine Pass, providing additional exit points for U.S. supply. In the electricity sector, the transition from fossil fuels to renewable sources continued as the competition between the old and new heats up. This piece explores the themes we'll be looking out for as 2019 progresses.

Natural Gas Storage

Natural gas storage will continue to be center of mind for the market in 2019, as the Lower 48 enter the new year with historically low levels of working gas in storage (Storage Shortage in the East; Natural Gas Storage, Will It Be Enough?). The Energy Information Administration's week-ending inventory levels for Dec. 28 had 2.7 trillion cubic feet of working gas in storage, which is 247 billion cubic feet below the lowest inventory level over the past five years for the same week (Exhibit 1). However, prices have continued to come off from the highs reached in mid-November, when the country experienced the first signs of winter. Prices today are sitting around $3.00 per million Btu, which is the first time Henry Hub futures have settled below $3.00/mmBtu since the fall of 2018.

Exhibit 1 Lower 48 Working Gas in Storage (bcf)



Source: EIA.

Natural gas storage levels will continue to be a topic of interest in 2019 for at least two reasons. First, the low inventory levels bring risks for the market as the Lower 48 enter the typical high-demand months of January and February. Recent milder temperatures provided some wiggle room, but if the weather trends to the colder side, supplies could become exceptionally tight. Second, questions remain about the ability of the market to inject enough natural gas into storage in time to meet summer demand.

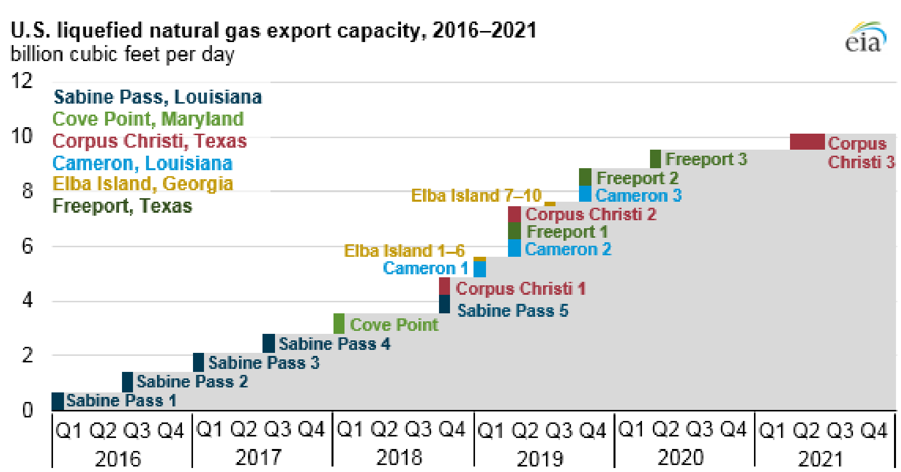
Coal retirements and continued growth in natural gas generation point to significant growth in natural gas demand in 2019, which changes the market's perception about the role of storage in pricing. If prices fail to react in the high-demand months of January and February at current inventory levels, this may be a sign that the market is confident that natural gas production will continue to be strong.

LNG

U.S. export capacity for LNG is expected to grow significantly in 2019. Three new projects are expected online in Cameron, Elba Island, and Freeport. Corpus Christi LNG will also add a train in the first half of 2019 (Exhibit 2). The projects are expected to add 4 bcf per day of nameplate export capacity by the end of 2019 with the EIA forecasting 2019 LNG exports to grow by 2.3 bcf/d to 5.2 bcf/d from an average of 2.9 bcf/d in 2018.

While the growth in export capacity and volumes will be a noteworthy story, the fate of approved projects that have not started construction will set the long-term tone for the industry. Six export projects are sitting in approved status (Sabine Pass Train 6, Magnolia LNG, Lake Charles LNG, Golden Pass LNG, and Delfin FLNG) with a combined capacity around 4 bcf/d. In 2019, we will be watching which of these projects move a step closer to putting steel in the ground. The projects are either waiting for long-term offtake agreements or final investment decisions. Delays or lack of shipper commitment will be a bearish signal for U.S. LNG, especially at a time when demand for natural gas across the world is expected to grow.

Exhibit 2 U.S. LNG Export Capacity and Projects



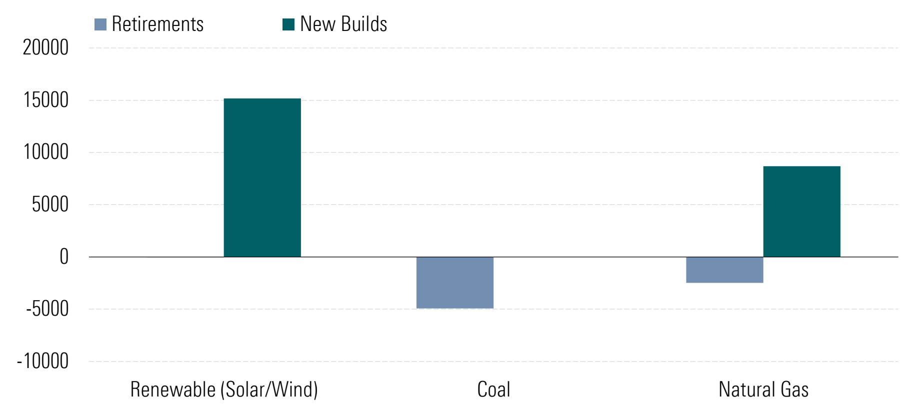
Source: EIA.

Shift to Renewables

If the last several years were about coal to natural gas switching, the story in 2019 will be renewable penetration and the risks it provides to the traditional fossil portfolio.

Looking at all projects tracked by the EIA, for 2019 we see an additional 5,000 megawatts of coal retirements and 2,500 MW of natural gas retirements across the country (Exhibit 3). Almost all the natural gas plants slated for retirement this year came on line before 1990, representing an older and less efficient segment of the natural gas fleet. While the country is losing some older natural gas generation, the EIA has an additional 8,500 MW of new natural gas projects slated for commercial operation this year.

Exhibit 3 2019 Retirements and New Builds by Fuel Type (MW)



Source: EIA.

As competition between coal and natural gas fades, the narrative will shift to expansion in the renewable fleet and its relationship with natural gas in balancing the grid. The EIA fleet additions data shows around 15,000 MW of new renewable generation expected on line, or 6,500 MW more than new natural gas plants. About two thirds of the renewable generation will come from wind, with the remainder from solar. As greater focus is put on the impacts of climate change and states take more aggressive stances against emissions, renewables will be one part of the solution. Because renewables occupy the lower end of the supply stack, the conversation will shift away from their ability to compete with natural gas on cost and toward their reliability. Several states have elected Democratic majorities in their legislatures, increasing the prospects for more ambitious plans to set higher clean energy targets and renewable portfolio standards.

The Role of Government

Several significant regulatory and policy developments took shape in 2018, and many will continue in 2019. Last year the Trump administration, through the Environmental Protection Agency and the Department of Energy, started to chip away at environmental regulations put forth by the previous administration. On some level, the rollback of Obama-era regulations were designed to offer relief to the coal and nuclear sector, but the fact that these fuels remain uncompetitive will test whether the changes will be effective in stimulating demand. The Trump administration had announced an interest in using its executive powers to prevent coal and nuclear plants from retiring in the fall of 2018 but chose not to follow through. The administration could still resurrect these plans in 2019, challenging utilities and market operators with the prospect of keeping an uneconomic asset alive in the face of lower-cost alternatives.

The Trump administration also brought trade issues to the fore in 2018, and we expect conflicts between the United States and its international trading partners will continue in 2019. Negotiations between the U.S. and China are set to begin in early January, and failure to reach an agreement within the 90-day cease-fire negotiated on the sidelines of the G-20 summit could mean further escalations. As China is the number-two importer of LNG, several yet-to-be-built U.S.-based export projects are reliant on growing demand from that country. An escalation in the trade war could further hamper approved but not committed projects, helping competing LNG shippers around the world.

On top of the U.S.-China trade war, Mexico welcomed a new administration in President Andres Manuel Lopez Obrador. AMLO ran for office as a protectionist and has been very critical of energy reforms started by the previous administration. Although AMLO said he would honor existing contracts, the role of foreign direct investment in Mexico's energy sector will change. However, as the demand for U.S.LNG increases in Asia and Europe, Mexico faces greater competition for these molecules, given its energy sector's increased reliance on U.S.-based supply. We expect the coming year to shed light on the priorities of the new Mexican administration and the U.S.' continuing role in its energy sector.

Looking Forward to 2019

2019 will bring a combination of old and new themes, but the change happening in the power and natural gas sector is structural. The growth in production and export capacity will reposition the U.S. in the global LNG supply chain. Despite the efforts by the Trump administration, coal and other uneconomic generator retirements are likely to continue as renewables take a larger share of the generation stack. The largest risks in 2019 are likely to come from the regulatory environment and uncertainty from the Trump administration. A failure to resolve trade disputes will have ripple effects through the sector, and the first test for the administration with China is likely to set the tone for the rest of the year.

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