cutting through complexity

Market Update: Oil and Gas

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Oil Markets
Monthly Round Up

January 2015

Falling oil prices continued to dominate news headlines in December and early January. Both the WTI and Brent contracts slumped to 5½ year lows as bearish demand data triggered further selling pressure.

During December, both OPEC and the International Energy Agency revised down oil demand growth estimates for FY2015. The OPEC demand revisions came just a few weeks after its decision to maintain production at 30 mb/d – which caught some market participants by surprise. The bearish tone continued into the early part of 2015 with both the ICE Brent and NYMEX WTI contracts falling below $50/b.

CONTACT

Anthony Lobo
Head of Oil & Gas EMEA and ASPAC

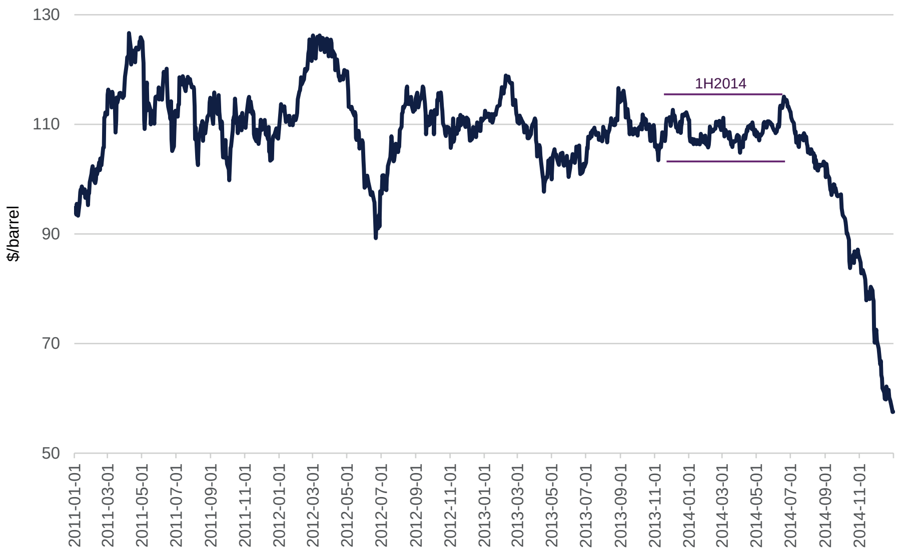
T: +44 20 7311 8482
E: anthony.lobo@kpmg.co.uk

The precipitous fall in oil prices continued throughout December with both the NYMEX WTI and ICE Brent futures contract finishing out the year recording their second largest annual decline, closing at $53.27/barrel and $57.55/b respectively. The OPEC basket price meanwhile averaged out the year sub-$100/b for the first time since 2010, at $96.29/b.

2014 Pricing Retrospective

In 2014 Brent oil prices exited the safe harbours of the $90 - 125/b trading range where prices have remained for the last 4 years. In the first half of 2014 ICE Brent futures traded within a narrow range of $105-115/b; with the US production boom largely nullified by the geopolitical tensions in Iraq, Russia and Libya. In the second half of the year prices broke out of the narrow range and tumbled to multi-year lows at $55.81/b. The sell off was particularly severe in the fourth quarter of 2014, with the ICE Brent front month contract shedding almost 60 cents per day (on average).

ICE Brent - Front Month Daily Closing Price 2011-2014



Analyst Estimates – Oil

Oil price forecasts taken in December contained significant downside revisions for 2015 following the OPEC decision to maintain the 30 mb/d production quota.

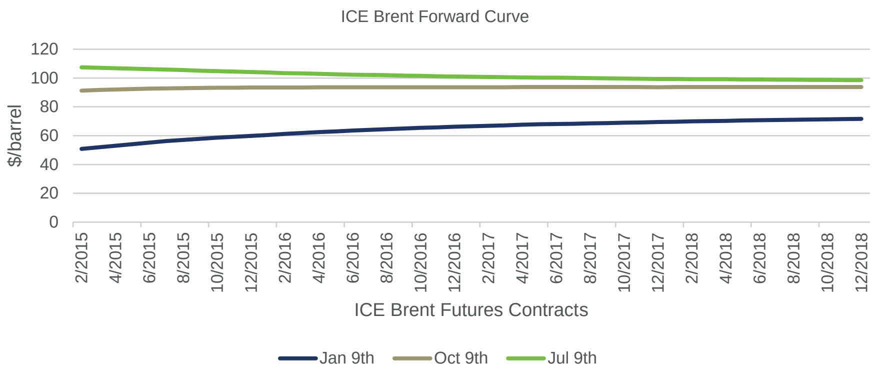
Brent	2015*	2016**	2017***
November Average	93.9	96.0	96.0
December Average	75.9	82.1	88.2
November Median	94.5	96.5	95.0
December Median	73.3	83.0	90.0

*20 estimates ** 15 estimates *** 11 estimates
Source: Based on a poll of 20 external energy market analysts

The Return of Floating Storage?

The demand-supply imbalance in the oil market has seen record levels of crude oil and refined product injected into storage facilities globally. Recent inventory data released by the Energy Information Administration (EIA) revealed that US petroleum stocks were at all-time highs. The IEA meanwhile predict 300 million barrels of crude to be injected into storage globally in the first half of 2015 – which would test the limits of OECD storage capacity.

The weak demand and supply fundamentals in the oil market have caused a steepening contango along the forward curve of the WTI and Brent contracts. In a contango market traders are able inject crude oil into storage and sell at a profit at a later date. The ICE Brent contango has widened significantly over the festive period. The February-September spread, currently valued at $-6.30/barrel, is "approaching" a floating storage play, analysts have posited.



Supply Side Headlines

- US Crude and refined products stocks at 1.149bn barrels, the highest on record, a 8.7% annual rise (Source: EIA)
- Russian oil production at rose 0.3% in December to record a post-Soviet record of 10.667 mb/d (Source: Russia's CDU-TEK)
- For 2015, the outlook for Russian production was revised downwards by 70 kb/d for FY2015 on international sanctions and a plummeting rouble (Source:IEA)
- Libyan production fell in November to 638 kb/d (Source: OPEC) amid violence at a number of key oil fields – El Sharara and El Feel
- Iraq crude exports for December reached 2.94 mb/d, the highest since the 1980s (Source: Bloomberg)

Demand Side Headlines

- OPEC revised down demand growth estimates for OPEC crude (FY2015) by 300k b/d to 28.9m b/d (Source: OPEC)
- IEA The outlook for global oil demand growth for 2015 has cut by 230 kb/d to 0.9 mb/d (FY2015 93.3 mb/d (Source: IEA)

Analyst Estimates – Gas

Long term estimates for Henry Hub gas were nudged lower by analysts in December on increased supply from shale formations.

Henry Hub	2015*	2016**	2017***
November Average	3.9	4.2	4.4
December Average	3.9	4.2	4.3
November Median	4.0	4.2	4.5
December Median	3.9	4.2	4.3

*18 estimates ** 14 estimates *** 6 estimates
Source: Based on a poll of 18 external energy market analysts

Gas markets – monthly round up

Industry benchmarks

US

Henry Hub natural gas spot price traded lower in December as unseasonably mild temperatures in the US impacted prompt demand. Ample gas stocks were also cited as a contributory factor for lower prices. Prices closed at $2.889/MMBtu. (Source: Bloomberg)

UK

NBP front month relinquished gains in November closing at 49.63p/th. Warmer weather was seen as key factor behind the fall as the UK experienced its fourth Christmas without snow (Source: Bloomberg)

JAPAN

The Platts' Japan Korea Marker (LNG Spot price) for January delivery averaged $10.062 per million British thermal units (/MMBtu) in December, a 46.9% year-on-year fall. High Asian inventories and limited buying interest from India and China were seen as driving forces behind the low values which have not been seen since the week of the Fukushima disaster. (Source: Platts)

An 1980s revival?

Analysts have likened the 2014 selloff with the oil price collapse of 1986 owing to the strikingly similar market fundamentals. Our industry experts give their opinion on the latest movements in oil price.

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Thoughts from our industry experts

Oil: Upstream activity

"There's little comfort out there to suggest prices are due for a significant upside correction any time soon – so further selling pressure is a real possibility. Smaller companies and marginal shale producers without strong balance sheets and access to funding, may struggle to weather the storm, particularly if there are further price falls in the pipeline. We've already seen significant cutbacks to capital expenditure for 2015 across the industry as a whole, however, we're yet to see scale-backs to production."

Anthony Lobo,
Head of Oil & Gas, EMEA & ASPAC

Oil: The Global Economy

"The 50 per cent fall in the oil price since the summer is a game-changer for the global economy. Lower prices are here to stay, because Saudi Arabia is no longer prepared to cut production to offset the increased supply from shale, following the fracking revolution. The effect will be to boost demand by around 1 per cent of GDP in most oil consuming countries (less in the UK) and to further reduce global inflation. The Eurozone now faces a period of falling prices, which could even extend to the UK."

Bill Robinson,
Chairman, Economics and Regulation, KPMG in the UK

Oil: Return of the Contango

"The widening contango we've seen over the last few weeks will benefit traders with access to storage facilities. Storage optionality means traders are not forced to sell at the current spot price, instead, they can store the oil and lock-in a higher future price - providing shareholders with almost risk-free profits. In a contango market the trader with storage options is the one holding the aces."

George Johnson,
Executive Advisor, Oil & Gas, KPMG in the UK

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