Market Update: Oil & Gas – April 2015

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Oil & gas markets: monthly roundup

Global crude benchmarks drifted south in March and early April as news of a possible Iranian nuclear deal began to filter down to trading floors. An agreement between Iran and the P5+1 group (China, France, Russia, UK, US and Germany) is likely to see Iranian production sanctions lifted – potentially adding more volume to an already over-supplied market. Bearish sentiment was further compounded by reports of further builds to US crude inventories.

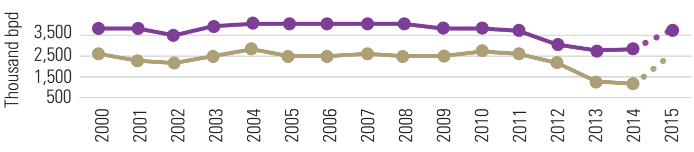
Market news was not entirely bearish. Data released by the Energy Information Administration (EIA) has indicated that US oil production has fallen, prompting some to suggest the US maybe approaching a peak. This will be welcomed news for the Organization of the Petroleum Exporting Countries (OPEC) members – which could support market share with additional barrels from Iran.

Over the last month ICE Brent futures registered a 12 percent drop, falling to 55.11 US dollars (US$) per billion barrels (bbl) on 31 March, from US$62.58/bbl on the last day of February. During the same period, the Brent contract sunk to a low of US$52.57/bbl before rallying to US$62.5/bbl on news of Yemen airstrikes and US production nearing its summit. The New York Mercantile Exchange (NYMEX) West Texas Intermediate (WTI) benchmark experienced a similar fate, losing 4 percent in March.

Iranian oil supply

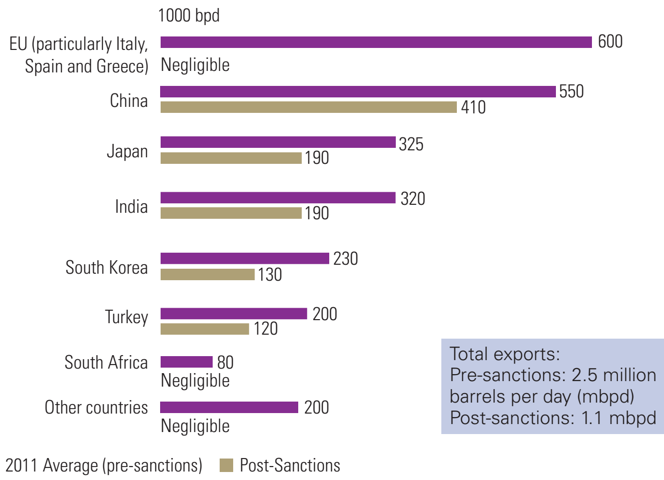
The 2 April preliminary nuclear agreement between Iran and the P5+1 nations should lead to a phased reduction in oil export sanctions, releasing an additional 1 million bpd (mpbd) of Iranian crude at a time when both Iraq and Saudi Arabia have been ramping up production. With current OPEC levels already slightly over its 30 mbpd quota, any further rise in output is likely to further threaten attempts to keep within this limit.

Iran crude oil production and exports



Source: OPEC

Top oil buyers from Iran



Source: Congressional Research Service, Federation of American Scientists

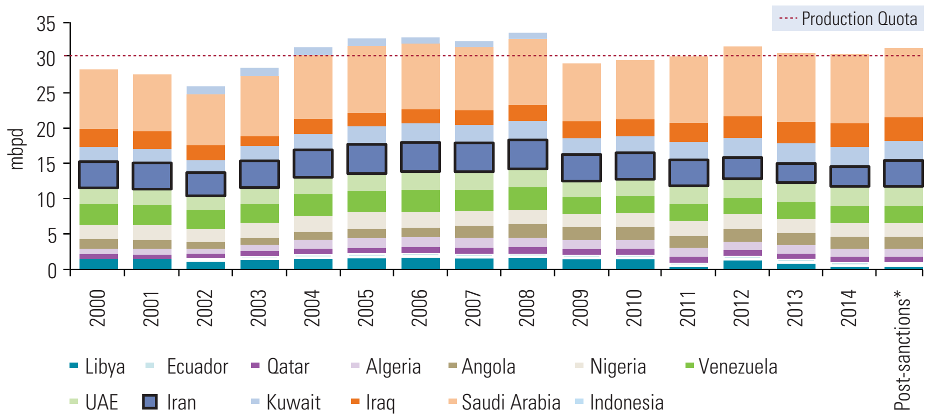
Sanctions and the Iranian economy

A lifting of sanctions could give a much-needed boost to Iran's economy. Prior to the imposition of sanctions in 2012, the country's oil sector constituted approximately 20 percent of Iran's gross domestic product (GDP), 80 percent of its foreign exchange earnings and between 50-60 percent of government revenues. (Source: Congressional Research Service (CRS))

It is, therefore, little surprise that the current constraints are not only reducing oil production and exports, but also hampering overall GDP and currency valuations.

- Iran's GDP contracted by 30 percent in 2013 to US$368.9 billion (Source: World Bank)
- Oil export limits of 1.1 mbpd (a 56 percent drop from 2011 sales of 2.5 mbpd) caused a US$65 billion revenue loss (Source: CRS)
- The value of the Iranian Rial has fallen by 40-50 percent, from 11,300 per US$ in early 2012 to 28,000 in March 2015. Furthermore, Iran has approximately US$80 billion in hard currency in foreign accounts that cannot be repatriated due to sanctions (Source: CRS)

OPEC production – could Iran return to 2011 production levels?



Source: OPEC

*A relaxation of sanctions in Iran is likely to attract foreign investment in to the oil-rich country, analysts predict.

Supply side headlines

- OPEC supply increased to 30.63 mbpd – the highest since October 2014 – as Iraq's exports rebounded following bad weather, and Saudi Arabia produced at record rates. (Source: Reuters Survey)
- US crude oil production fell to 9.2 mbpd in January from 9.2 mbpd in December. However, production increased by 1.2 mbpd to 8.7 mbpd in 2014, marking the largest volume growth in more than 100 years. (Source: EIA)
- Global supply increased by 180,000 bpd month-on-month in February, to 94 mbpd, supported by non-OPEC production, which more than offset declining OPEC crude. (Source: IEA)
- Production of hydrocarbon gas liquids (HGLs) at natural gas liquids plants is expected to increase from 2.6 mbpd in 2013 to 3.2 mbpd in 2015 and 3.5 mbpd in 2016. (Source: EIA)

Analyst estimates: oil

Brent price forecasts showed minimal change from February's forecast. Analysts affirmed that the recent spate of capital expenditure cuts across the industry are likely to halt long-term supply, leading to a higher price in 2018.

Brent (US$/bbl)	**2015**	**2016**	**2017**	**2018**
February average	60.3	71.3	82.7	87.4
March average	60.8	72.5	82.7	87.4
February median	60.0	70.0	80.0	90.0
March median	60.0	70.0	80.0	90.0
Number of estimates	19	16	10	7

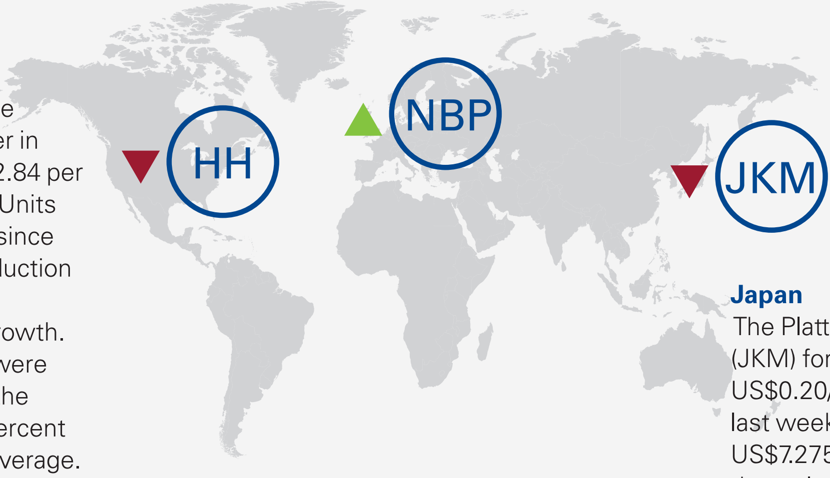
Source: Based on a poll of 19 external energy market analysts

Demand side headlines

- Saudi Arabia increased official selling prices for Asian customers for May delivery, due to strong demand. (Source: Bloomberg)
- Global oil demand is expected to grow by 1 mbpd to 93.5 mbpd in 2015. (Source: IEA)
- For the first time in 22 years, Saudi crude imports into the US Atlantic Coast declined to zero, from 32,000 bpd. The increase in crude-by-rail shipments into the US East Coast has shifted supply dynamics for Atlantic Coast refiners. (Source: EIA)
- India is buying 8 mbpd of crude to build its first strategic oil reserve, with US$330 million of funds. (Source: EIA)

Gas markets: monthly roundup

Industry benchmarks



UK

Natural gas futures prices increased in March as concerns eased over disruptions to Russian supply. ICE UK Natural Gas Futures, May 2015 contract, fell 3 percent month-on-month to 45.16 pence per therm (GBp/Btu). (US$0.67) (Source: ICE)

US

Natural gas prices at the Henry Hub traded lower in March, averaging US$2.84 per million British Thermal Units (MMBtu) – the lowest since 2012 – as growing production from shale formations outstripped demand growth. March average prices were 74 percent lower than the 2014 average and 23 percent lower than the 5-year average. Although prices were depressed in March, recent news of a drop in gas storage volumes (18 billion cubic feet (Source: EIA)) helped prices recover in early April.

Japan

The Platts Japan Korea Marker (JKM) for May deliveries fell US$0.20/MMBtu over the last week in March to close at US$7.275/MMBtu on 2 April – due to lower offers and limited spot demand in the region. (Source: Platts)

Analyst estimates: gas

Henry Hub price forecasts will remain below the US$4 mark throughout 2016, as supply continues to outpace any incremental demand increases. Analysts predict gas prices to average higher in 2017 and beyond.

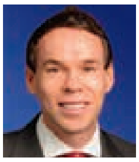
Henry Hub (US$/MMBtu)	2015	2016	2017	2018
February average	3.2	3.7	4.2	4.2
March average	3.2	3.6	4.1	4.4
February median	3.2	4.0	4.3	4.3
March median	3.1	3.8	4.0	4.3
Number of estimates	17	17	7	4

Source: Based on a poll of 17 external energy market analysts

A global insight

Our industry experts give their views on market movements over the last 4 weeks. The Iranian story took center stage across regions, while strong crack spreads in the US helped refiners cash in healthy margins.

UK



George Johnson
Executive Advisor, Oil & Gas
KPMG in the UK
T: +44 7879 498872
E: george.johnson@KPMG.co.uk

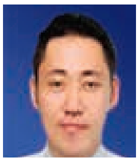
"The global oil market could be braced for more uncertainty in the coming months. The Iranian nuclear deal is likely to see sanctions on exports lifted, leading to an increase in Iranian crude oil production. The speed at which these barrels hit the market is currently unclear, and foreign investment will be key to unlocking this potential. Any incremental rise in production will certainly test the 30 mbpd OPEC production quota and add a new dimension to the OPEC meeting in June."

US

Brian O'Neal
Managing Director, Oil & Gas
KPMG in the US
T: +1 713 319 3865
E: boneal@kpmg.com

"Although prices have risen slightly in recent weeks, US crude prices remain very low. At the other side of the processing cycle, refined products markets are comparatively strong. The largest labor strike in 35 years has led to decreased production at some refineries, while motor fuels usage has increased thanks to an increase in highway travel and employment rates. The combination of low crude prices and stable fuel prices has led to attractive crack spread margins across the US. This development, along with improved spot market optimization capabilities, has delivered a double benefits to many refiners, as they have left a significant portion of their margin unhedged."

ASEAN



Oliver Hsieh
Associate Director, Commodity & Energy Risk Management for ASEAN
KPMG in Singapore
T: +65 6411 8037
E: oliverhsieh@kpmg.com.sg

"If sanctions on Iranian crude exports are eased, the impact could be wide-ranging, although uncertain. China has long capitalized on trade sanctions placed on Iran – lifting approximately 550,000 bpd of crude cargos, most likely at a comparatively advantageous price level. With sanctions removed, China faces a wave of demand competition from the energy-hungry consumption centers of Asia. Iran would be able to re-direct its relatively sweeter crude to Asia's burgeoning downstream sector – potentially recapturing its place as OPEC's second-largest exporter behind Saudi Arabia. A cautious approach to the short-term impact of Iranian crude exports is advisable, as geopolitical unrest in the gulf continues to shroud the region in uncertainty."

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