Market Update: Oil & Gas – June 2015

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Oil & gas markets: monthly roundup

The Organization of the Petroleum Exporting Countries (OPEC) continued its global market-share strategy by deciding to maintain the production ceiling at 30 million barrels per day (mb/d) during the 5 June 2015 meetings in Vienna. The ceiling is slated to remain in place for the next 6 months until December 2015, when the next OPEC meeting is due to take place. The decision to maintain production levels was accepted with minimal opposition from Venezuela, Algeria and Nigeria, who have been severely hit by low oil prices since the last OPEC meeting in December 2014. OPEC also took the opportunity to approve Indonesia's application to rejoin the oil exporters group, following a 7-year hiatus.

OPEC's decision to maintain production levels did not cause any major surprise among oil market participants – evidenced by muted volatility in futures prices. The New York Mercantile Exchange (NYMEX) and West Texas Intermediate (WTI) futures contract was up a modest 1.13 US dollars (US$) per barrel (b) from the previous day's trade – closing at US$59.13/b. ICE Brent also edged higher at US$63.31/b, up 2 percent.[1]

OPEC production vs. quota

OPEC's track-record of keeping production within the 30 mb/d quota is likely to come under further scrutiny in the coming months. Production in May 2015 exceeded 31.50 mb/d, continuing a trend of breaching the quota for last 12 consecutive months. This lack of control, coupled with the prospect of increased volumes from Iran has prompted some analysts to question whether the quota will be adjusted. Recent comments made by the Iranian Oil Minister Bijan Namdar Zanganeh, imply that Iranian production could increase by 500,000 b/d, within months of a nuclear agreement being reached.

OPEC's strategy

OPEC's strategy, intended to displace vulnerable US shale oil producers, appears to be on course, if rig count data is to be believed. Data published by Baker Hughes revealed that the number of oil and gas rigs employed in the US declined to 889 in May 2015, a 52 percent year-on-year fall. However, a sustained recovery in oil prices could see a flurry of players re-enter the market – particularly those with low set-up costs and equipment ready to deploy.

Rig counts	US	International
May average	889	1,158
Month-on-month change	▼ 9%	▼ 4%
Year-on-year change	▼ 52%	▼ 14%

Supply side headlines

- Iran's production increased 90 kb/d to 2.88 mb/d in April – the highest level since 2012 (IEA)[2]
- US oil production surged to a 43-year high to 9.6 mb/d in May 2015 (EIA)[3]

Demand side headlines

- Global oil demand in 2015 is projected to rise at a slightly higher rate of 1.18 mb/d, driven by increased requirements from OECD region. (OPEC)[4]
- Long-term global oil demand is expected to increase to 111 mb/d by 2040. (OPEC)[5]

[1] "Brent Crude Futures, Continuous Contract #1 (B1) (Front Month)," Quandl website , accessed June 2015; "NYMEX Crude Oil Futures, Continuous Contract #1 (CL1) (Front Month)," Quandl website, accessed June 2015.
[2] "Monthly Oil Market Report," OPEC website, accessed June 2015
[3] "US oil production at 43-year high as OPEC prepares to meet," CNBC website, accessed June 2015
[4] "Monthly Oil Market Report," OPEC website, accessed June 2015
[5] "Interview: Dr. Omar Abdul-Hamid, OPEC," Siemens website, accessed June 2015

Demand side headlines cont.

- Global refinery crude throughputs are expected to decline to 77.8 mb/d in 2Q15, from 78.2 mb/d in 1Q15. (EIA)[6]
- New chemical plants are expected to boost industrial natural gas use by 4 percent in the US in 2015. Industrial consumption in 2016 is expected to be 5.5 bcf/d – 33 percent higher than 2009 levels. (EIA)[7]
- Global gas demand is expected to grow at an average annual rate of 2 percent during 2014-2020 – slower than the 2.3 percent average over the previous 10 years. (IEA)[8]

Analyst estimates: oil

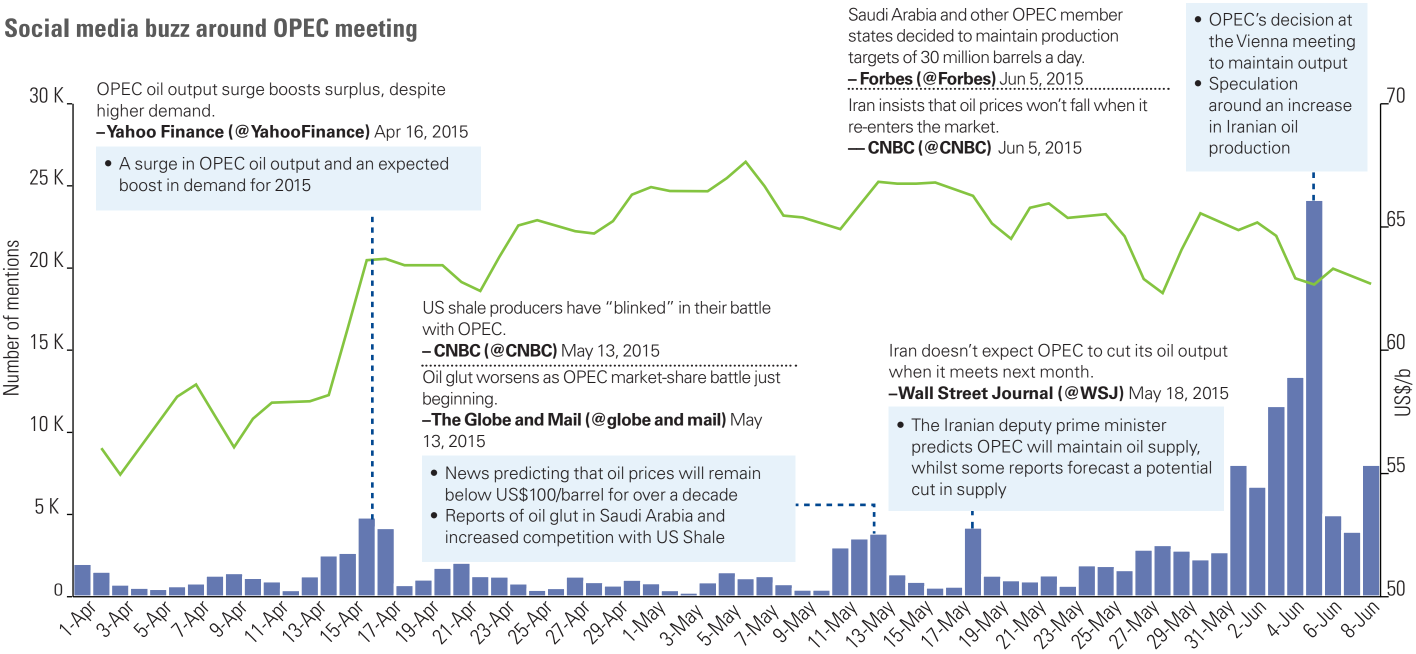
Analysts continue to present mixed views on oil price forecasts, with some expecting 2015 prices to fall on lower non-OPEC supply growth. Whilst others expect prices to be supported by stronger demand from Europe, China and India. Price forecasts showed minimal change from those submitted in April.

Brent (US$/bbl)	2015	2016	2017	2018
April average	60.3	70.8	80.3	85.5
May average	60.7	70.5	81.1	85.9
April median	59.0	70.0	80.0	84.0
May median	60.0	70.0	80.0	80.0
Number of estimates	19	17	11	7

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

The analysis presented below displays the social media buzz in the oil sector during the buildup and aftermath of the Organization of the Petroleum Exporting Countries (OPEC) production decision on June 5th.

Social media buzz around OPEC meeting

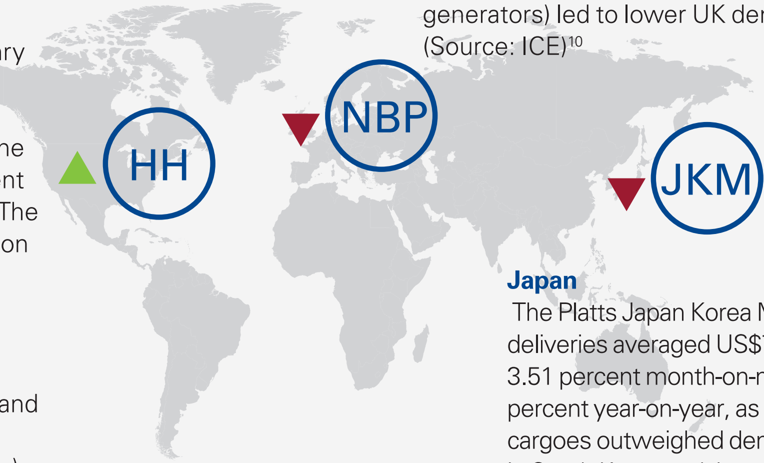


Source: Crimson Hexagon; Brent Crude Futures, Continuous Contract, Quandl website, accessed on 9 June 2015

[6] "Monthly Oil Market Report," OPEC website, accessed June 2015
[7] "Natural Gas Weekly Update," EIA website, accessed June 2015
[8] "Global gas use to rise on low prices, but below expectations: IEA," Platts, accessed June 2015

Gas markets: monthly roundup

Industry benchmarks



US

Natural gas prices at the Henry Hub delivery point averaged US$2.9 per million British Thermal Units (MMBtu) for the month of May – up 9.4 percent from the April 2015 average. The Natural Gas Supply Association (NGSA) predicts a record US demand of 65 bcf/d for the summer months of 2015, primarily driven by 8 percent growth in power sector demand (owing to fuel switching and retirement of coal-fired plants) and 4.5 percent growth in industrial sector demand. (Source: EIA)[9]

UK

ICE UK Natural Gas Futures, dipped 6.5 percent month-on-month to 42.12 pence per therm (p/th) as supply outpaced weak demand. Warm weather along with reduced demand from gas-fired power generators (due to rising output from wind power generators) led to lower UK demand for gas. (Source: ICE)[10]

Japan

The Platts Japan Korea Marker (JKM) for June deliveries averaged US$7.12/MMBtu, down 3.51 percent month-on-month and 50.26 percent year-on-year, as an abundance of LNG cargoes outweighed demand. Higher inventories in South Korea and Japan, caused by mild temperatures and reduced gas demand from industrial users, resulted in a diminished appetite for incremental cargoes. (Source: Platts)[11]

Analyst estimates: gas

Analysts continued to lower Henry Hub price forecasts citing supply build-up from robust winter production growth. The North American gas market is expected to remain over-supplied until new outlets for supply emerge, including LNG exports and Mexican pipeline exports.

Henry Hub (US$/MMBtu)	2015	2016	2017	2018
April average	3.1	3.5	4.0	4.1
May average	2.9	3.4	3.8	4.0
April median	3.0	3.4	4.0	4.1
May median	2.8	3.4	3.9	4.0
Number of estimates	17	17	10	5

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

[9] "Henry Hub Natural Gas Spot Prices," EIA website, accessed May 2015; "Natural Gas Supply and Demand to Be Record-Setting This Summer, Says NGSA Forecast," accessed June 2015

[10] "ICE UK Natural Gas Futures #1 (M1)," Quandl website, accessed June 2015.

[11] "JKM for June delivered LNG averages $7.12/MMBtu, down 3.51% month on month," Platts Commodity News, 18 May 2015, via Factiva, accessed June 2015

A global insight

Points of view from KPMG's Oil & Gas subject matter experts

UK

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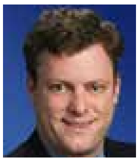
Build up to the OPEC meeting could lead to further price volatility

"This month's OPEC meeting was largely overshadowed by uncertainty surrounding the upcoming Iranian nuclear agreement deadline, due to be finalized at the end of the month. An agreement could see production sanctions lifted and a surplus of Iranian barrels entering the market within a matter of months. OPEC will either need to reach a collective agreement with its members to reduce constituent production (to accommodate the extra volumes into the quota), or, increase the overall quota. Naturally, a decision either way will be heavily influenced by oil prices at the time."

US



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Capital markets provide relief to E&P sector, help maintain production rates

"Major players, especially private equity, continue to line up capital to purchase distressed assets and companies when the time is right. However, "the right time" appears to have been pushed back as highly-leveraged E&P companies have been able to raise financing from non-traditional sources in order to continue operations. Their continued production has kept pressure on prices in the short-term, as has OPEC's announced decision to keep its volumes stable. While the E&P sector continues to struggle, refining is maintaining attractive margins. Low crude prices help, but a seasonal increase in demand and the end of labor strikes have combined to help refiners capture both margin and volume."

ASEAN

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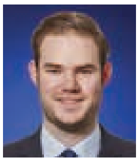
OPEC stimulating overall Asian demand

"While the energy industry has been dictated by the course of OPEC's production trajectory, we should not ignore the demand side of the equation. One of OPEC's core objectives is to increase the overall size of the 'oil consumption pie'; through keeping the oil taps firmly open, low oil prices should simultaneously stimulate (absolute) demand and suppress investment into alternative energy sources. In recent years, much noise has revolved around non-oil and renewable sources dominating future energy frameworks in Asia. With OPEC maintaining a sustained laissez-faire stance to oil supply, oil's relative demand in power generation could hold."

Switzerland



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Is it the calm before the storm?

"The latest Brent price action has been quite uninspiring. After short-term momentum indicators reached overbought condition a few weeks ago, Brent prices moved more or less sideways over the last four weeks. The medium-term upward trend is still valid. Due to this latest price action, it seems unclear whether it will be resolved by continuing upward movement or a price correction – both seem possible. There is still strong support for the price to hover at US$50-60/barrel. A sustainable break of the long-term moving average – which is currently at US$70/barrel – would be a very positive sign."

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