Market Update: Oil & Gas – September 2015

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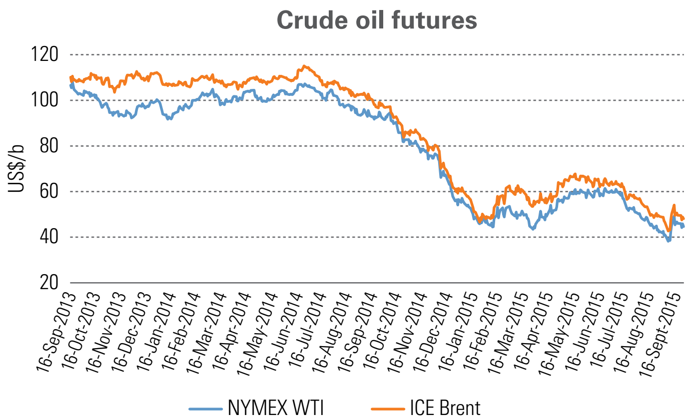
Oil & gas markets: monthly roundup

Volatility in the oil markets persisted in August and mid-September as market contagion from Chinese equities spread to various commodity bourses, including oil price benchmarks which sunk to 6 year lows. Prices were quick to rebound on speculation of an OPEC production cut, triggering a rally that saw ICE Brent prices gain in excess of 11 US dollars (US$) per barrel (b) in 3 days – the largest gain in 3 days since 1990. Prices were further supported by revised US production data for the first half of 2015, which revealed lower than expected production volumes.

At time of writing, the front month ICE Brent contract traded at US$48.14/b, while the NYMEX WTI contract changed hands at US$44.63/b.



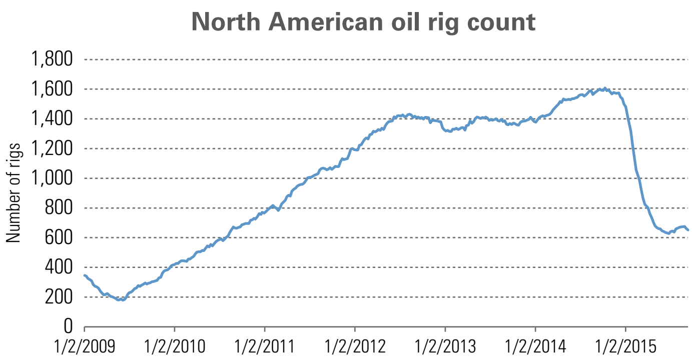
Source: Reuters

US production to "bear the brunt of oil price decline": IEA

The International Energy Agency (IEA) announced that oil's latest fall will reduce non-OPEC oil supply in 2016 by almost 0.5 million barrels per day (mb/d) to 57.7 mb/d, marking the biggest decline in 24 years. US tight oil is expected to take up 80 percent of the 0.5 mb/d reduction.

The IEA anticipates that closures of high-cost production facilities across various regions could lead to the production decline. US tight oil will be hardest hit as the fall in drilling and completion rates takes effect.[1]

US oil rig counts meanwhile fell for a second successive week to 652, down 940 from a year ago.



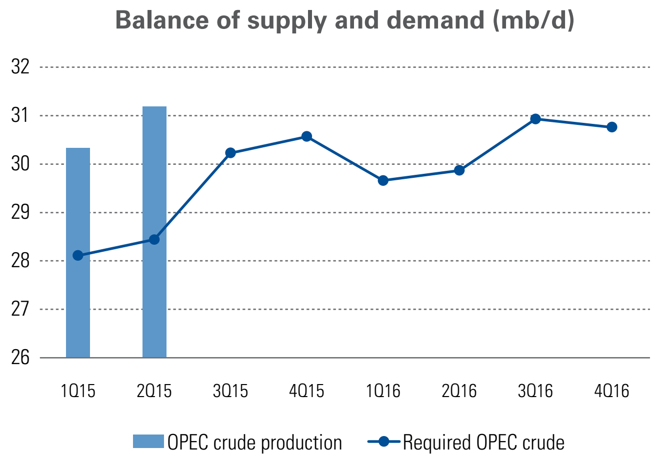
Source: Baker Hughes

[1] "Oil Market Report," IEA website, https://www.iea.org/oilmarketreport/omrpublic/, accessed September 2015

OPEC demand set to increase

Demand for OPEC crude is forecasted to increase by 0.2 mb/d in 2016 to 30.3 mb/d, approximately 1 mb/d higher than this year.[2] The increase reflects an upswing in demand and the downward adjustment to non-OPEC production.

The IEA also revealed a potential increase in OPEC demand for 2016 in its latest report, with estimates as high as a 32 mb/d "call on OPEC" in order to keep the market in balance. With Iranian production set to come online and increased speculation that Indonesia will join the oil producing group, the likelihood of an OPEC production ceiling increase becomes a real possibility. The potential change in fortunes between the US and OPEC indicates that the OPEC market share strategy is paying dividends.



Source: OPEC

Supply side headlines

- Non-OPEC supply in 2016 to fall by 0.5 mb/d to 57.7 mb/d – marking the biggest decline in more than two decades. (IEA)[3]
- OPEC crude oil supply fell by 220 kb/d in August to 31.57 mb/d due to declines in Saudi Arabia, Iraq and Angola. (IEA)[3]
- Global refinery throughput reached a seasonal peak of 80.9 mb/d in August 2015. (IEA)[3]
- Production from seven major shale regions in the US is expected to decline to 44.9 billion cubic feet per day (bcf/d) in September 2015 compared with high of 45.6 bcf/d witnessed in May 2015. (EIA)[4]
- Indonesia set to rejoin OPEC after a seven-year hiatus. (OPEC)[5]
- US Department of Commerce's Bureau of Industry and Security has approved physical crude oil swap agreement between the US and Mexico. (EIA)[6]

Demand side headlines

- Global oil demand growth is expected to climb to a five-year high of 1.7 mb/d in 2015, before moderating to 1.4 mb/d in 2016. (IEA)[3]
- OPEC has cut global oil demand estimate for 2016 by 1.29 mb/d (to 94.08 mb/d), amid slower economic momentum in Latin America and China. (OPEC)[7]

[2] "Monthly Oil Market Report, September 2015," OPEC website, accessed September 2015
[3] "IEA releases Oil Market Report for September", accessed September 2015
[4] "EIA expects near-term decline in natural gas production in major shale regions", accessed September 2015
[5] "Indonesia officially asks OPEC to reactivate its membership", accessed September 2015
[6] "Crude oil swaps with Mexico could provide economic and environmental benefits", accessed September 2015
[7] "OPEC scales back 2016 oil forecast as emerging markets disappoint", accessed September 2015

Analyst estimates: oil

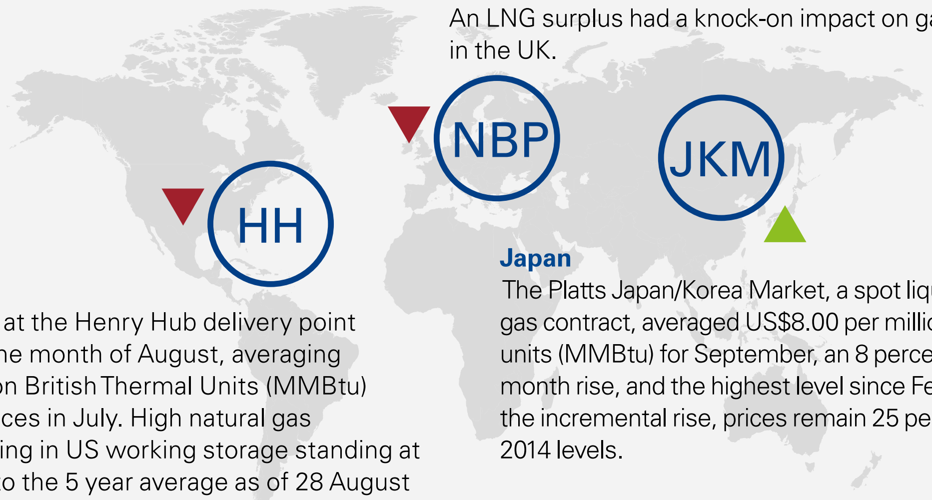
Brent forecasts have seen a small downside revision from last month due to concerns over Iranian sanctions and the possibility of higher production from Saudi Arabia via enhanced oil recovery techniques. Analysts maintain their prediction of a medium-term recovery in prices as capex cuts and low spare capacity will support Brent.

Brent (US$/bbl)	2015	2016	2017	2018
July Average	62.2	69.7	80.2	85.1
August Average	59.9	68.2	78.9	85.9
July Median	61.5	70.0	80.0	80.0
August Median	60.0	67.8	80.0	80.0
Number of estimates	18	17	14	7

Source: based on a poll of 18 external energy market analysts

Gas markets: monthly roundup

Industry benchmarks



UK

ICE UK Natural Gas Futures declined 7 percent month-on-month to 40.05 pence per therm (p/th). An LNG surplus had a knock-on impact on gas prices in the UK.

Japan

The Platts Japan/Korea Market, a spot liquefied natural gas contract, averaged US$8.00 per million British thermal units (MMBtu) for September, an 8 percent month-on-month rise, and the highest level since February. Despite the incremental rise, prices remain 25 percent down on 2014 levels.

US

Natural gas prices at the Henry Hub delivery point fell 2 percent for the month of August, averaging US$2.78 per million British Thermal Units (MMBtu) compared with prices in July. High natural gas inventories, resulting in US working storage standing at a 122 bcf surplus to the 5 year average as of 28 August 2015, has prevented gas prices from rising.

Analyst estimates: gas

Henry Hub forecasts showed little movement from last month for 2016/2017. Prospects for slower supply growth momentum and coal/gas switching flexibility may support prices going forward, but analysts continue to expect an oversupplied market in the near term.

Henry Hub (US$/MMBtu)	2015	2016	2017	2018
July Average	2.9	3.4	3.9	3.9
August Average	2.9	3.3	3.7	3.9
July Median	2.8	3.4	4.0	3.9
August Median	2.8	3.3	3.7	3.9
Number of estimates	17	17	13	6

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

A global insight

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

UK

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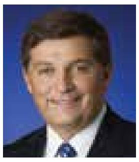
Light at the end of the tunnel for beleaguered bulls?

"The late-August price action demonstrates the challenging market conditions participants face as oil prices continue to oscillate around US$45/b – particularly the many US upstream players with unhedged physical exposure – who will be feeling every bump in the road. However, despite these rapid price movements many E&P players will be reluctant to lock in forward production hedges with oil trading at these historically low levels. Many will be hoping the US$11/b rally is a sign of things to come. Further rhetoric from OPEC on production cuts, or threats to US production could trigger another upside move, but for such a rally to be sustained over the longer term the demand-supply imbalance needs to be redressed."

US



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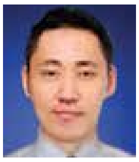
US oil production decline – a response to low oil prices?

"The US Energy Information Administration (EIA) Petroleum Supply Monthly Report released at the end of August surprised market participants with a significant reduction in domestic crude oil production. EIA data for Jun-15 showed a decline in crude production of 0.21 mb/d to average 9.3 mb/d for the month. The year-on-year dropped to its lowest level since mid-2012 and is the first sign of a response by oil producers to the current low price environment. A continuation of this trend over coming months could create a floor for crude prices in the near term. If the crude market can weather the upcoming refinery turnaround period and if a cold winter can bring distillate inventories back to normal levels by next spring, there could be some upside to US oil prices in 2016."

ASEAN



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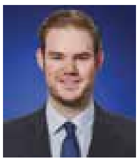
Iran and Indonesia: Two opposite sides of the same coin

"It appears as though sanctions on Iranian crude exports are to be eased – a transition that has profound industry ramifications. Global crude supplies will be amplified, compounding downward price pressure. Moreover, regional demand competition will intensify, with Asia hosting four of the five largest consumers of Iranian crude. Southeast Asia's largest energy consumer, Indonesia, is considering re-joining OPEC, despite 2014 oil production hitting its lowest level since 1969. Facing an acute supply-demand imbalance and lacking adequate downstream infrastructure, Indonesia has evolved as an energy importer. OPEC could be the vehicle Indonesia uses to stabilize local energy prices and secure downstream investment."

Switzerland



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A re-test of the August low could cause further falls

"The latest short-term oil flat price action has been no surprise. Volatility has picked-up as market participants remain unsure about when these lower prices will stimulate global demand. Secondly, the market seems unclear whether larger players have suffered enough pain to see a need to trim production. The medium-term outlook remains weak. Bullish positions are very risky and participants should carefully watch the late August low. A re-test of the August low cannot be ruled out and a break of these levels would indicate a further price decline. Long-term investors may be hesitant to commit, and may wish to wait until the long-term picture clearly indicates a bottom formation."

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