Energy Monitor March

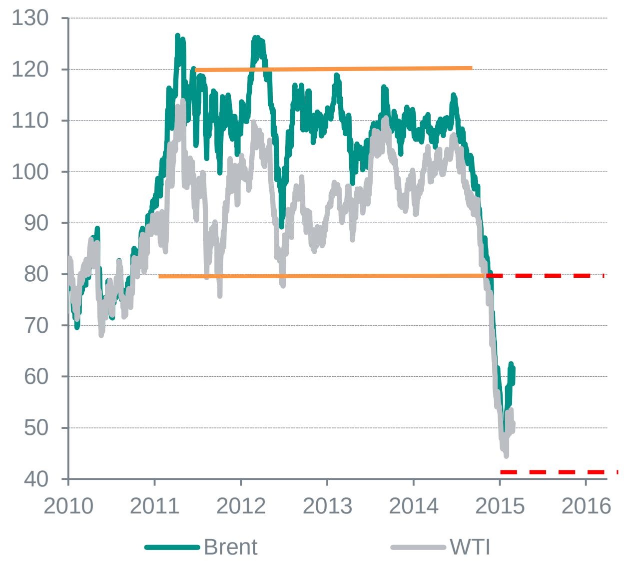
The search for stability

Group Economics
Commodity Research

3 March 2015

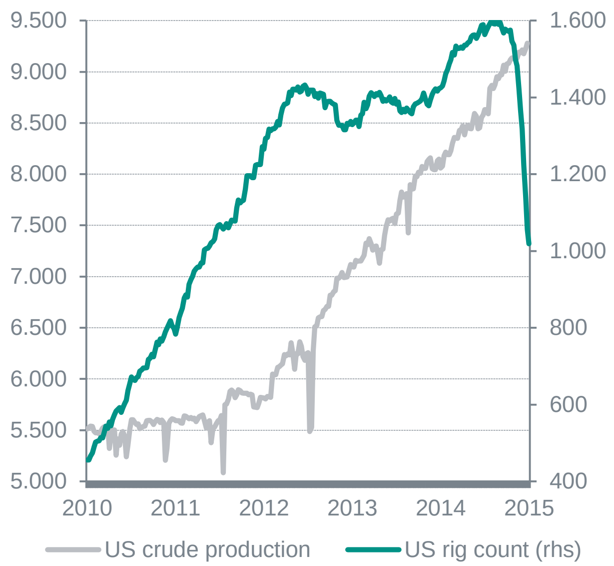
- **Recovery of the oil price, but no changes to the market fundamentals seen (yet)**
- **The search for a new balance in supply and demand of oil leads to increased nervousness**
- **Low gas prices as a result of global effects**

Figure 1: Oil prices have recovered, but search for new balance continues (in USD/bbl)



Source: Thomson Reuters, ABN AMRO Group Economics

Figure 2: Drop in rigs, but production still rises (lhs in kb/d)



Source: Baker Hughes, Thomson Reuters

Oil price recovery

Following the release of our Energy Monitor of 12 January, oil prices have recovered significantly. In that update, we indicated that in our view, oil prices had dropped too far and too fast. We also adjusted our oil price expectations to USD 60/bbl from USD 90/bbl for Brent oil. One day later, on 13 January, the Brent oil price hit a new 2015 low of USD 45.19/bbl, the lowest level since March 2009. After that, however, oil prices rallied to levels above USD 60/bbl (+35%) in just a few weeks' time (Figure 1). Over the past two weeks, oil prices seem to have stabilised somewhat. The oil price recovery was driven by several factors:

- Speculative motives (i.e. profit-taking on short positions, new long positions by hedge funds);
- Extra oil demand for storage;
- Strong decline in the number of US rigs;
- Signals of delay (and/or cancellation) of more expensive oil-related production projects;
- Lower exports from/oil production in Libya;
- Stronger economic data (mainly from the eurozone);
- Somewhat weaker US dollar.

The number of US rigs is declining rapidly, while US crude production continues to rise (Figure 2). The lower oil price leads to lower costs (due to less drilling, and renegotiations of services and prices with service suppliers), but also to increased production efficiency (more production from one well). An additional factor is that oil and gas production are increasingly combined in one production well. Therefore, a drop in oil prices does not necessarily automatically lead to the closure of a 'non-profitable' well. After all, the gas production at the same well might still prove profitable. We expect a drop in the growth of US crude production, but this will only become visible in the course of the year.

The search for a new balance

The main question is whether oil prices have started to bottom out, or whether it is too soon to make this call. We believe the latter. The recovery is partly speculation-driven, and partly driven by the expected effects of the low oil price on both the demand and supply of oil. But basically, nothing has changed in the oil fundamentals over the past several weeks. Oversupply is still an issue, and this caps the upside potential of oil prices in this supply-driven market. Normalisation of the supply – demand balance is not expected before the second half of the year. In fact, up to now, US crude production has continued to rise, and the total production of the OPEC countries does not appear to have changed. The drop in export and production of Libyan oil has been absorbed by increased oil production in Saudi Arabia and Iraq. Oil prices could come under pressure again as soon as demand for

Figure 3: Brent/WTI spread increases (USD/bbl)

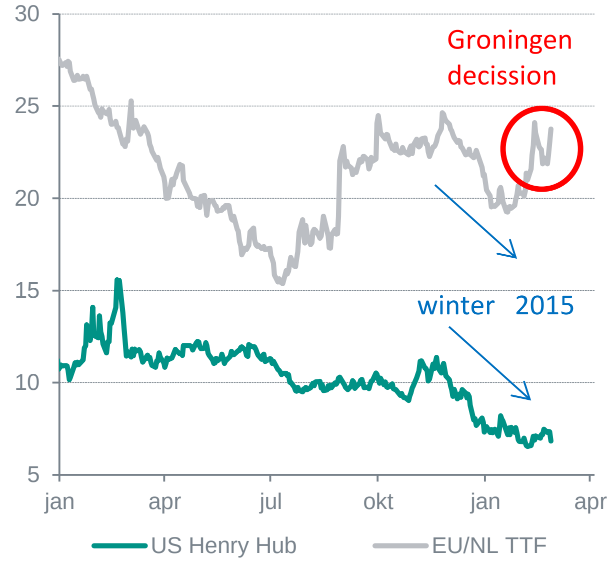
Source: Thomson Reuters, ABN AMRO Group Economics

Table 1: ABN AMRO oil and gas price forecast (Oil: USD/barrel, HH: USD/mmBtu, TTF: EUR/MWh)

Price	Q1 2015	Q2 2015	Q4 2015	2015*	2016*
Brent	50	55	65	60	75
WTI	45	50	60	55	70
HH**	3.25	3.50	4.00	3.75	4.00
TTF***	20	17	20	19	18

Source: ABN AMRO Group Economics
* year average ** Natural Gas Henry Hub *** Title Transfer Facility
(Please see our Quarterly Commodity Outlook for details regarding our longer term forecast)

Figure 4: Brent/WTI spread increases again (USD/bbl)



storage diminishes, economic data disappoints and/or oil production exceeds expectations (which automatically translates into a rise in inventories). A new test of the 2008 lows (USD 40-45/bbl range), can therefore not yet be excluded in the coming months.

Brent-WTI spread widens again significantly

The spread between Brent and WTI is currently widening (Figure 3). The difference increased to more than USD 10/bbl. This may seem odd as overall drivers saw little change, but can still be easily explained. After all, Brent oil prices rose on the back of the previously mentioned factors. The impact of these factors on WTI was less pronounced as a result of the above-described continuous rise of US oil production, and the fact that US inventories are at record high levels. We expect that the Brent/WTI spread will normalise in the course of the year to a level of approximately USD 5/bbl (Brent being more expensive than WTI).

The search for stability goes hand in hand with increased volatility

We also expect that during the second half of the year, oil prices will recover on a more structural base. The effect of low prices on oil production will become clearer, while the (positive) effects of the low prices will become more visible in the economic data. We believe that USD 80/bbl would be a 'fair price', at which both producers and consumers will feel comfortable. This does not mean we will see this price anytime soon. The search for stability – or a new balance with relatively stable prices – could take quite some time. In the meantime, this search could go hand in hand with increased price volatility. This fits perfectly within our forecast for an average oil price of USD 60/bbl in 2015, and USD 75/bbl in 2016 (See also Table 1).

Winter in America… is not so cold

Gas prices are showing a capricious pattern. For the time of year, prices are very low, not only in Europe but in the US and Asia, among other areas. Mild weather conditions, high inventories, and alternative energy sources are resulting in this pressure on gas prices (Figure 4).

In the US, gas prices are extremely low and even near 2012 levels, when production started to be cut back as it was no longer profitable to continue at those levels. But although a new cold front has proven somewhat supportive for US natural gas prices over the last week, US inventories appear to be continuing to break record high levels. As a result of these elevated inventories, Henry Hub gas prices dropped significantly below USD 3/mmBtu (similar to EUR 7.30/MWh). This is an unusual price during the winter season, when demand for (heating) gas normally would be the highest. However, the price drop is starting to look much like the 2012 scenario. More downward pressure cannot be excluded in the near term, especially when seasonal demand will decrease even further in the coming weeks.

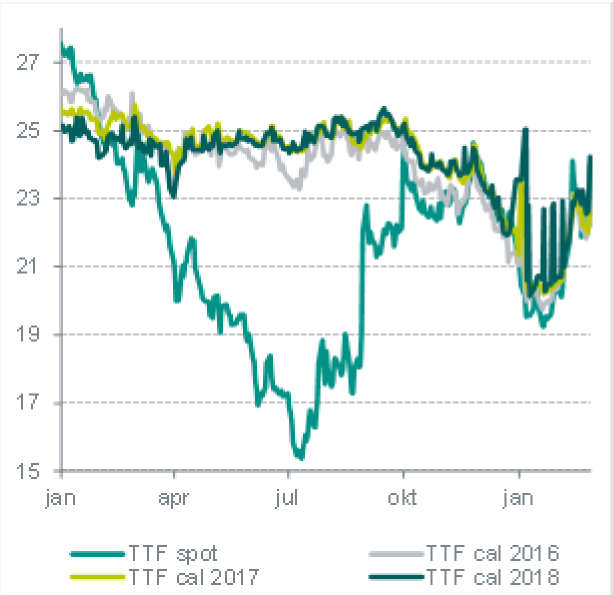
We do believe that a structurally much lower price is not very likely. As in 2012, prices could overshoot as a result of overproduction. However, such an event would be temporary as producers would step down production which, in turn, would balance gas prices. This effect may be even stronger now than it was in 2012, as more and more oil and gas production is combined and oil prices are significantly lower than in 2012. For now, we will not change our price forecasts for US Henry Hub (USD 3.75/mmBtu in 2015).

Source: Thomson Reuters, ABN AMRO Group Economics

Figure 5: Brent/WTI spread increases again (USD/bbl)

Source: Thomson Reuters, ABN AMRO Group Economics

Figure 6: TTF spot and future prices are trading aligned again (x EUR/MWh)



Source: Thomson Reuters, ABN AMRO Group Economics

Global effects affects gas prices

Gas prices also fell in other parts of the world. The fact that the situation between Russia and Ukraine is relatively quiet has helped ease fears of gas shortages in Europe in the near term. However, given that the mild winter in these countries is coming to a close, increased discussions of old issues have come to the fore. Russia/Gazprom is once again accusing Ukraine of bad payments, while Ukraine blames Russia/Gazprom for defective gas deliveries.

Meanwhile, gas prices are also under pressure in Asia, mainly due to new developments in Japan. As a result of the re-start of some nuclear power plants – which were closed following the Fukushima disaster – demand for gas in Asia is easing. This triggered a strong decline in Asian Liquefied Natural Gas (LNG) prices (Figure 5).

Thanks to lower geopolitical tensions, high gas inventories, and more available LNG, European gas prices (including National Balancing Point – NBP, Transfer Title Facility – TTF, and Zeebrugge) all dropped to their lowest level in four years. It is remarkable that not only spot prices were under pressure, but also future prices (Figure 6). Adequate supply, new alternatives, the expectation that geopolitical tensions will not lead to gas shortages, the (slow) decoupling of the oil price, and the focus on energy efficiency all contributed to the relative calm on the futures market.

Price effect cap on Groningen gas seems premature

That is, until 9 February. On that day, the Dutch Minister of Economic Affairs announced plans to impose a cap on Dutch gas production for the Groningen gas field for the first half of 2015 (see also Figure 4). This cap was set at 16 billion cubic metres (bcm). In light of the mild winter and the back-up of large inventories, this should not have come as a surprise. However, the market had a different opinion and, as a result, TTF gas prices jumped higher. Not only were spot prices supported, but futures also traded higher (Figure 6). Minister Kamp then postponed the decision to set the gas production cap for 2015 until July. He is therefore keeping open the possibility of fully implementing the earlier announced cap at 39.4 bcm.

In the meantime, we have received many questions about whether this production cap could potentially lead to gas shortages in the Netherlands. This seems very unlikely. After all, there are sufficient alternatives in the near term, such as an increase in imports of gas from the UK, Norway and/or Russia or more LNG imports via the Gate terminal. And longer term solutions could include an increased focus on renewable energy sources as well as energy efficiency, a European energy union, nuclear and/or coal. The choice of one or more of these alternatives would, however, have a significant effect on a) the Dutch treasury, b) the Dutch energy bill (for consumers and industry), and c) the country's climate goals.

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