December 2015 - Market Summary

Review of Market Trends

Report No. 12
Martin Rawlings
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Macro Economics

<table>
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<tr>
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<th>Closing Rate</th>
<th>% Change</th>
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<tbody>
<tr>
<td>EUR</td>
<td>1.3619</td>
<td>1.97%</td>
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<tr>
<td>USD</td>
<td>1.4628</td>
<td>2.82%</td>
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Unsurprisingly GBP/USD has traded a narrow range over the last 24 hours. Amid the relative quietness, US Pending Home Sales were released and came in under market expectations. The dollar weakened a touch on the news and GBP/USD pushed a little higher. The pair opens this morning at 1.4628. US Unemployment Claims and Chicago PMI are the main events today as far as the ever thinning markets are concerned.

Blizzard anticipates a range of 1.4800 to 1.4900

Euro

EUR/USD has traded sideways since yesterday morning. It opens this morning at 1.3619. Spanish Flash CPI printed a bit weaker than market forecasts but it had little impact on the rate. Meanwhile, GBP/EUR has been climbing steadily and it trades at 1.3619 currently.

Blizzard anticipates a range of 1.3540 to 1.3620
Oil Market: Brent $37.79/bbl, WTI $37.87/bbl

<table>
<thead>
<tr>
<th>Benchmark</th>
<th>Price</th>
<th>Change</th>
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<tbody>
<tr>
<td>Brent ICE (USD/b)</td>
<td>37.79</td>
<td>↓</td>
</tr>
<tr>
<td>Gasoil ICE (USD/t)</td>
<td>334.50</td>
<td>↓</td>
</tr>
<tr>
<td>Fuel 1% Fob cg (USD/t)</td>
<td>148.09</td>
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Close to close at $37.79/bbl for Brent ICE

Why?
Crude oil prices spent the break in the zone between $36/b and $38/b around end-of-2008 low of $37.2/b amid low activity. The American benchmark also held around multi-year lows with a minimum touched just below $34/b on Dec-21, still $1.6/b above 2008 low at $32.4/b. Since Mid-December and the last fall of prices down to 2008 lows, the Brent/WTI spread gained almost +$3/b and now trades around $0/b: the Brent is priced close to parity with the American benchmark. Main event during the break was President Obama signing the bill removing the ban on US crude exports on Dec-23 and the latest tensions between Shiia and Sunnis in Middle-East revived yesterday by Saudi Arabia. Today, Brent has edged up to $37.4/b and it holds very close to WTI prices.

Main events:
The event of the week was the quick deterioration of relations between the two Gulf top producers Iran and Saudi Arabia. Tension rose between the two rival regional super powers after Riyadh executed a prominent Shi'ite cleric on Saturday. Then, things moved fast as Iranian protesters stormed the Saudi embassy in Tehran early on Sunday and Shi'ite Iran's top leader, Ayatollah Ali Khamenei, predicted "divine vengeance" for the execution of Sheikh Nimr al-Nimr. Riyadh immediately cut ties with Tehran and it seems we enter a new chapter of the Long history of rivalry between the Kingdom and the Islamic Republic with the backdrop of religious schism. Markets fear potential supply disruption as the battleground between the two countries covers the whole Persian Gulf region from Yemen to Iraq.
The clash between the two Middle Eastern countries comes as Iran hopes to ramp up oil exports following the expected removal of sanctions against it quite soon: Iran has been dismantling parts of its nuclear program faster than many anticipated and could meet its obligations for the lifting of some sanctions as soon as January (at least before the legislative elections there on 26-Feb -2016). At the same time, data showed Iran's oil exports have fallen to around 1 Mbd in December (+0.5 Mbd before +1 Mbd is expected after sanctions are lifted).

Oil output in Russia, one of the world's largest producers, hit a post-Soviet high last month and in 2015: last year, Russia produced an average 10.73 Mbd (from 10.58 Mbd in 2014) and it reached 10.83 Mbd in December (compared with 10.78 Mbd in November).

On the demand, concerns once again come from Asia this morning as data showed China's factory activity shrank for a 10th straight month in December in a context industry struggling with slack demand all over the region at the moment.

**Outlook:**

Traders are back on their desk and they discover prices holding close to their multi-year low with no clear direction. After two weeks in this $2/b zone around the last known support, the market has yet not decided if it is time for rebound or if we have to seek for deepest targets. At the moment, despite a slight support from tensions in the Gulf, the mood remains mostly bearish: Asian economies are still showing signs of weakness (with stocks strongly down for this first 2016 session), US production is resisting more than expected and other producers maintain full steam output ahead of Iran come-back.

We have to wait to see the evolution of the situation in Middle-East this week but the support could be short-lived knowing that both countries involved do not really have interest of an escalation in the very short term. Main driver will be the US ISM and this week it will be the US job report on Friday. Market operators will set the tone of this New Year in the coming hours/days and we all hope they will really try to make the barrel of crude great again!

**European Gas Market NBP Price:** 1.303 pence/kWh

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<tr>
<td>Day Ahead (p/therm)</td>
<td>38.20</td>
</tr>
<tr>
<td>January 2016 (p/therm)</td>
<td>38.33</td>
</tr>
<tr>
<td>Summer 2016 (p/therm)</td>
<td>35.10</td>
</tr>
</tbody>
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![UK IPE Gas Price Chart](chart.png)
Close to close at 15.66EUR /MWh for TTF CAL 17 (This morning at 15.40EUR /MWh)

Why?
Colder weather forecasts for the last few days gave a boost to oversold gas prices in the first trading session after Christmas. But bears regained control afterwards as supply remained healthy and mild weather is still expected to prevail in January despite a cold start.

Main Events:-
Colder weather forecasts for the last few days gave a boost to oversold gas prices in the first trading session after Christmas. But bears regained control afterwards as supply remained healthy and mild weather is still expected to prevail in January despite a cold start.

Outlook:-
The UK system is undersupplied due to an increase in residential demand compared to the last trading session of 2015. In addition, expectations of lower temperatures in the very short-term in the UK could continue to support NBP spot prices. Nevertheless, bears could continue to hold their grip on curve contracts as the cold episode could be short-lived with the return of milder weather in the coming days in north-western Europe. Moreover, fundamentals remain comfortable on the supply side with strong imports from Russia and Norway and high stock levels which could continue to pressure near-curve contracts in the absence of a significant cold wave in the coming weeks or/and a significant rebound in oil prices.

UK Electricity Market Average Buy Price: £38.09/MW

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<tbody>
<tr>
<td>Day Ahead (p/kWh)</td>
<td>3.800</td>
<td>↓</td>
</tr>
<tr>
<td>January 16 (p/kWh)</td>
<td>4.005</td>
<td>↓</td>
</tr>
<tr>
<td>Q1 2016 (p/kWh)</td>
<td>3.985</td>
<td>↓</td>
</tr>
<tr>
<td>Summer 2016 (p/kWh)</td>
<td>3.750</td>
<td>↓</td>
</tr>
<tr>
<td>Winter 2016 (p/kWh)</td>
<td>4.145</td>
<td>↓</td>
</tr>
<tr>
<td>Summer 2017 (p/kWh)</td>
<td>3.615</td>
<td>↓</td>
</tr>
<tr>
<td>Winter 2017 (p/kWh)</td>
<td>3.985</td>
<td>↓</td>
</tr>
<tr>
<td>Summer 2018 (p/kWh)</td>
<td>3.480</td>
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Close to close at £38.00/MWh for CAL 16

UK power prompt contracts gained value at month end, following forecasts of increasingly colder weather conditions into January; with temperatures expected to fall below seasonal norms. This in turn prompted the prospect of a rise in domestic demand for heating over the coming days, which provided support to the Day-ahead contracts. In spite of this, the upward drive was curbed during the course of the month by forecasts of higher wind generation, with wind output anticipated to lift from 3.5GW to 7GW. Meanwhile, the scheduled return of the Heysham 1-1 nuclear reactor and Fiddler’s Ferry-1 coal plant back to the grid, further helped limit gains on products. Supply during the session, saw gas-fired generation ramp up to account for 38.2% of the UK’s total energy supply mix, while coal-fired generation represented just 14.5%. On the front of the curve, contracts pushed above their previous settlement assessments as they tracked the bullish sentiment on equivalent gas products. However, the gains were less substantial as a result of a stronger pound against the euro after higher than expected UK construction PMI data was released. Further along the curve, the initial upward drive was steadily eroded throughout the day by a weaker wider fuels complex. The benchmark Brent and coal contract stepped down in response to a firm US dollar and poor Chinese economic data, while carbon prices took their direction from losses on the German power market.

Coal Buy Price: £29.33/tonne
Carbon Buy Price: €8.54/tonne

News

OUTLOOK ’16: The year the world drowned in oil

21 December 2015

The international crude oil market is rarely stable and 2016 will not disappoint. Iranian crude oil returns to the international markets adding to the global oversupply while brimming US crude stockpiles is seriously testing storage limits. South Korea’s freight rebate policy reform could potentially skew international oil pricing benchmarks while China’s expected launch of a crude oil derivatives contract will challenge Brent and WTI benchmark status.

In the first quarter of 2016, Iranian crude oil is expected to return to international oil markets after the International Atomic Energy Agency (IAEA) verifies that Iran has complied with the Joint Comprehensive Plan of Action (JCPOA) to curb Iran’s nuclear capability, signed 14 July.

Iran’s crude oil exports currently stand at 1.10m bbl/day and production at 3.12m bbl/day, OPEC data shows. Iran believes it can raise production quickly, by 500,000 bbl/day, and incrementally add another 500,000 bbl/day by the end of the year. But before this flood of oil, there will be a tsunami wave that will hit the market first.

Since Europe raised sanctions against Iran in 2012 causing EU imports of Iranian oil to come to a complete halt, much of the excess crude oil produced since sanctions has been stored while production was drawn down.
The International Energy Agency estimates that Iran has 40m barrels of crude oil stored on vessels and these are set to sail as soon as the IAEA gives the green light.

**Pressure on the benchmark**

The first quarter could also see some potential downward pressure on the UK North Sea Forties Blend and the Dated BFOE benchmark and variants. This unintentional pressure is caused by the South Korean Energy Ministry, which has reformed its crude oil import freight rebate policy for importing non-Middle Eastern crude.

The freight rebate, designed to widen South Korea’s sources of crude and shift away from the volatile Middle East, gave importers a rebate on the freight difference. However from early 2016 the programme will exclude spot deals favouring the security of term deals only.

South Korea has developed a taste for Forties. According to GAC shipbrokers, South Korea imports around 2.00-6.00m barrels/month, equating to three to 10 cargoes/month since 2012 when exports to South Korea began.

If South Korean demand disappears, this could not only put pressure on the value of Forties but potentially pressure the benchmark because the daily value of Forties is almost the de facto physical grade used in the daily benchmark calculation for around 70% of all physical crude oils.

The benchmark calculation picks the cheapest of the Brent, Forties, Oseberg and Ekofisk as part of the benchmark calculation and it is usually Forties because of its relative poorer quality. Additionally, the quality of Forties itself is also deteriorating with a rising amount of sulphuric Buzzard crude in the blend, according to BP data.

Forties is a blend of crude oils from different oilfields and the largest contributor is the Nexen-operated Buzzard oil field, which has made Forties increasingly sulphuric since 2007 when it was added to the blend. Nexen is a subsidiary of China National Offshore Oil Corporation.
China goes international

Later in the year, China’s national currency, the renminbi, will become more international as it enters the International Monetary Fund’s (IMF) Special Drawing Rights (SDR) basket of currencies, which includes the US dollar, the euro, the British Pound and the Japanese Yen.

The SDR is an international reserve asset defined and maintained by the IMF. Members can buy and sell SDRs in return for freely usable currencies of IMF members and can be used to provide liquidity to governments and major institutions in exceptional circumstances such as the 2009 financial crisis.

The addition of the Renminbi into the SDR basket in September may roughly coincide with the launch of the long delayed crude oil derivatives contract planned by the Shanghai International Energy Exchange (INE), which sources say are close to finalising the product.

The Shanghai Crude oil futures contract will be renminbi-denominated and fully open to the International market. Their initial year is likely to see the contract dominated by Chinese domestic refiners for hedging purposes.

Overtime it is expected that the contract will eventually win a significant portion of the trillion dollar crude oil futures market away from the incumbents ICE Brent and NYMEX WTI simply because China is now the largest importer of crude oil, petroleum products and other liquids since September 2013, according to data from the Energy Information Administration (EIA).

Supply volatility

The 2016 story is inevitably going to be oversupply, but the effect on pricing is selective due to differing crude oil qualities. Iran’s crude oil is mostly sour, much like Russia’s with similar export destinations, where one is the Mediterranean/southern Europe.

Sanctions against Iran benefitted Russia’s Urals and narrowed the price spread against the better quality light-sweet grades such as Algeria’s Saharan Blend and on occasion even surpassed its value. The spread will widen next year and sour crude exports to southern Europe will be a buyers’ market, while lighter grades in the region will at least sustain some strength due to its higher quality.
But there is an unpredictable source of volatile light-sweet crude that could return from war torn Libya where production was last heard quoted by the Libyan National Oil Corporation (NOC) at 375,000 bbl/day, well below its pre-civil war levels at 1.60m bbl/day. The rival government’s latest agreement will see both sides form a unity government and have elections within two years, but the fighting goes on and now also with the Islamic State.

The global oil market may also see a stable source of crude oil from the US which cannot export domestically produced oil and only tiny volumes of non-US oil under the Energy Policy and Conservation Act 1975. The reasons for reversing the export ban are mounting, literally, as the US is seriously running out of storage space and hitting record high stockpiles in April.

Although the story is oversupply, there is fear that the worsening conflict in Yemen could spill over to Bab Al Mandeb, the strait where around 4.00m bbl/day of oil flows, potentially cutting this supply to the market, which will more than wipe out Iran’s renewed contribution.

Decommissioning brought forward

The flood of crude oil from OPEC producers has forced US shale oil producers to cut back production. According to data from the EIA, US shale oil production fell each month since February as production remains uneconomical.

Although some US shale oil producers can return to production once oil prices are more favourable, for some mature regions such as the North Sea, the low oil price is already pushing producers to bring forward decommissioning plans, according to the UK lobbyist group, Oil and Gas UK (OGUK).

Bringing forward decommissioning plans in the North Sea will forever shut out a supply of crude oil because the oil cannot be produced even if prices recover since the infrastructure for production would have been removed already and at immense cost.

Decommissioning the UK North Sea over the next 10 years will cost around £17bn to scrap 79 platforms and plugging 1,200 oil wells, according to OGUK.

The US Gulf of Mexico, which provides around 25% of total US conventional crude oil production, is also facing a similar situation where high production costs are forcing producers to bring forward decommissioning plans forever shutting another source of oil supply even if prices recover to the point where production is profitable.

Conclusion

Looking back to 2016 from the future may indicate the year when the oil market began to fundamentally change.

The likely launch of a Chinese crude oil benchmark and China’s entry in the SDR basket is a major crack in the US dollar hegemony over the crude oil market and also numerous commodities and political strength. After all, US sanctions against Iran and others would have been largely ineffective if Iran could fall back on another dominant currency to sell its natural resources.

After US and Europe raised sanctions against Russia over the annexation of the Crimea region, the pipeline deals struck with China and the oil and gas to be sold was already denominated in a mixture of renminbi and Russia’s rouble.

The US central bank’s plans to raise its federal funds rate and therefore the interest rate gradually in 2016 and the European Central Bank plans to loosen its monetary policy puts both banks in opposite paths as the US dollar will strengthen while the euro will weaken.
The ECB’s fight against deflationary pressures is an attempt to inflate away its high levels of debt, but the fight will be ineffective since the crude oil oversupply is reducing global transportation costs and also the manufacturing cost base. The fight against deflation is really a fight against oil supply.

However, the above are just knowns and rarely a year has passed without some surprises in the oil market that could overturn the supply story to one of a shortage. Only time will tell.

After all, 2015 was the year when conflict in the Middle East increased, while oil prices fell, showing we are already in new territory.

This is the last report of 2015, it has been an interesting year and we cannot wait to see what 2016 has in store for energy buyers. All that remains is for Blizzard to wish all its readers a happy and successful New Year.
Terminology
- All oil prices: in US dollar
- Oil product: Brent crude or West Texas Intermediary (WTI)
- Mb/d – Million Barrels per day.
- Freight rates: US dollar per tonne.
- Natural gas prices quoted as pence per therm.
- Power prices quoted as Pounds Sterling per MWh.
- CO2 market: EURO

Information & Data Sources
1. Total Gas & Power
2. GdF Suez
3. Haven Power
4. Coal spot.com
5. FT
6. ICIS
7. BBC
8. Guardian

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