

January 11, 2015
The New Oil Order
Lower for longer to keep capital sidelined
 Commodities Research

Shale is creating a new more dynamic margin of adjustment

EBPs can conserve cash as impressively as they can spend it. The search for a new equilibrium continues. Unlike in the past when the rebalancing took place primarily in the 'physical' and 'paper' markets, in the current environment, the 'capital' market is playing the dominant role. This new source of adjustment is generating disorientation, but also the need to reassess.

Faster 'time to build' makes capital...
 Previous paradigms were plagued with one slow to move due to the long time lag between capital investments and a new margin of the collapsed time lag shale has created and when production rises, as well as production decline rates, to quickly throttle back production. With capital driving the adjustment process, balance the market - credit, equity and cash.

The need for sidelined capital may...
 The credit, equity and oil price mix today is the slowdown in supply growth needed to hit 2016. Overall capex in the US E&P sector is down 12% in mid-December - and drilling has previous bear markets. But the short-cycle shale requires that such pressure remain in, sideline the large amount of low cost capital can rebound quickly once capital investment needs to trade near \$40/bbl for most of 1H15.

The one-year ahead one-year swap...
 Excess storage and tanker capacity suggests for a very long time, preventing storage blow ories. This leaves cash prices as a simple strip forwards. As producers hedge 9-12 months, focuses on the 12-24 month strip, making the capital markets to balance the for capital sidelined, this strip needs to remain normal WTI estimate for the marginal cost of

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8. Once a 2H15 US supply growth slowdown is more certain and given the very high decline rates on US production, renewed Libyan disruptions and an already visible demand response in the US, we expect the market to rebalance with inventories drawing rapidly from Q115 onwards. To accommodate the substantial expected first half inventory build and using the storage arbitrage to the one-year ahead swap, we are revising down our 3-, 6- and 12-month price forecasts for Brent to \$42/bbl, \$43/bbl and \$70/bbl, respectively, from \$80/bbl, \$85/bbl and \$90/bbl, and for WTI to \$41/bbl, \$39/bbl and \$65/bbl from \$70/bbl, \$75/bbl and \$80/bbl. The later expected trough in WTI prices is due to excess US storage capacity.

9. A new industry will likely be born out of the environment with lower costs driven not only by cost deflation in other commodities, currencies, rig rates and oil services but also by substantial productivity gains created by engineers facing tighter margins. Importantly, while shale is the marginal barrel today, we don't believe it will represent dominant technology progress, which includes the capture and technologies to occur for

Exhibit 1: We now see prices staying lower for longer to keep capital sidelined
 \$/bbl

	WTI			Brent			WTI-Brent		
	New	Old	Forwards	New	Old	Forwards	New	Old	Forwards
1Q15	46.00	75.00	49.00	47.00	85.00	51.50	-1.00	-10.00	-2.50
2Q15	40.50	70.00	50.00	42.00	80.00	52.50	-1.50	-10.00	-3.00
3Q15	44.00	75.00	50.50	48.00	85.00	53.50	-4.00	-10.00	-3.00
4Q15	58.00	75.00	51.50	64.50	85.00	55.00	-6.50	-10.00	-3.50
1Q16	65.00	80.00	52.00	70.00	90.00	56.00	-5.00	-10.00	-4.00
2Q16	65.00	80.00	53.00	70.00	90.00	57.00	-5.00	-10.00	-4.00
3Q16	65.00	80.00	53.50	70.00	90.00	58.00	-5.00	-10.00	-4.50
4Q16	65.00	80.00	54.00	70.00	90.00	58.50	-5.00	-10.00	-4.50
2015	47.15	73.75	50.25	50.40	83.75	53.15	-3.25	-10.00	-3.00
2016	65.00	80.00	53.15	70.00	90.00	57.40	-5.00	-10.00	-4.25

Source: CME, ICE, Goldman Sachs Global Investment Research.

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