

Press release

09 March 2010

The era of cheap oil is over, natural gas in the spotlight

- Prices increased too far, too fast – upside potential remains limited
- Most drastic decrease in demand since the 1980s, whereas oil supply clearly sufficient – next oil shock in 2012?
- Shale gas to increase by 71% by the year 2030 - exploration and acquisition activity in Poland and Ukraine expected
- Oil price: 1st half 2010 max. USD 90 - 100, 2nd half 2010: trend reversal, average 2010: 72 USD / barrel

“The Stone Age did not end for lack of stone, and the Oil Age will end long before the world runs out of oil.”
Sheik Zaki Yamani

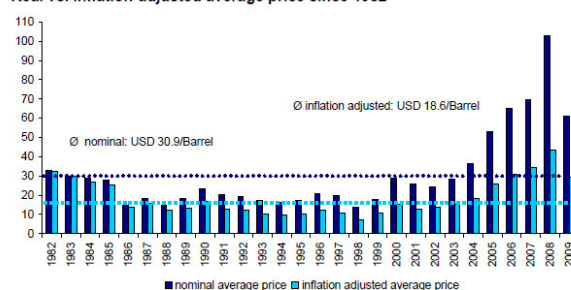
The global stimulus measures taken by governments and central banks and the almost worldwide near-zero interest rate policy triggered a revival of commodity investments in 2009. According to a report by Barclays¹ the commodity sector recorded an inflow of more than USD 60bn last year. Another reason for the rising oil price was of course the weak US dollar. The five-year correlation of oil prices and the EUR/USD exchange rate is currently 88.2%.

“The economic recovery is intact, but we think that the oil price has been clearly overshooting. Although demand has picked up considerably – particularly in the emerging countries – it is still clearly below its highs. Additionally, we are critical of the blind trust in the Chinese economy as recovery and growth engine. China cannot and will not be the sole driver of global recovery, nor the sheet anchor and messiah for the global economy, nor the only hope for oil demand,” states Ronald Stöferle, commodities analyst at Erste Group. *“The structural problem of crude oil has clearly subsided and eased off in recent months and we believe that the focus of the oil price discussion should be shifted to the supply side again.”*

Is oil now cheap at its current level of almost USD 80?

The illusion of a “cheap” oil price is probably based on the fact that many market participants regard the all-time-high of close to USD 150 as referential value. On its current level the oil price is more than 100% above its long-term average of USD 30.9 and the median of USD 24. Adjusted for inflation the oil price is still expensive. OPEC seems to regard an oil price between USD 70 and 80 as optimal. On the one hand it is low enough in order not to burden the still frail economy too much, on the other hand alternative sources such as oil sand or deep sea oil are not attractive and mostly unprofitable at this level. Wind and solar power are no serious competitors (without massive subsidies that is) at this price level either. According to OPEC, the current prices are meant to satisfy both producers and consumers.

Real vs. inflation-adjusted average price since 1982



Sources: Datastream, Erste Group Research, sharelynx.com, Bloomberg

¹ Commodity Investment Expected To Remain Strong in Early 2010“, Wall Street Journal, 4 January 2010

Oil supply is clearly sufficient at the moment

OPEC currently produces close to 60% of total volume but owns more than 80% of reserves. The economic and of course also political power of OPEC will continue to increase; the IEA expects 80% of additional production to come from OPEC countries. However, The IEA has issued its first peak oil warning, saying it may occur by 2020². Upon analysis of 800 oilfields the IEA reached the conclusion that, if demand develops in a similar fashion, new resources of 40mn barrels/day would have to be discovered by 2030 (i.e. four times the production of Saudi Arabia) in order to avoid a long term price shock. Currently there is enough oil around, but the structure of the supply would suggest considerably higher prices in the long run. Given that oil was sometimes traded below the marginal costs of production last year, which caused numerous oil nations severe financial hardships, investments worth almost USD 100bn were scrapped. This could be the base for a fourth oil shock 2012 or 2013; this year the Erste Group analysts only see little upward potential left.

"We are running the risk of another oil crisis when demand outstrips supply around 2014 or 2015. There won't be enough oil and gas by the middle of the next decade."

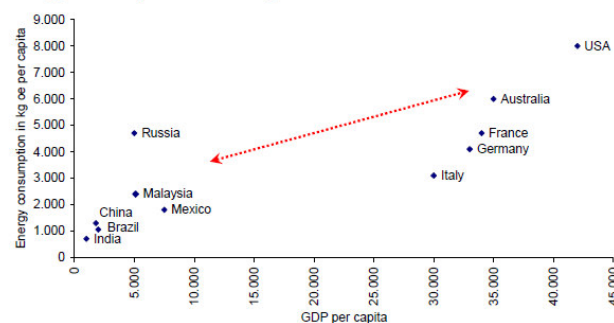
Christoph de Margerie, CEO Total, September 2009

Most drastic decrease in demand since the 1980s

For the first time since 1983, global demand for oil fell in two consecutive years (2008: -0.3% to 85.7mn barrels/day, 2009: -1.6% to 84.3mn barrels/day). The consensus expects an average increase of 1.4% or 1.2mn barrels/day in 2010. The IEA expects global energy demand to double by 2050. Oil demand is expected to soar from currently 85mn barrels to 105mn barrels by 2030. Even if alternative forms of energy are becoming gradually more important, oil and gas will continue to cover the majority of energy demand (60% in 2008 vs. 58% in 2030). The high inventories probably represent the Achilles heel of the oil price, as the current oversupply will exert pressure on the price. As soon as demand is primarily covered from inventories, the downward momentum should pick up speed again. Therefore Erste Group analysts believe that as soon as the global stimulus programmes expire (and do not get replaced), oil demand should recede again.

The graph shows the discrepancy between the oil consumption of Western industrialized nations and emerging countries: North America accounts for 4.5% of the global population, but consumes 28% of global energy production; less than 4% of the Chinese own a car, whereas in the USA the penetration rate is almost 78%.

Energy consumption vs. GDP/capita



Source: United Nations, Population Prospects

Shale gas to increase by 71% by the year 2030 - exploration and acquisition activity in Poland and Ukraine expected

The IEA expects the production from unconventional gas reserves³ to increase by 71% by the year 2030. This would make the segment the most rapidly growing energy source in the coming decades. Although natural gas will not be able to substitute the receding oil production, shale gas should become ever more important especially for the USA and Europe (cue "resource nationalism"). The USA is becoming self-sufficient in energy practically overnight because of shale gas. According to a study by Rice University⁴ shale gas could also drastically reduce the dependence of Europe on Russia and the Gulf States. We are therefore optimistic that the exploration of shale gas reserves in Europe will become massively more important. We expect particularly vivid exploration and acquisition activity in Poland and Ukraine. *"For this reason we regard unconventional gas – especially shale gas – as the most interesting investment opportunity in the energy sector"*, recommends Stöferle. *"For the next three to five years we*

² http://www.economist.com/businessfinance/displaystory.cfm?story_id=15065719

³ The following gas reserves are called unconventional: Shale gas, Coalbed methane (CBM) – methane from unused coal seams, Coal mine methane – methane from abandoned coal mines, Gas sands

⁴ "US-Canadian shale could neutralize Russian energy threat to Europeans", May 2009

expect prices within a band of at least USD 7 to 10. This should ensure attractive margins for alternative natural gas producers.”

Target oil price outlook: 1st half of 2010 max. USD 90 – 100, 2nd half: trend reversal; average price 2010: USD 72 barrel

Seeing that there is an oversupply of oil, Erste Group analysts do not expect the oil price to trade above the "magic" mark of USD 100/barrel on a sustainable basis. The market seems to be in good balance for 2010. Only a broad, sustainable, and - especially - global economic upswing could trigger supply shortages. *“Therefore we expect - for technical and tactical reasons - a continuation of the recent uptrend in the first half of 2010. Due to the negative divergences, poor seasonal factors and the weak fundamentals, we expect a trend reversal for the second half of the year at the latest, where the oil price should dip to the USD 60 area or even lower. Therefore we forecast an average price of USD 72/barrel in 2010”,* concludes Stöferle.

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