

Oil Prices Respond to OPEC-plus, but Shale Likely to Push Them Back Below USD60/bbl

The extension of the OPEC-plus agreement has helped reduce excess stock and improve the near-term outlook for oil prices. But U.S. shale growth and responsiveness should result in a production surplus during 2018, which Fitch Ratings thinks will take prices back below USD60/bbl.

We have raised our oil price assumptions for 2018 and 2019 by USD5/bbl and USD2.5/bbl, respectively, to USD57.5 for Brent and USD55 for WTI, to reflect the recent improvements in the market fundamentals. These include a significant reduction in excess stock and higher year-to-date oil prices, mainly driven by high compliance with the OPEC-plus production cut agreement throughout 2017, and our expectation that compliance will remain fairly strong in 2018. We have extended our forecasts to 2020, when we also expect an average price of USD57.5 for Brent and USD55 for WTI.

The production deficit in 2017 helped consume a significant part of excess oil inventories and sent Brent prices above USD60. But this may not last throughout 2018 as we expect U.S. shale oil production growth to continue due to further efficiency gains and higher activity. We believe the market will return to a moderate surplus, partially reversing inventory reduction and bringing prices back to USD50-60/bbl.

Our long-term price forecasts are unchanged at USD57.5/bbl for Brent and USD55/bbl for WTI to reflect our view that U.S. shale should be able to meet a significant portion of global demand growth for the next several years. We also think the potential for the OPEC-plus agreement to ensure strict compliance beyond 2018 and to keep prices above USD60/bbl may be challenged.

Some countries may be reluctant to cede market share to U.S. shale, and many oil-producing economies are gradually adjusting to a lower price environment. In the longer term, the OPEC-plus curtailment could become less effective given the possibility of slower demand growth due to the increasing use of electric vehicles, although we believe demand will remain robust for several years at least.

Fitch Oil and Gas Price Assumptions

	2017A	2018	2019	2020	Long term
Base Case					
Brent (USD/bbl)	54.8	57.50	57.50	57.50	57.50
WTI (USD/bbl)	50.8	55.00	55.00	55.00	55.00
Henry Hub (USD/mcf)	2.99	2.75	3.00	3.00	3.00
NBP (USD/mcf)	5.97	6.00	5.50	5.75	5.75
Stress Case					
Brent (USD/bbl)		45.00	42.50	47.50	50.00
WTI (USD/bbl)		42.50	40.00	45.00	47.50
Henry Hub (USD/mcf)		2.25	2.00	2.50	2.75
NBP (USD/mcf)		4.50	4.25	4.75	5.00

Source: Fitch

Authors

Dmitry Marinchenko
Corporates
+44 20 3530 1056
dmitry.marinchenko@fitchratings.com

Dino Kritikos
Corporates
+1 312 368 3150
dino.kritikos@fitchratings.com

Lucas Aristizabal
Corporates
+1 312 368 3260
lucas.aristizabal@fitchratings.com

Ying Wang
Corporates
+86 21 6898 7980
ying.wang@fitchratings.com

Brian Coulton
Chief Economist
+44 20 3530 1140
brian.coulton@fitchratings.com

Alex Griffiths
Credit Policy
+44 20 3530 1709
alex.griffiths@fitchratings.com

Mark Brown
Fitch Wire
+44 20 3530 1588
mark.brown@fitchratings.com

Related Commentary

Fitch Outlook 2018: U.S. Energy (Oil & Gas)

Fitch 2018 Outlook: EMEA Oil & Gas

Fitch 2018 Outlook: Latin American Energy (Oil and Gas)

Fitch 2018 Outlook: Asia-Pacific Oil and Gas

Batteries Update: Oil Demand Could Peak by 2030

Using Commodity Prices in Corporate Projections

We revised up our UK National Balancing Point (NBP) gas price assumptions by USD0.75/mcf to USD6/mcf for 2018 to reflect relatively high year-to-date prices. Those have mainly been the result of higher oil prices, and lower-than-expected LNG volumes coming to Europe from the U.S. due to unexpectedly strong demand growth in China. Otherwise, our NBP assumptions remain in the range USD5.5-5.75/mcf.

This reflects our expectation that growing LNG capacity worldwide is likely to outpace demand in the coming years, potentially resulting in underutilised liquefaction capacity capping prices in Asia and Europe. We also expect increased LNG exports to help reduce regional pricing disparities and introduce more spot-based pricing.

Our view for Henry Hub gas prices remains relatively stable. U.S. Lower 48 (L48) storage levels have moved back down towards historical averages, benefiting from favorable winter draws and growing export volumes, which should support prices in the USD2.75/mcf range in the near term. We reduced our long-term price forecast to USD3/mcf from USD3.25/mcf to reflect continued unit economics improvements and associated gas production growth.

U.S. Shale: Efficiency Gains Will Continue

We believe U.S. shale oil production will be the main supply growth driver over the coming years. Continued efficiency gains with companies moving towards larger pads, longer laterals, and higher-intensity completions will help U.S. producers drill more wells per rig, and to produce more oil per well.

The recent increase in the L48 rig count suggests rising activity due to the recent rebound in oil prices. Service cost inflation continues to creep up, but Fitch expects the full-cycle breakeven oil price to continue to fall, providing favorable U.S. well returns, even as the increased focus on capital and shareholder returns is likely to heighten producer discipline and divert some capital away from drilling.

Moderate Supply Surplus Could Push Prices Down in 2018

We expect U.S. oil production to increase by at least 1.5-1.7MMbpd year on year in 2018 (average to average, including the growth in natural gas liquids). Assuming relatively flat OPEC production and a moderate growth in some other non-OPEC countries (such as Brazil and Canada), this could move the market into a moderate surplus, potentially pushing prices below USD60/bbl.

In this scenario, we assume OPEC production will remain broadly flat year on year. This assumes production in Venezuela stabilizes at early 2018 levels, Libya and Nigeria produce broadly at the levels of 2H17, and other OPEC countries broadly comply with the production cut agreement.

Compliance Should Be Generally Strong in 2018, Lack of Exit Strategy a Risk

OPEC-plus compliance should remain fairly strong throughout 2018. We believe that Saudi Arabia and Russia, two main driving forces behind the OPEC-plus agreement, will continue to adhere to the deal. Saudi Arabia has managed to lower its fiscal breakeven oil price, but we estimate that it remains relatively high at USD68/bbl.

The planned IPO of Saudi Aramco is another incentive to limit production, as the company's valuation will be largely a function of oil prices. Russia could more easily tolerate a lower oil price as its budgetary position is stronger, but the agreement remains an important element of the Saudi-Russia relationship. Recent price volatility and rising U.S. production should also support broad adherence to quotas in 2018.

OPEC's longer-term ability to control production and prices is questionable. Fiscal breakeven prices will probably keep falling as oil-producing countries make further budgetary adjustments, and some OPEC members may tire of losing market share to U.S. shale producers.

Limited Rating Impact for Corporates

We do not expect this price deck revision to trigger multiple positive rating actions. Fitch's "through the cycle" ratings approach puts more weight on medium-term financial forecasts and incorporates other factors in addition to the financial position.

Higher price assumptions for 2018 and 2019 could marginally improve projected credit metrics, but for some companies the positive effect may be offset by higher capex and dividends. However, the upward revision of the near-term price deck could moderately improve the liquidity positions of deeply high-yield exploration and production companies, for which liquidity remains an important credit driver.

Stress Case Scenario

Fitch's stress case price deck remains broadly unchanged. In our downturn scenario we assume oil prices will fluctuate broadly in the USD40-50 range – remaining weak in 2018-2019, followed by some price recovery in 2020 and a conservative mid-cycle long-term price of USD50/bbl for Brent and USD47.5/bbl for WTI. This scenario could materialise if there were massive oversupply similar to 2015-2016, for example if the OPEC-plus deal ended early combined with continued U.S. shale growth. In this scenario some ratings may come under pressure, especially those of non-integrated upstream producers.

Fitch Wire offers rapid Fitch opinion on the most important events affecting the global credit markets.

Subscribe to our daily email alert, or visit the Fitch Wire homepage.

Fitch Wire Analysts

Justin Patrie

Head of Fitch Wire
+1 646 582 4964
justin.patrie@fitchratings.com

David Prowse

Financial Institutions
+44 20 3530 1250
david.prowse@fitchratings.com

Mark Brown

Sovereigns and Structured Finance
+44 20 3530 1588
mark.brown@fitchratings.com

Dan Martin

Asia Pacific
+65 6796 7232
dan.martin@fitchratings.com

Rob Rowan

Public Finance and Structured Finance
+1 212 908 9159
robert.rowan@fitchratings.com

Laura Kaster

Financial Institutions
+1 646 908 9123
laura.kaster@fitchratings.com

Fitch Wire Editors

London:

Mike Rothschild, Mark Leech, Chris Bishop, Suzy Bibko, Ian McDiarmid, Brian Reid, Kevin Turner

New York:

Jennifer Hickey, Louis Standish, John Forde

Chicago:

Kamron Kissamis, Philip Milano

Asia Pacific:

John Laubscher, Marissa Chew, Joanna Pelc

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.