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

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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

Related Commentary

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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.

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