S&P Global Platts: Oil and Gas Outlook 2017

LONDON, Jan. 6, 2017 /PRNewswire/ -- S&P Global Platts, the leading independent provider of information and benchmark prices for the commodities and energy markets, offers an overview of the key trends and themes to watch for in 2017. Below is focused on the global oil and gas markets.

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Oil
The first OPEC-led global production cut in 15 years underpins an emerging but fragile recovery, with 2017 set to see a huge stock overhang disappear by the third quarter and the oil market move from over-supply to a more balanced supply/demand situation, according to Platts Analytics.

With Saudi Arabia and Russia joining forces to cut output by almost 800,000 b/d in the first six months of the year, and other oil producers under pressure to comply with their share of cuts to bring the total close to 1.8 million b/d, there remains a great deal of optimism in some quarters that the pace of rebalancing will be accelerated; in others there is skepticism that OPEC and its non-OPEC associates can really deliver.

Just how fast the market rebalances will depend on the discipline to enforce and maintain the cuts across a disparate group of oil producers, especially with crisis-ravaged OPEC members Libya and Nigeria exempted from the agreement, but with the potential to see large additions in output.

Moreover, the speed of return by *US shale producers* could ultimately keep a lid on prices. Most oil companies appear generally optimistic that prices will rise to a more sustainable level in 2017, but spending is likely to stay modest for now and production growth moderate. Caution is likely to dominate the North Sea oil industry, with a mini-revival in production in the last two years juxtaposed against years of decline since production peaked in 1999.

Paul Hickin, Oil Editorial Director, S&P Global Platts: "The next few years will be shaped by the relationship between US shale and OPEC, Russia and other key oil producers. This landmark agreement between OPEC and non-OPEC is providing a floor to oil prices and US shale is providing the ceiling. Compliance to the deal until the stock overhang disappears, most likely by the third quarter of 2017, according to Platts estimates, will be pivotal to ensuring the price floor holds, while the speed of return of US shale will determine how low the ceiling becomes."

Reflecting large production cost reductions and productivity gains, *Platts Well Economics Analyzer* estimates that if US crude benchmark West Texas Intermediate reaches $65/b, leading US production areas have an internal rate of return of between 35 and 40%. The Permian Basin could be the biggest beneficiary of expected double-digit increases in capital budgets in 2017. Platts Analytics forecasts that production in the West Texas/New Mexico basin will reach 2.226 million b/d in 2017 up from slightly below 2 million b/d in 2016.

An increase in US crude production and a wider WTI-Brent spread since the end of 2016 are raising hopes that 2017 will be the year when US crude exports see a marked increase.

For the third year in a row, *India's* oil demand growth will outpace *China's*. Platts Analytics is forecasting a 7% rise to 4.13 million b/d in Indian oil demand in 2017, compared with a 3% rise in Chinese oil demand to 11.50 million b/d.

China's independent refiners, which had emerged as increasingly significant importers of crude, are facing uncertain times. China has removed independent refiners from its oil product export quota allocation, which should see independents' crude imports fall sharply. These challenges are likely to undermine the independent refiners' profitability and slow increases in refining capacity. For the wider market, the trend to follow is the move towards importing sweeter crudes with lower sulfur notably from Angola, the North Sea and possibly the US.

Gas
The big question for the gas market in 2017 is whether strong signs of the emergence of a truly global gas market, evidenced by a large degree of price convergence between regional markets in 2016, will evolve further. Traditional pricing in international gas trade has been based on oil indexation, but the oil price rollercoaster of the last few years, increasing LNG production and growing competition between LNG and pipeline gas have led to a rethink. The trend for de-indexation to oil is likely to continue in 2017.

This is illustrated by the emergence of the*Japan Korea Marker (JKM*) as a regional benchmark for LNG delivered into Japan and Korea. The marked increase in liquidity for swaps based on JKM prices is indicative of a market need for a pricing mechanism more reflective of the specific supply/demand balance of the gas market, one that offers more effective risk management opportunities.

Platts Analytics forecasts an increase in LNG production in Asia to 127 million mt/year for 2017, up 16% on 2016, led by increased capacity in Australia, while commissioning of the world's first floating LNG plant in Malaysia heralds new global opportunities for LNG production. Nevertheless, Asia will continue to be a net LNG importer as demand across the region is forecast to grow 6% to 195 million mt/year in 2017. While demand in the large, mature Japanese and Korean markets is likely to remain flat, Platts Analytics expects *China* and *India* to boost their imports of LNG respectively by 28% and 38%.

As LNG production capacity continues to expand rapidly, particularly in the US and Australia, Platts Analytics forecasts an inevitable global LNG surplus that is expected to last until 2024. Some of this surplus is expected to find buyers across Asia, as the region is in structural deficit and pricing conditions remain economically viable.

In the *US*, the march towards a globalizing gas market means growing pipeline exports to Mexico and rising LNG exports to Latin America, Asia and Europe. Platts Analytics estimates US gas production will resume its growth and hit 74.7 Bcf/d in 2017, up 2.5 Bcf/d on 2016, while tighter regional market conditions, thanks to growing export opportunities and stronger domestic demand, should lead to higher prices.

In *Europe*, the availability of -- and growing access to -- LNG imports has led to a market share offensive by traditional pipeline suppliers. Russian gas supplies to Europe, which hit an all-time high in 2016, are expected to be strong again in the first months of 2017 as buyers look to max out their take-or-pay volumes ahead of a likely rise in oil-indexed contract prices. Falling domestic European supply from Norway, UK and the Netherlands means a growing supply gap that will need to be filled, mainly by LNG and Russian gas. Moreover, coal-to-gas switching, and the closure of coal plant in Europe, should provide a boost to European gas demand.

Ross McCracken, Managing Editor of Platts Energy Economist, S&P Global Platts:"2016 saw significant price convergence in the gas market and the strengthening of the JKM towards end-year is likely to prove temporary. The growing surplus of LNG, combined with the desire to burn cleaner fuels, creates positive conditions for coal-to-gas switching in 2017. In turn, this could provide the basis for more sustained growth in world gas demand and eventually another round of investment in the global LNG sector."

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