



The Abdullah Bin Hamad  
Al-Attiyah International Foundation  
for Energy & Sustainable Development



Research Series  
Issue 06 – February 2017





# Al-Attiyah Foundation Research Series

Expert energy opinion and insight

## Oil outlook 2017: seeking stability, fearing volatility

Three main factors will shape the oil market in 2017. The success of the deal between OPEC and several other producers will be paramount. Compliance has started off high, but historical precedent suggests it will fade. The deal's success also hinges on the reaction of US tight oil to stronger prices. Second, on the demand side, forecasts for robust consumption growth this year depend on macroeconomic stability. But this is not guaranteed: the protectionist bent of the Trump White House and the reaction of major trading partners is one risk; others emanate from potential turmoil in the EU. Geopolitics is the third force that could unsettle global oil markets. The unpredictability of US global leadership, including uncertainty over the White House's policy in the Middle East and on China, together with deepening crises in producer countries like Venezuela, inject risk into any oil-market outlook.

### Supply-side variables

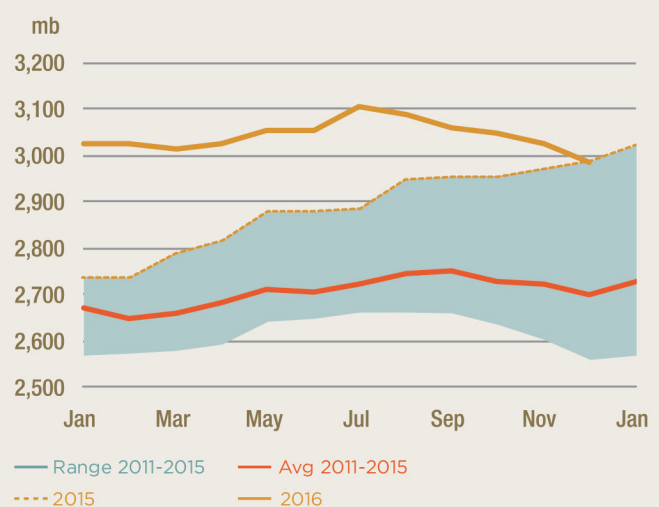
The November 2016 OPEC agreement, followed in early December by the deal with big non-OPEC producers including Russia, is the dominant supply-side force in the oil market — and will remain so until the pact ends or fails. Its purpose was both defensive (to prevent another retreat in oil prices) and offensive (to stabilise benchmarks at a higher price). It has succeeded so far in both aims. By mid-February, Brent futures were 15% above their price before the November deal; and since the agreement from non-OPEC countries to join the cuts the front-month contract has traded in a rough \$3 band between \$54.37/b and \$57.68/b.

Global inventories are shrinking — another core aim of the cuts — although this trend started before the 30 November OPEC deal (see Figure 01). The International Energy Agency (IEA) said in mid-February that OECD stocks had fallen by 800,000 b/d in the fourth quarter 2016 and now stood at less than 3bn barrels. This remains well above the five-year average and it looks doubtful that the overhang will be gone by mid-year, when the producer deal is due to expire or be extended. Also, the IEA notes that stocks at sea and in China have risen. Still, the direction of travel within the OECD, at least, is favourable to OPEC.

The pace of further stock drawing, in terms of the supply side, will depend on three factors: the level of compliance with the cuts achieved by OPEC and its partners over the course of

the deal; the growth in supply from Libya and Nigeria, both exempt from the deal; and the reaction of American tight oil. Historical precedent gives some hints about the first two but not about the latter: tight oil has never been through the full market cycle of boom-bust-recovery, so the speed of its supply growth in 2017 is uncertain.

FIGURE 01: TOTAL OECD OIL STOCKS (mb)



Source: IEA Monthly Oil Market Report, February 2017



Start with the outlook for compliance. OPEC countries pledged to remove just under 1.2m b/d of supply starting in January. The secondary-source data used by both OPEC and the IEA to assess production both show high compliance, at or above 90% in January (see Figures 02 and 03).

OPEC's leaders have already urged members to improve on this historically high observance rate — Saudi Oil Minister Khalid al-Falih has talked of achieving 100%.

But the history of earlier OPEC deals does not suggest this is likely. In 2009, following the OPEC deal of December 2008 to remove 4.2m b/d of supply, compliance started at around 80% and faded in the months thereafter, reaching 58% within a year. A similar pattern was visible in 1999. If compliance with the latest deal follows the same trajectory as that in 2009, OPEC's cuts in May, when the deal will be due for renewal or termination, will amount to 800,000 b/d. Put another way, this would imply OPEC production growth of about 300,000 b/d compared with January.

One difference this time is that a proportion of the cuts are involuntary, meaning the market can bank on their duration. Venezuela, for example, pledged to reduce supply by 95,000 b/d. But its output fell by about 210,000 b/d during 2016 and that decline rate may continue or even accelerate this year. Mexico's 100,000 b/d pledge was in line with Pemex's pre-deal guidance on supply losses in 2017. The same is true for Azerbaijan.

### OPEC committed, others less

Still, the political will behind the deal is strong. OPEC's Secretary-General and other key ministers have since 1 January continued to exclaim the merits of the deal and press for observance, publicly and through diplomatic channels. Saudi Arabia, whose reversal of policy to support cuts was

critical to the agreement, has cut more deeply than it pledged to in November. It has so far tolerated the ambivalence of Iraq, whose production fell sharply between end-December and end-January, but was still 120,000 b/d above its target. As discipline elsewhere in the group fades, the kingdom could continue to mask these failings by removing yet more oil to sustain a high overall level of compliance.

But Saudi willingness to do this could wane: the kingdom explicitly wishes to avoid a repeat of the experience of the mid-1980s, when it cut repeatedly in pursuit of supply/demand balance but lost swathes of market share. Furthermore, while OPEC has achieved most of its cuts, its non-OPEC partners have not. Compliance among these producers — more difficult to verify because of the paucity of data from some smaller producers — is around 50% of the 558,000 b/d pledged.

Russian supply fell by an estimated 100,000 b/d in January, leaving it 200,000 b/d shy of its pledge. Its cuts were to be met over six months: not an average reduction but an eventual target. In theory, this means Russian supply should keep falling until end-May. But it also means that if Russia does meet its 300,000 b/d target it need do so only briefly, and at the end of the deal. (Russian participation was also predicated on full OPEC compliance, giving it justification to comply at equivalent levels.)

But the market remains sceptical of Russian intentions — for good reason, given that it has promised to support OPEC with cuts in the past only to do the opposite. The latest data, from mid-February, showed Russia's production was stable in the first two weeks of the month, at 11.48m b/d. The production drop in early January may have been due to weather, suggesting producers could restore output as the winter eases in Siberia. The Kremlin has not agreed with

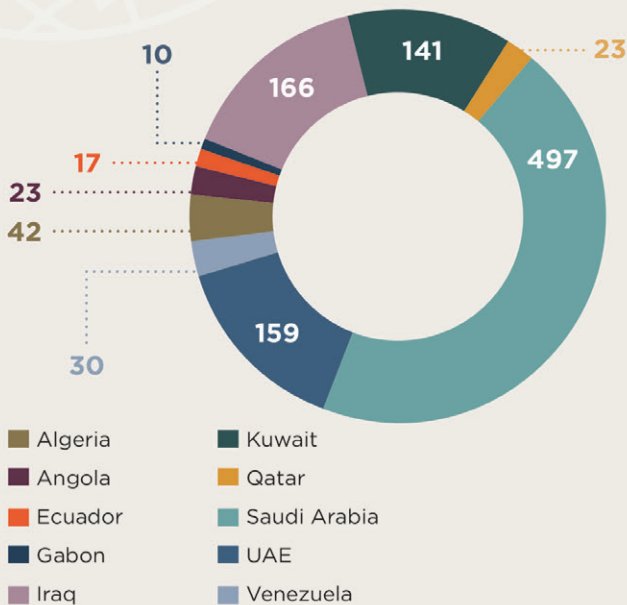
FIGURE 02: OPEC OIL OUTPUT CUTS BY MEMBER ('000 B/D)

|              | Pledge target (in Jan) | Volume pledged | December output | Actual (Jan) | Over/below target (Jan) | Dec-Jan difference | Compliance Jan vs target (%) |
|--------------|------------------------|----------------|-----------------|--------------|-------------------------|--------------------|------------------------------|
| Algeria      | 1,039                  | 50             | 1,087           | 1,045        | 6                       | -42                | 88                           |
| Angola       | 1,673                  | 78             | 1,674           | 1,651        | -22                     | -23                | 128                          |
| Ecuador      | 522                    | 26             | 544             | 527          | 5                       | -17                | 81                           |
| Gabon        | 193                    | 9              | 209             | 199          | 6                       | -10                | 33.3                         |
| Iraq         | 4,351                  | 210            | 4,642           | 4,476        | 125                     | -166               | 40                           |
| Kuwait       | 2,707                  | 131            | 2,859           | 2,718        | 11                      | -141               | 92                           |
| Qatar        | 618                    | 30             | 641             | 618          | 0                       | -23                | 100                          |
| Saudi Arabia | 10,058                 | 486            | 10,443          | 9,946        | -112                    | -497               | 123                          |
| UAE          | 2,874                  | 139            | 3,090           | 2,931        | 57                      | -159               | 59                           |
| Venezuela    | 1,972                  | 95             | 2,034           | 2,004        | 32                      | -30                | 66                           |
| Totals       | 26,007                 | 1,164*         | 27,223          | 26,115       | 108                     | -1,108             | 91                           |

Notes: Excludes Iran (permitted to add 90,000 b/d), Libya and Nigeria (exempt). \*Includes permitted addition of 90,000 b/d from Iran.  
Source: IEA and OPEC

key domestic producers — all of which still talk of plans to increase output this year — about which of them will cut and how they would be compensated. Rosneft, the dominant state-controlled oil producer, remains resistant.

FIGURE 03: SAUDI ARABIA SHOULDERS CUTS



Source: IEA and OPEC

Russia is also planning to increase exports through 2017. Alexander Novak, the energy minister, says these may rise by 4-5.5% this year. Exports through Transneft's pipeline system in January were almost 190,000 b/d higher than a year earlier. Russian refineries continue to process less crude, freeing volumes for export. None of this breaks the deal. Indeed, some data on tanker traffic out of the Middle East in January imply that exports from Gulf OPEC members rose steeply compared with the previous month — a move that will drain producer stocks, though not quickly. But as the market's attention turns to how much supply is still reaching consumers — and not simply how much crude oil is being extracted — deal-supportive sentiment could wane.

### Supply wild cards

The other major supply-side forces are beyond OPEC's control: Libya and Nigeria; and tight oil. Libya's output recovery since August has added about 500,000 b/d to supply. It hopes to increase production again in 2017 by a similar amount. This hinges on its dysfunctional politics, state company NOC's ability to repair damaged infrastructure and the return of services companies. Prospects are therefore incalculable — another decline in Libyan production is as plausible as more growth. Nigeria's government has targeted an increase of up to 600,000 b/d. But this too depends on politics in the form of a durable settlement in the Niger Delta. The market has largely discounted any significant rise from Nigeria's current 1.6m b/d, a level roughly equivalent to its 2016 average.

The outlook in the US is different, and the data increasingly suggest that the recovery may be stronger than OPEC expects. The group's February market report forecast a rise

in US oil supply, led by tight oil, of 240,000 b/d compared with 2016.

This is beneath the forecasts for 2017 US oil supply from the IEA (320,000 b/d), the Energy Information Administration (EIA — 360,000 b/d) and much of Wall Street. But even more significant — in terms of OPEC members' view of their deal's efficacy — than these year-on-year forecasts are those for US supply growth during the deal, from the end of 2016 to mid-2017 (when it is due to expire) and end-2017 (when an extension might expire). The EIA, for example, projects US liquids and crude production rising from 13.4m b/d in December 2016 to 13.8m b/d in June 2017 and 14.4m b/d in December 2017. This means that during six months of the OPEC deal, the US on its own may replace up to 400,000 b/d of the oil OPEC pledged to remove. If OPEC extended the deal to end-2017, US supply would by then replace almost all the barrels OPEC was withdrawing.

The early signals from US tight oil are not reassuring to OPEC either. Texas's prolific Permian Basin was the epicentre of the industry's M&A activity in 2016 as producers rushed to grasp high-yielding assets. Well productivity across all but one of the seven major shale plays in the US has risen sharply through the price slump. US crude stocks continue to rise — possibly reflecting an easing of gasoline demand — and exports are sharply higher (see Figure 04).

That is a large exogenous threat to the OPEC deal and efforts to rebalance the market. It suggests that while OPEC's members have done enough to establish a price floor, tight oil producers will stand on it to install the price ceiling, expanding market share as they do. This will trouble OPEC members, not least within the GCC, that were already sceptical about the decision to cut. This will be doubly significant if prices remain around \$55/b for much of the year.

If income has not risen, market share is down, and prices are lodged at a level just high enough to restore rival supplies, how enthusiastic will GCC OPEC members be to extend the deal at the end of May? Many of them have deployed more rigs to maintain high levels of upstream activity and would be primed to lift output quickly — especially after several fallow months that have allowed for maintenance to existing assets.

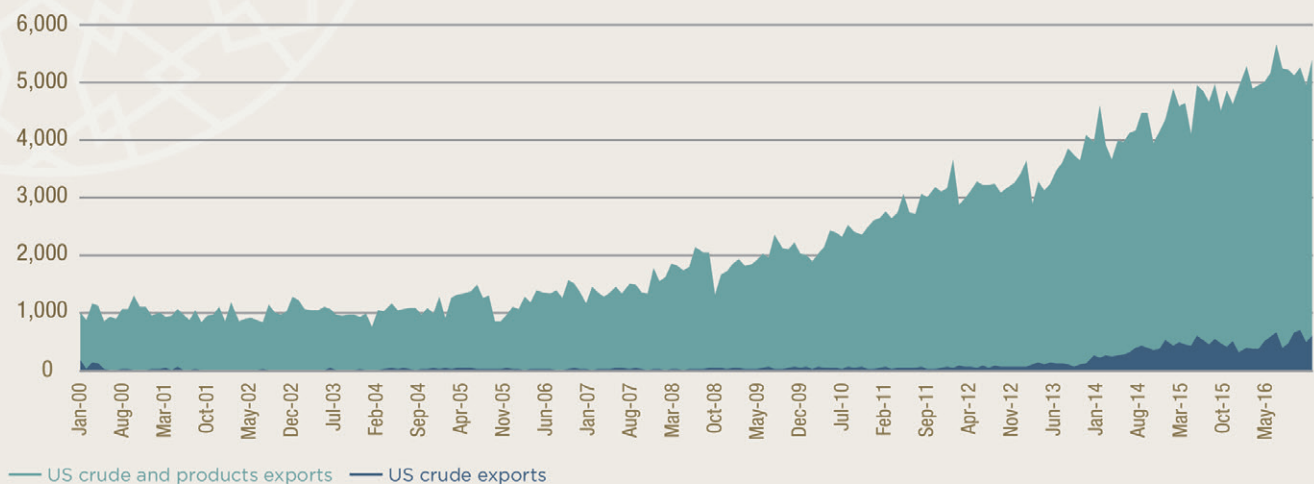
In sum, despite OPEC's early compliance success and the retreat of crude oil stocks, the supply-side picture is mixed, for reasons both internal to OPEC (its members' history of observance) and external to it (Russian supply plans and tight oil's reaction).

### Macroeconomic concerns

The demand side of the equation looks more reliable, but is also pregnant with risk. The IMF expects the world economy to expand by 3.4% this year, a rise on 2016's 3.1%. Using that foundation, the IEA foresees oil-demand growth of 1.4m b/d in 2017, a retreat from the 1.6m b/d of 2016 but still broadly in line with long-term trends. Consumer strength is visible in India and, after a lull, China. Even the EU is expected to consume more oil in 2017 than it did last year, overcoming years of stagnation.

The longer-term headwinds to oil-demand growth are now well known — climate-change policy, natural gas and electric-

FIGURE 04: US LIQUIDS EXPORTS 2000-2016 ('000 B/D)



Source: EIA

vehicle penetration of the transport segment, and other conservation efforts — but will not be decisive in 2017. Yet shorter-term risks are rising. The EU's oil-demand recovery could be strangled by renewed macroeconomic weakness. The French presidential election in April/May offers the unsettling prospect of a far-right victory that threatens closer EU economic integration. Angela Merkel may win re-election in Germany in September, but a change of political course in the bloc's most important economy is plausible. The economic outcome of the UK's Brexit vote has so far been less disruptive than expected, but exit negotiations will hang over the European economy from March. Above all, an unexpected further lurch to nativist economic policies in the EU cannot be discounted.

This risk is already translating into fact across the Atlantic, where President Trump's "America First" policy is a new spectre hanging over the global economy. Although stock markets are buoyant and initial economic data show strength in the US economy, the protectionist bent of the new administration cannot be ignored. The withdrawal from the Trans Pacific Partnership and Trump's vow henceforth only to sign bilateral agreements; talk of revising or scrapping NAFTA, imposing a border tax on goods reaching the US, or erecting other trade barriers; new local-content rules (such as using US steel for new projects); accusations of currency manipulation directed at China and Germany; and, in the White House's first energy statement, a vow to "achieving energy independence from the OPEC cartel" all signal, at best, a more aggressive trade posture from the US.

### Geopolitical risks

By contrast, the third major force influencing the oil market this year (and beyond) is geopolitical, and should support oil prices. On the surface, Trump's foreign-policy redirection, now underway, is not guaranteed to be bullish. A rapprochement between the US and Russia, for example, if it included a lifting of sanctions, would imply a renewed sharing of US technology in the Russian upstream, offering more Siberian supply. An optimistic view of Trump's roughly sketched plan for Islamic State in Syria — destruction — is that it might bring some stability to the region. More broadly, his support for Gulf Arab states may bolster their security.

But the oil market will not take so sanguine a view. Not since 2001, or possibly before, has geopolitical risk emanated so plainly and directly from the Oval Office itself. The chief short-term risk, especially given the approaching Iranian presidential election in May, is of a sharp escalation in hostile rhetoric between Washington and Tehran. Trump has already tightened sanctions on Iran and has been relentlessly critical of the nuclear agreement with Tehran. Rolling back the deal is diplomatically difficult. But it cannot be discounted as a risk. Nor can a much more serious escalation. For oil, the implications of worsening relations between the two countries range from snapback sanctions that would reverse Iran's output recovery, to military conflict that threatens the shipping lanes in the Gulf or further destabilises Iraq.

This is more troubling for the oil market because it is not clear how US leadership will deal with a crisis. Venezuela, for example, could provide a test. Under mounting sovereign and PDVSA debts, Caracas will struggle to restore economic stability with oil prices at \$55/b. The IMF predicts the country's inflation will hit 1,600% this year. If this economic and fiscal deterioration sparks civil disorder the potential supply-side consequences are obvious: a fall in oil output that exceeds the decline already underway.

### Conclusion

In sum, the oil market will be buffeted by competing forces in 2017. Price-supportive factors include OPEC's cuts, unavoidable production declines in some countries (worsening their political stability), and a new era of geopolitical uncertainty caused partly by the unpredictability of US foreign policy and aggressive rhetoric. But US shale's response to recent price strength will bring extra oil into the market — possibly more quickly than expected. OPEC's cuts also have the effect of bolstering spare capacity, which could be drawn on in the event of a supply-side crisis, or if the deal collapses. Macroeconomic threats also stem from European elections and the new "America First" policy. Price direction in 2017 will only emerge as this battle between politics and economics plays out.



The Foundation's mission is to provide robust and practical knowledge and insights on global energy and sustainable development topics and communicate these for the benefit.

WE THANK ALL OF OUR MEMBERS  
FOR THEIR CONTINUED SUPPORT:





The Abdullah Bin Hamad Al-Attiyah  
International Foundation for  
Energy & Sustainable Development

Barzan Tower  
4th Floor  
West Bay  
Doha  
Qatar

Tel: +974 4042 8000  
Fax: +974 4042 8099

Website: [www.abhafoundation.org](http://www.abhafoundation.org)  
E-mail: [info@abhafoundation.org](mailto:info@abhafoundation.org)