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

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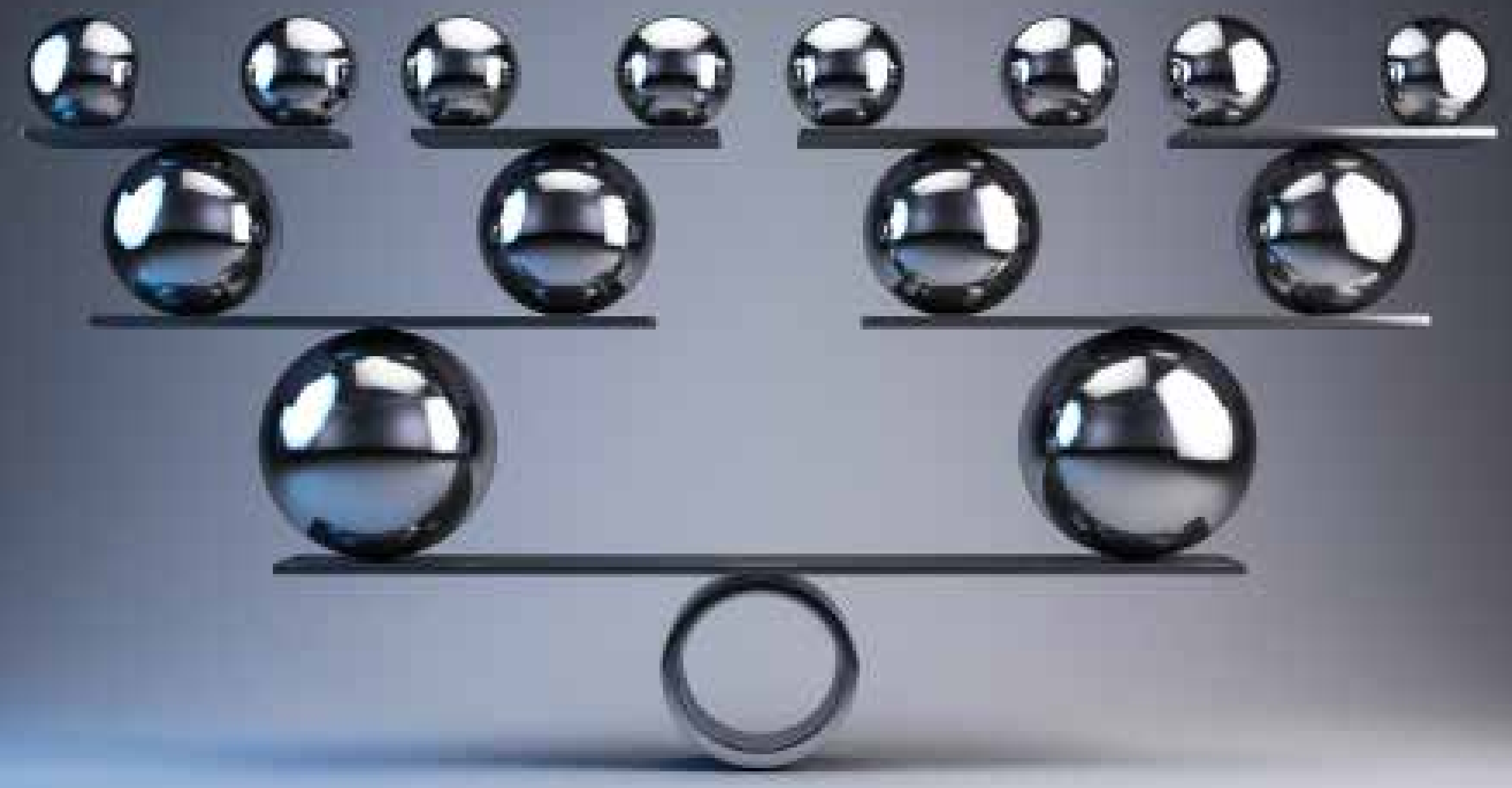
2016 WHITE PAPER

OIL OUTLOOK 2017: *Return to Balance?*



OIL OUTLOOK:
A New Horizon, or a Trick of Light?

The pendulum of sentiment in the global oil market has found a new middle ground after swinging erratically between tentative optimism and bearish forecasts since prices plummeted in mid-2014. But, will it last?

A rare meeting of minds between OPEC and non-OPEC producers in Vienna on November 30 has quelled the simmering panic that has burdened oil producers since a supply glut pushed oil prices to a 12-year low at sub-$30 a barrel (bl) in January this year. Saudi Arabia-led OPEC agreed to cut output by 1.2 million barrels a day (m b/d) from January 2017, which will limit the 13-member group's output to 32.5m b/d. The cuts follow a record high production of 34.2m b/d in November. Russia-led cuts by non-OPEC producers of 558,000 b/d will also start in January.

Most importantly, the collaboration that underpins the Vienna Agreement is a welcomed break from the bickering and backroom talks that have long characterized the oil markets. The Agreement marks the first cut made by OPEC since 2008 and the first deal including non-OPEC producers in 15 years.

It also communicates OPEC's retreat from efforts to control market share – especially against the booming US shale market – which has significantly contributed to the global supply glut since November 2014. It appears that the price crunch has become too heavy a cross to bear in exchange for weakened competitors.

But, it is a risky strategy for OPEC. Mounting debt piles and bankruptcies have severely depressed US shale production since 2015, but the beleaguered market will have the financial breathing space it needs to ramp up domestic production if bullish sentiment surrounding the Agreement pushes prices to $60/bl and above. A stronger domestic market would also allow the US to leverage the removal of Washington's 40-year ban on domestic crude exports in December 2015 and expand its global footprint.

On the demand side, the Paris-based International Energy Agency (IEA) has increased the global forecast for 2017 by 110,000 b/d to a total of 1.3m b/d. China, the US and India are the

1.2
After two years of intentional inaction, OPEC has agreed to cut production by 1.2m b/d from January

34.2
OPEC's production reached a record high of 34.2m b/d in November

558,000
Non-OPEC producers, including Russia, will cut 558,000 b/d in the first half of 2017

2001
The Vienna Agreement is the first deal including OPEC and non-OPEC producers in 15 years

2008
The Vienna Agreement marks the first production cuts made by OPEC in eight years

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world's biggest energy consumers, respectively, and the IEA has pegged India to be the fastest growing crude consumer up to 2040. Plus, the rising appetite of countries in the Organization for Economic Co-operation and Development (OECD) should not be discounted, with many eager to spur domestic growth now that they have a firmer financial footing following the global recession in 2008.

The Agreement has not extinguished the lurking mistrust that characterizes the relationships within OPEC, non-OPEC producers and energy investors. It makes sense for producers to agree to cuts to quickly bolster the oil price and their strained balance sheets, but the temptation to cheat will rise in correlation to a rising oil price. Saudi Arabia's decision to only proceed with the involvement of Russia worries what is already a nervous market. Russia's Minister of Energy, Alexander Novak, agreed to cut 300,000 b/d up to mid-2017. But, this potentially puts the price of oil in the hands of a producer who has a checkered past when it comes to implementing agreed cuts.

SHINING LIGHT ON THE SHADOWS

A Joint Ministerial Committee has been established to oversee producers' compliance of the Agreement up to OPEC's next scheduled meeting in May, which helps give the deal a stamp of credibility. Yet, it remains to be seen whether the committee can successfully improve producers' sense of accountability, as stakeholders frequently provide misinformation on production figures to protect their market share.

Multiple data sources and basic data harvesting can also be problematic. OPEC publishes production estimates from figures reported by members, as well as those generated by independent sources. While this helps counter a monopoly on information, it can also lead to numerical discrepancies and risks denting stakeholders' confidence in the figures.

A greater push by OPEC and non-OPEC members to improve data submissions – whilst safeguarding intellectual property – would of-

1.3
The IEA has increased its global oil demand forecast for 2017 by 110,000 b/d to 1.3m b/d

2040
India, the world's third largest energy consumer and sixth biggest economy, will be the fastest growing crude consumer up to 2040

300,000
Russia's has agreed to cut 300,000 b/d up to mid-2017

fer a clearer insight into the supply-demand balance of oil products and potentially ease price volatility. OPEC and the UAE's Ministry of Energy contributed to what must be a global effort by launching a new and free smartphone application in November for OPEC's Annual Statistical Bulletin (ASB). Many more similar steps must be taken by stakeholders along the supply chain, from research and development (R&D) into innovative technologies through to shipping and trading.

Opaque data hinders oil stakeholders' adaptability to sharp price and policy changes, which is a hazardous habit considering the market's strained bank balances, bankruptcies and shortened payrolls since 2014. The need for flexibility was most recently illustrated by the UN agency International Maritime Organization's (IMO) decision in October to introduce a new Sulphur emissions limit of 0.5% from the current 3.5% in 2020, instead of 2025.

Aside from the value of data transparency to help carve out robust strategies, the IMO's decision highlights two key points for the oil industry. Firstly, the new Sulphur limit will be one of many increasingly strict environmental regulations that the oil industry must adapt to as the world's leaders, including those in the Gulf, pursue a low-carbon future. Secondly, the decision will reshape refinery economics, which could play well for the Middle East's booming refining sector if stakeholders work with the shipping industry to discourage the use of cheaper and non-compliant fuels.

NAVIGATING POLITICAL SHIFTS

A wave of surprise political developments will create a challenging policy environment in 2017, which may force some investors to reposition their portfolios towards a more cautionary spend rate. For example, the IEA said the global spend on oil and gas fields fell by 25% in 2015 to $583 billion, with another 24% decline to approximately $450 billion anticipated for 2016. A similar narrative in 2017 is likely, which would mark the first consecutive three-year decline on record.

Topping the list of political surprises is the US' President Elect Donald Trump's move into the Oval Office in January. Oil men in the US welcomed the prospect of what President Elect Trump described as a "bonfire of regulations" in the oil and gas sector in 2017. Democrat Hilary Clinton would have likely taken a similar pathway, but she also would have introduced a progressive agenda on other issues, such as foreign policy. How the President Elect's campaign promises, including the economic stimulus, impact the country's energy outlook will have global ramifications.

Brexit is also on the agenda, with the UK's Prime Minister Theresa May likely to trigger Article 50 next year. The formal notification of the UK's intention to withdraw from the European Union (EU) could see the country's split from the EU being confirmed by April 2019.

3%
The percentage cut to the Sulphur emissions limit introduced by the IMO in October – the new limit will be 0.5% from 2020

583
Global spending on oil and gas fields fell by $583 billion in 2015 – a 25% reduction, according to the IEA

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General elections in the Netherlands in March will reveal the depth of the country's appetite for a 'Nexit' and give a wider indication of the state of the EU's energy allies. The selection of China's political bureau – the nexus of all power in China, the world's biggest energy consumer and second largest economy – is scheduled for the fourth quarter next year.

Iran's presidential election on May 19 will reveal whether current President Hassan Rouhani can add a second term to his time in office since 2013. Advocates point to his efforts to improve relations with the West and the lifting of the majority of the Western-imposed sanctions on January 17, 2016. Whether President Elect Trump's unsupportive comments jeopardize the sanctions deal will be clearer next year, but a deteriorating relationship with the US could significantly impact Iran's strong return to the global energy stage this year. Oil production in Iran, which is OPEC's third largest producer and home to the world's fourth largest proven crude reserves, is already nearing pre-sanction levels of just over 4m b/d with current production at 3.89m b/d. A cap of just under 3.8m b/d will be applied from January, as per the Agreement.

NEW IDEAS, NEW BLOOD

Whatever transpires from the tentative OPEC and non-OPEC alliance, the intellectual and technological solutions of yesteryear that have spearheaded the growth of the global oil industry no longer suffice. Many Gulf countries' bid to evolve into knowledge-based economies as per their National Visions by 2020 and 2030 means government, industry and academia must do considerably more to strengthen millennials' skill sets. Much of the wisdom in the oil markets currently lies with the older and retiring generation.

The volume of petroleum engineers graduating in Europe and the US is rapidly shrinking, with half of the world's such professionals expected to retire over the coming decade, for example. Part of the talent gap is being plugged by petroleum engineers from Asian universi-

24%
Nervy investors and strained budgets means the IEA expects the global spend on oil and gas fields to slide by another quarter to $450 billion this year

19
Iran's presidential election is scheduled for May 19, with current President Hassan Rouhani seeking a second term since he took office in 2013

ties, but the poor culture of collaboration that pervades the global oil industry means such talent remains locked in small geographies and the fragmentation of the industry worsens.

Disjointed efforts must be replaced by partnerships, especially against a backdrop of increasingly demanding consumer profiles over the longer term. The United Nations (UN) expects the global population to climb by 30% to 9.7 billion people by 2050, while the US' Energy Information Administration (EIA) forecasts a 48% increase in global energy consumption between 2012 and 2040. BP's Energy Outlook forecasts a 60% rise in the Middle East's energy consumption alone by 2035.

Amidst the intensifying demand, energy-centered Gulf countries are running short on time to establish supply chains of innovative technologies and mindsets that can spearhead knowledge building across the global oil industry. The extraordinarily fast evolution of the US' energy markets – it has become a net gas exporter for the first time in six decades – highlights how Gulf countries risk missing a golden opportunity to maintain their position as the epicenter of global oil markets if they do not act quickly.

Adjusting mentalities has recently been successfully demonstrated by Gulf governments' cuts to energy subsidies, which have long been considered a birthright in the region's psyche. Aside from saving governments billions of US dollars in today's low oil price environment, the cuts will also take some of the sting out of future price volatility.

If the Vienna Agreement were to crumble before May next year, the supply glut would intensify, investors would shy even further away and the chances of another alliance between OPEC and non-OPEC producers to counter unsustainable price volatility would be considerably slimmer. For now, the narrative of oil markets in 2017 depends on producers' loyalty to the game plan. The Agreement could herald an era of stability, or rule-breaking by just one producer could trigger a domino effect that sees the alliance becoming yet another empty promise.

3.8

Iran, which is nearing its oil production target of 4m b/d, has agreed to limit production to 3.8m b/d from January

48%

Global energy consumption between 2012 and 2040 will rise by 48%, according to the US' EIA

9.7

The UN expects the global population to rise by nearly a third to 9.7 billion by 2050

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