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# Predicting Oil Prices for 2017

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Oil prices are a key element in the world economy. Predicting oil price movements is notoriously difficult: politics, economics, and technological developments all have a big impact.

Our partner John Buck, who after leaving the FCO was Group Director, Government and Public Affairs for a major international oil company, has joined with the leading global energy market intelligence publisher NewsBase Research to provide insights into oil prices in 2017. To view their full article on the top five supply side risks to the oil price, please see http://promo.newsbase.com/5risks.

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## 1. The fragility of the OPEC deal

The recent OPEC deal to cut production and balance the market was the stimulus for an oil price move above $50. It was a clear signal that the major exporters had changed their strategy back towards supporting prices. The main risk to oil price recovery is undoubtedly the fragile stability of that deal.

Renewed optimism will be short lived if there is widespread cheating. The core Gulf Arab swing producers (Saudi Arabia, UAE, Kuwait and Qatar) have a good track record of complying, but most other OPEC countries do not, and non-OPEC countries are worse.

Many of the major producers are suffering severe economic problems – Venezuela, Russia, Iran, Iraq and of course Saudi Arabia itself. If the oil price doesn't rise fast enough – and it seems likely that US shale will put an effective US$60-65 cap on the price in the short term – internal political tensions may make the temptation to seek unilateral market share difficult to resist.

The greatest danger is likely to be disputes between Saudi Arabia, Iran and Iraq in particular. Iran and Iraq both grew production strongly in 2016, and have ambitions to increase output even more. Given Iran's rivalry with Saudi Arabia and its Gulf Arab allies, they will not want to be shackled for long.

## 2. US tight oil

The election of Donald Trump as the next US president introduces considerable uncertainty into the international political and economic system. Given the game-changing impact of US output growth on the global oil market over the last few years, which triggered the attack on prices from Saudi Arabia back in 2014, the election of an aggressively pro-energy American president may will have an impact on price recovery.

Trump has spoken of unleashing as much as US$50 trillion of fossil fuel reserves in the US. This number may be implausibly large. But it is worth noting that US production is now only 0.6 mbpd off its peak of 4.7 mbpd. The flexibility of US shale production, and the potential speed and scope of any production increase, is what makes US tight oil a considerable risk to oil prices in 2017 – placing it at number two on our list.

## 3. Russia's production strength

Russia's production strength has been 2016's surprise. Russian production reached a post-Soviet record of 11.23 mbpd in October 2016, where it has more or less remained.

Russia has benefited from currency weakness deriving from the imposition of Western sanctions from mid-2014, with the rouble depreciating against the dollar by around a half. Converting dollar barrels into roubles has thus shielded Russian producers from much of the impact suffered by producers elsewhere. But domestic budgetary pressures remain.

Past behaviour (Russia has reneged on several promises made to OPEC over the last 15 years) and domestic pressures suggest that Russia's willingness to comply with agreed cuts may not last long, particularly as it seems to be performing more strongly in the new environment.

Moreover, Russia has previously claimed that it does not have the same control over production as its OPEC rivals, due to the harsh Siberian climate and the presence of many private companies. This gives Russia a ready-made excuse for non-compliance.

These considerations lead us to put Russia's production renaissance at number three on our list.

Russian non-compliance would put pressure on OPEC and particularly on Russia's rival in Syria, Saudi Arabia.

## 4. Iran in the international market

Iran has around 158 billion barrels of proven oil reserves, second in the Middle East only to its regional rival Saudi Arabia.

Having been largely off limits for nearly a decade, Iran is once more free to seek foreign investment in oil and gas production, and to export these products. Most non-US sanctions on Iran were lifted in the course of 2016 as a consequence of the P5+1/Iran nuclear deal. Oil production grew strongly last year in response, from around 2.9 mbpd at the end of 2015, to more than 3.7 mbpd in late 2016, which is broadly in line with the level before the introduction of sanctions on oil exports in early 2012.

It will take long lead times for investment to filter down to the wellhead, with the Iranian energy industry in dire need of fresh capital. We suspect Iran could be a much greater risk to oil prices in 2018 than in 2017 – provided of course that the nuclear deal does not unravel in the meantime.

**5. Rapid production recovery in Libya**

Libya has been racked by violence and disorder since Gadhafi's overthrow in 2011. UN-backed attempts to extend the authority of a unity government under a Presidential Council formed a year ago are not succeeding. The seizure of territory in 2014 by foreign ISIS jihadists has been ended by the retaking of Sirte in December, but the militants are now scattered in the region and could return to exploit continuing disunity. The forces of General Haftar based in Eastern Libya and backed by Egypt, UAE and increasingly Russia, have taken control of the main oil exporting facilities, but will face resistance if they try to move westwards towards Tripoli.

After dipping sharply last summer, Libyan oil production is beginning to rise again, though still far off the pre-2011 level of around 1.6 mbd. UN-mandated measures have succeeded in ensuring that exports can only be handled through the National Oil Corporation, whichever faction controls the terminals. This element of stability will favour further production increases. But politically the scene is set for further political stalemate, insecurity and potentially another round of outright civil war. Whether renewed international efforts will prevail to rebuild a political consensus will have a major influence on whether production continues to rise.

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