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Standard & Poor's Revises Its Crude Oil Price Assumptions; Natural Gas Assumptions Unchanged

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Standard & Poor's Ratings Services has updated its price assumptions for Brent crude oil and West Texas Intermediate (WTI) crude oil according to the methodology set forth in "Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns," published Nov. 19, 2013.

Over the coming weeks, we will be updating our forecasts, and we anticipate a number of corporate rating actions in the upstream and oil field service sectors. However, any such actions also depend on company-specific factors, including our other rating assumptions and issuers' flexibility to adapt to lower prices, hedge positions, and liquidity. We anticipate few immediate sovereign rating changes as a direct consequence of these updated price assumptions, following several outlook revisions earlier this month.

Standard & Poor's Oil And Natural Gas Price Assumptions

	New Prices*			Old Prices		
	Brent	**WTI**	**Henry Hub**	**Brent**	**WTI**	**Henry Hub**
	$/bbl	**$/bbl**	**$/mmBTU**	**$/bbl**	**$/bbl**	**$/mmBTU**
2015	70	65	3.75	80	75	3.75
2016	75	70	4.00	85	80	4.00
2017 and beyond	85	80	4.00	85	80	4.00

*Prices rounded to the nearest $5/bbl and $0.25/mmBTU.

The repeated downward revisions to our 2015-2016 oil price assumptions reflect the precipitous declines in futures prices for both Brent and WTI. This reflects a combination of relatively unconstrained supply and weaker demand. Our oil assumptions for 2017 and beyond are unchanged.

We recognize current spot oil prices are even significantly lower than our $70/bbl Brent ($65/bbl WTI) average price assumption in 2015. We still expect some stabilization and ultimately recovery is likely as oil companies curb production of high cost wells and push out new capital spending, while uncertainty also remains on OPEC's future decisions.

From a commercial perspective, a reduction in U.S. shale development drilling is likely in 2015 if WTI prices remain below $75/bbl, which should thereafter slow production growth and could support prices. Energy consultants, Bentek, estimate that a 10% cut in annual drilling activity by exploration and production companies would result in a 4% reduction in production growth in six key U.S. resource plays in 2015 and a 6% reduction in 2016. It also estimates that a 25% cut in spending would result in 11% and 16% reductions, respectively. Similarly, such prices render developments of many deep-water oil fields less economically viable.

At its meeting on Nov. 27, 2014, the Organization of the Petroleum Exporting Countries (OPEC) decided to maintain oil production quotas at a combined official 30 million barrels/day (mbopd) rather than limit supply to support

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near-term prices. In fact, actual OPEC production has been closer to 30.6 mbopd or higher for six months. This implies that the ongoing supply increases in North America could continue to weigh on crude prices in the context of data indicating softening demand for crude and refined products globally outside the U.S., especially from European and Asian economies.

Growing output from U.S. regions--including the Bakken shale, Permian Basin, and Eagle Ford shale--has also put downward pressure on prices. Before the recent price declines, Bentek Energy expected that U.S. crude oil production would average nearly 10 mbopd in 2015, a 14% increase over its estimate for full-year 2014 average production of 8.7 mbopd. We do not foresee a dramatic drop in near-term U.S. crude production, but we believe the rate of investment in growth is likely to slow with prevailing spot and futures prices.

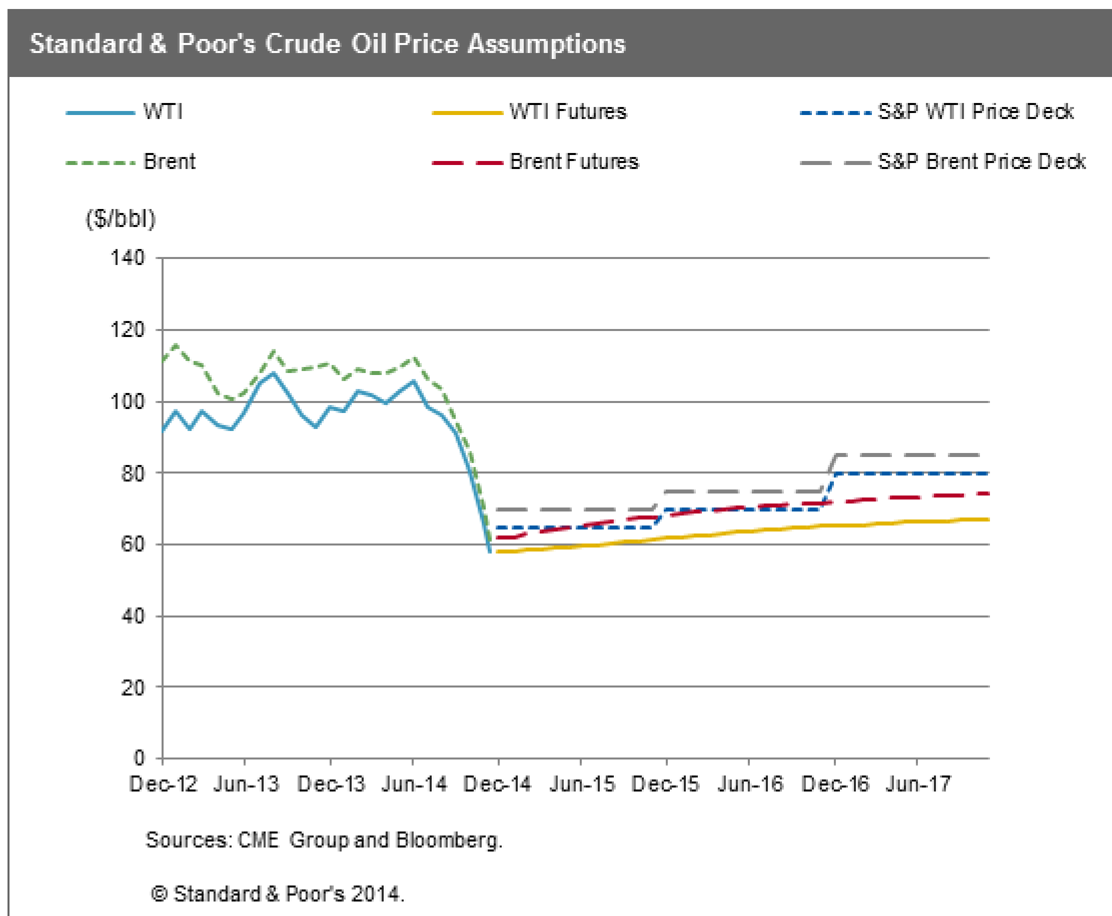
Until the second half of 2014, oil prices had been robust for about two years due to expectations that demand would keep pace and concerns over political risk-related supply disruptions. Prices subsequently declined as shipments from Libya resumed and fighting in Iraq did not interrupt production from the main southern oil fields. In addition, we understand that Saudi Arabia--OPEC's most influential member--is maintaining current oil production levels rather than cutting output to support prices. Furthermore, a series of negative economic data has led to reduced expectations for oil consumption, including the International Energy Agency, which reduced its global demand growth forecast for 2015 to 900,000 barrels/day in its December monthly report from 1.1 million barrels previously.

Lastly, a strengthening U.S. dollar relative to other major currencies has driven down the dollar-price of oil. The combination of relatively unconstrained supply and weaker demand has prompted us to lower our average price assumptions for 2015 and 2016.

From a sovereign perspective, we believe Brent below $80/bbl is less than the fiscal breakeven price--the implied oil price needed to balance government budgets--for many major oil-producing countries. (For data on Gulf Cooperation Council states' fiscal breakeven oil prices and a discussion on their vulnerabilities to a sharp and sustained decline in the oil price, see "Hooked On Hydrocarbons: How Susceptible Are Gulf Sovereigns To Concentration Risk?" June 30, 2014.)

In December 2014, we have revised our outlooks on several oil-exporting sovereigns (see "Bahrain Outlook Revised To Negative On Weakening Fiscal Position; 'BBB/A-2' Ratings Affirmed," Dec. 12, 2014; "Sultanate of Oman Outlook Revised To Negative From Stable; ‘A/A-1’ Ratings Affirmed," Dec. 5, 2014; and "Saudi Arabia Outlook Revised To Stable From Positive; 'AA-/A-1+' Ratings Affirmed," Dec. 5, 2014). For many oil exporters, oil accounts for a significant proportion of their exports, and so lower oil prices affect their current account receipts and fiscal revenue.

In our view, sovereigns that are more vulnerable to falling oil prices are likely to attempt to influence key decision makers within OPEC, such as to support oil prices. Geopolitical risks related to these or other factors persist, and shipments from Libya in particular could be interrupted again. Such security factors were likely responsible for elevated prices earlier in 2014 and before. Barring supply interruptions or improved economic growth, however, we anticipate that markets will be well supplied, leading to prices markedly below the levels of the past two years.



Related Criteria And Research

Related criteria

- Key Credit Factors For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns, Nov. 19, 2013

Related research

- Hooked On Hydrocarbons: How Susceptible Are Gulf Sovereigns To Concentration Risk? June 30, 2014

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