Oil and Gas Market Outlook: What Does 2019 Hold?

3 January 2019

Overview

As part of its energy talk series, Access for Women in Energy (AccessWIE) organised a roundtable discussion on Oil and Gas Market Outlook for 2019. The event took place in the House of Lords in London on 13 December 2018.

World leading experts shared their views on the major developments that shaped the global, political, economic and energy landscape in 2018 and their projections for the year ahead. The panel of speakers included (by order of speaking):

- Lord Howell, Former Secretary of State for Energy in the UK and Co-Chairman of AccessWIE, provided an overview of geopolitics and how they are affecting the global energy industry.
- Christof Rühl, Former Chief Economist of BP and Global Head of Research at Abu Dhabi Investment Authority (ADIA), covered the macro-trends that are shaping oil markets.
- Peg Mackey, Senior Oil Market Analyst at International Energy Agency (IEA), focused on OPEC and the challenges facing the organisation in the coming year.
- Anne-Sophie Corbeau, Head of Gas Analysis in Group of the Chief Economist at BP, addressed the emerging trends in global and US gas markets.
- Howard V Rogers, Chairman and Senior Research Fellow at Natural Gas Research Programme at the Oxford Institute for Energy Studies (OIES), focused on the European gas market.

Dr Carole Nakhle, CEO of Crystol Energy and Director of AccessWIE, chaired the discussion and set the scene, highlighting, among others, that, oil markets, in particular, have been on a rollercoaster with some analysts constantly swinging their forecasts from one extreme - "lower for longer" to another - heading to the "three-digit numbers". In reality, however, oil markets are big and slow-moving beasts. Gas markets may have been relatively subtler, but things will be changing in the year ahead (and after).

The speakers from left to right: Peg Mackey, Christof Rühl, Lord Howell, Dr Carole Nakhle, Howard V Rogers and Anne-Sophie Corbeau

The discussion was followed by a Q&A.

The following sections summarise the key highlights of the discussion.

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Geopolitics

- The global political arena remains volatile, with plenty of dangers. **It is realpolitik at its ugliest**. The changes which will happen in 2019 will be undoubtedly interesting to observe and may push the world into a different dimension.
- The Gulf region continues to witness tensions between its core players, i.e. Saudi Arabia, the UAE and Qatar, with obvious immediate difficulties, which will continue throughout 2019.
- Saudi Arabia, the big boy of OPEC, is facing challenges with pressure on the international political arena. The US government has allegedly requested not to make significant production cuts for various reasons.
- President Trump will keep his foot firmly on Saudi Arabia's neck. He has used the Khashoggi affair to exercise pressure on the Kingdom, deterring any large cuts in OPEC production. Trump wants prices just nicely balanced - not too high to lose rural votes, and not too low to discourage the shale crowd.
- Trump has also made so many exceptions to the Iran sanctions, not least thanks to European governments supporting the JCPOA, that oil prices have come down.
- Israel and several Arab countries have been brought together by the US to challenge Iran.
- Europeans are torn over Iran: business says 'can't', politicians say 'can'.
- Outside the Middle East, Russia is turning the heat again in Ukraine and continues to use its political power to keep a leading position in Western Europe and limit any possibility of gas supplies from North America.
- The Chinese want to fund their One Belt One Road (OBOR) strategy from oil and gas projects they get involved in across the OBOR countries.

Energy Transformation

- The outlook for oil and gas could be defined by continuing big supply and continuing big demand. Shale and new technology will continue to expand plentiful world supplies of both oil and gas where demand will also steadily increase, despite green growth and increased efficiency; still 71% of world energy in 2040. Therefore, one should expect soft oil and gas prices but no collapse and no spikes unless there were black swans - e.g. Middle East all-out war, collapse of Saudi Arabia and other outside probabilities. Venezuela and Iran sanctions already 'in the market'.
- World energy transformation away from hydrocarbons has been very slow, and not nearly sufficient to meet emissions goals. Present policies and Paris climate change targets are rather inadequate, even if being met. **'Plan A' for greening energy has failed, cheated by Chinese and Indian needs.** 'Plan B' is urgently needed, for combatting global warming, if the Intergovernmental Panel on Climate Change (IPCC) scientists are right.
- Renewable energy costs are coming down especially for wind and solar, increasingly competing with fossil fuels. But enormous volumes of oil and gas have become available for development, with hitherto costly projects having a good chance to come on stream.
- Nuclear is limping along, still held back by high costs. The renaissance of nuclear building in the UK is running into considerable difficulties and the new fleet programme is faltering. The Chinese are much more involved than realised in the UK - both in new nuclear built (Hinkley, Sizewellc, Bradwell and maybe Wylfa (where Hitachi is having doubts) and Moorside (where Toshiba have pulled out).
- The notion that China will curb its energy growth is a myth. The country remains a large oil and gas consumer and a hot market for hydrocarbon imports from all over the world. China is also building 200GW of coal-fired electricity generation; India will add another 120GW.
- In the US, Trump is trying to get a coal renaissance but has not succeeded yet.

The Q&A session

Global Oil Markets

- There is too much oil around in the sense that production capacity exceeds effective demand. Any upside price pressure would therefore have to be created above ground. **The fundamentals do not support higher prices.** There needs to be a good reason for prices to increase. There has been some price volatility but within boundaries.
    - Two major observations:
    1. The shale revolution which has been a true game changer.
        - Only 6/7 years ago, few believed the US could become energy independent. To date, the US remains a very dominant, non-OPEC, supplier.
        - Shale in North America proved to be not only massive but also different – its ability to respond to price changes with high frequency allows for continuous price volatility in narrower bounds.
    2. For the last 10 years, since the financial crisis of 2008, it has been only a supply story. But it is time to bring demand back to the picture.
        - Partially because of the shale revolution, supply played the key role in shaping oil markets in 2010s. However, looking forward, the role of demand is increasing.
        - Demand growth is estimated to account for less than the 1.3 Mbl/day recorded in 2018. The risks include - but not limited to - a slower economic growth and trade disputes.
- The following trends both on supply and demand sides, have emerged in 2018 and are expected to play an important role in 2019:
    1. **Supply Side**
        - North America will gradually develop into a swing producer (and has been more effective at this than OPEC), while OPEC, in the long term, will have to learn how to compete as a low-cost market player in a completely new environment. This may create big problems for major producers within OPEC. But the big loser in the long-term is the high cost producer, such as Russia.
    2. **Demand side**
        - We will get into the territory of peak demand but it won't be a sharp peak – rather a smooth slow down.
        - Demand is expected to be affected by fuel-efficiency gains which remain in place once achieved, rather than just being dependent on the oil price changing over time. Oil intensity has already changed tremendously - in the last 40 years the amount of oil needed to generate a dollar-worth of global GDP has declined from 160 liters per $1,000 worth of global GDP to just $70 liters per 1,000 worth of global GDP (by 1.1% on an annual basis). Extrapolating this relentless trend, oil demand would peak in the 2030s.
        - The 'plastic fantastic' effect is anticipated to have a greater impact on peak oil demand than the rise of EVs. Petrochemical products, in particular plastics, are generally expected to drive oil demand growth through 2030.However, the substantial efforts in recycling in more and more global regions are likely to substantially diminish the positive expected effect of plastic demand on global oil demand.
    3. **Prices and growth**
        - The relationship between the oil price and the economy has changed. For decades, the dominant belief was that low oil prices prompted economic growth, and least in developed economies. Some economists estimate that a $10/bl fall in oil prices yields a 0.2% increase in GDP, boosting the economy and spending.
        - However, that link has almost disappeared, and the recent development has been driven mainly by the US, which is firmly moving into the league of exporters. Firstly, the strong positive correlation between the oil price and shale production in the US creates a positive balance of payments effect thanks to a reduction in imports to the US. Secondly, more investments made in the US energy sector create a positive overall investment effect. Thirdly, the tie between the oil price and consumption varies across the country: while in some states, the consumer benefits from lower prices, in others they suffocate the level of consumption due to revenue cutting and job losses. Trump's tweets to 'bring prices down' reflect an electoral base of high consuming, income poor voters, or a lack of understanding of this new and important dimension. **Once the US government recognises that high prices create new opportunities for the economy, it will be a 'game changer' from the political dimension.**

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OPEC

- Tensions have always built up ahead of OPEC meetings. The Vienna meeting in December 2018 was particularly tense.
- After almost 60 years of being a member of OPEC, Qatar decided to quit and refocus on gas. Although the Qatari Energy Minister mentioned that there was no political reason behind this decision, he was quoted otherwise.
- Qatar is the world`s largest LNG exporter and a relatively small crude producer compared to other peers in the group – its share in the total volume accounts for less than 2%. Hence, its departure will unlikely be dramatic. **However, there is general unhappiness among the smaller OPEC producers, who may also follow Qatar's footsteps.**
- Policy setting has been in the hands of Russia and Saudi Arabia, which decided on production cuts at the G20 meeting in Argentina, ahead of the December 2018 meeting.
- Later that month, in Vienna, Saudi Arabia decided to cut production to help the oil price to recover but insisted that all OPEC members should do it. However, peers such as Iran, Venezuela and Libya resisted the decision and were exempt from the cuts, with Novak ensuring truce between Saudi Arabia and Iran.
- Despite all intentions to reduce supply, OPEC production has recently grown by a net 1 Mbl/day, largely driven by Saudi Arabia.
- OPEC+ has reportedly set a target to reduce production by 1.2 Mbl/day from January 2019 for six months. Such a decision is crucial as otherwise the market would be oversupplied, putting additional pressure on prices.
- The partners will meet again in April 2019 just before the US announces its further plans regarding Iran sanctions.
- A lot can change, but as we sit today, we see the possibility of market returning to balance. Reasonable production reductions from OPEC, cooperation between all parties, along the decision of the Albertan government to cut production, as well as infrastructure constraints in the US, in addition to improvements in demand and lowering inventories projected for Q2 2019, all have a good potential to balance the market in early 2019.
- Because of the NOPEC bill, OPEC has recently avoided mentioning any price target.
- The fact that the US has become a net-exporter is supporting the pursuit of the NOPEC bill.

Global Gas Markets

- 2018 was a good year for gas markets, which saw a substantial increase in demand mainly driven by China and the US, combined with a fast increase in supply coming from Australia, Russia and the US. It has also been a special year for Russian pipeline gas, where supplies to Europe have increased.
- Gas prices were high during the year, except for Henry Hub (HH) which had flatted at around $3/Mbtu until recently and surged to $4.5/Mbtu in early December.
- Japan-Korea-Marker (JKM) gas prices tumbled to the low point in autumn due to mild weather and muted demand in Northeast Asia. Gas in Japan is also facing rising competition from nuclear power as the country has slowly started to turn its nuclear plants back on.
- **The outlook for demand growth in 2019 is ambiguous with more risks on the downside due to uncertainties around global economic growth, nuclear power development and commodity prices, including coal.**
- The US has been a big surprise. It is the largest natural gas market, so one would expect demand growth to be moderate but the country`s demand is projected to accelerate by around 70 Bcm, which is equivalent to the UK gas consumption, mainly led by the power sector.
- The IEA reports that the US liquefaction capacity will double next year. This, however, does not mean that US LNG exports will double as well due to the weakness of the global LNG market. Nevertheless, the increase in gas supply will be massive, largely driven by the increase in oil production and a significant portion of gas supplied to the domestic market in 2018 will be re-directed to the global market and Mexico in 2019.
- Though one would expect to see a notable refill of the US gas storage due to a production ramp up, interestingly, it is the opposite, i.e. 20% (20 Bcm) lower than the 5-year average. As a result, prices are expected to be quite volatile, especially if there is a cold winter.
- The possibility to switch from gas to coal when gas prices are rising is going to diminish due to the decommissioning of coal plants and nuclear outages. This will also put some pressure on gas prices.
- Speaking about the LNG market, it is important to look beyond 2019 to forecast when it is going to be short. Despite a long list of potential projects, only five projects have been approved since 2016, meaning that if there is a significant demand growth, new Final Investment Decisions (FIDs) will be required.

- On the demand side outside the US, China remains a very important LNG market, however, its future appetite for LNG is questionable as the volume of Russian pipeline gas imports are projected to grow notably from 2020 onwards while political tensions between the US and China may jeopardise long-term US LNG sales to China.
- Egypt has been a game changer in Africa; in the last several years, it first turned into an importer in the face of a shifting demand-supply balance then has come back to the exporting mode, particularly thanks to Zohr, a huge offshore gas discovery made by Eni.
- Iran is the largest gas producer in the Middle East. What is happening on the oil side will impact the gas side. Gas is the primary source for the power generation and petrochemical sectors, however, it will have to compete with large amounts of oil and condensate becoming available.

European Gas Market

- European gas demand has grown recently, and Russia has benefited the most due to worsened European production rates and lack of alternatives of supply. **European imports from Russia grew by 34% between 2014-17 despite all intentions to reduce such dependence and improve energy security – definitely not on any policy script.**
- However, the current capacity of Russian pipelines is limited and will unlikely be able to meet further increases in demand.
- Previously, during cold winters, Europe could get additional supplies from West Siberia. Today, this is not the case as there isn't much room for additional supplies from that region.
- European gas prices have grown owing to higher CO2 prices as well as anticipated competition between Europe and Asia for marginal LNG cargoes.
- In the mid-term, European gas demand is expected to be flat thanks to a shut-down of nuclear plants and retiring coal plants. However, in the longer-term, demand will be challenged by growing renewable capacity and planned decarbonisation of the heat sector. That said, an increase in the use of hydrogen in power generation will support gas demand.
- European gas production is projected to drop by 27% which will need to be replaced. This can be easily done as regional regasification capacity is quite high.
- Europe may face a supply crunch in 2022-23, if Asian demand pulls available LNG volumes and Russian backs off some of its exports to avoid crushing prices, NordStream 2 does not come on stream and no new LNG projects get approved.
- Post-2022, a new wave of LNG – which typically takes around 5 years – will come on stream.
- Market liberalisation and expansion of LNG trade will unlikely lead to price convergence as transport and liquefaction costs will continue to create price differentials between supply and end-user importing markets. Current UK wholesale prices ($8/MMbtu) are an approximate cost of US gas deliveries to the Northwest Europe.

The networking reception