Industry Top Trends Update

Oil and Gas

Ratings are supported by debt repayment

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What's changed?

Hydrocarbon prices. Oil prices have strengthened, and, barring a recession, it's likely they'll go higher as the EU looks to bar Russian oil and additional supply likely remains limited. Natural gas prices in the U.S. have also rebounded and are becoming "globalized" on the heels of gas shortages in Europe and heavy demand for liquefied natural gas.

Security first. With Europe facing potential natural gas shortages and oil prices possibly higher due to lower Russian imports, nations who focused on addressing climate change and energy transition are now more concerned about supply and hydrocarbon infrastructure while weaning themselves off of Russian oil and gas.

Refining margins. Insufficient capacity and strong demand have left the world short of crude, refined products, and natural gas. Gasoline, distillate, and jet fuel margins are at unprecedented levels. U.S. refineries are advantaged over European counterparts and are on pace to report record earnings and free cash flow, which they can use to reward shareholders and deleverage balance sheets.

What to look out for?

Further increases in hydrocarbon prices. Natural gas prices could rise significantly especially as Europe tries to reduce its exposure to Russian gas before October, the start of the heating season. Even so, Russia could decide to cut any remaining production to Europe and send global oil and natural gas prices soaring.

North American spending levels. Capex levels for N. American producers are likely to be constrained despite high hydrocarbon prices. Capital markets are still dictating that producers pay down debt and use cash flow for shareholder rewards. When that will change remains to be seen.

Policy headwinds. The Biden Administration and the EU are focused on lowering fuel prices and weighing policy options that could hurt refiners or oil and gas companies, including a crude export ban or a windfall profits tax. Higher retail prices may also dampen demand.

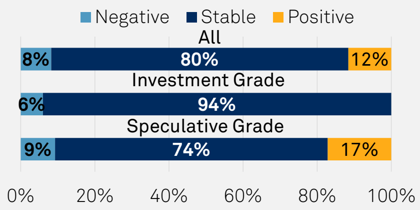
What if there's a recession?

Lower hydrocarbon prices. A steep drop in demand would likely cause prices to fall. However, in the event of a mild recession, we doubt oil and natural gas prices would fall and stay below midcycle prices given the global supply constraints

Rating actions. We would not expect the pace of downgrades for investment grade issuers in the upstream industry to rival prior cyclical troughs due to the amount of debt they've shed. We model our investment-grade ratings at a midcycle price of $50/55 and $2.75 for WTI/Brent and natural gas, respectively. Many investment grade E&P companies are focused on debt leverage under 1.5x at similar midcycle prices, a level that could support investment-grade ratings.

Refiners likely to weather the storm. Refining companies have significantly improved their credit profiles, using growing free cash flow to repay debt raised during the pandemic and retaining more excess cash after rewarding shareholders. We expect credit ratios to reach pre-COVID levels and provide a cushion against economic headwinds.

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	68	141	209
Downgrades	2	3	5
Upgrades	5	53	58

Ratings data as of end-June 2022. * Year-to-date

Ratings Outlook Net Bias