



Why This Could Be Just the Beginning Of the Oil Rout

Description

Well, it's official. The Organization of the Petroleum Exporting Countries (OPEC) has decided not to cut production. Both oil prices and the Canadian dollar are plunging as a result. Does the news get better from here? Well, not necessarily. Below are two big reasons why this could only be the beginning.

1. A war of attrition

First of all, there's an obvious question that needs answering: why isn't OPEC cutting production? After all, the cartel has cut production in the past, and gotten oil prices to stabilize as a result.

One reason is that OPEC's influence is clearly waning, mainly thanks to increased production from the United States. As it stands, the market is clearly in oversupply. So if any producer cuts production, then that may only result in reduced market share. This fact is not lost on Saudi Arabia, OPEC's most important member.

Instead, the Saudis look set for a war of attrition. After all, the country can afford a long period of depressed oil prices – its foreign currency reserves totalled US\$737 billion in August, over three years' spending. Meanwhile, other OPEC members (such as Venezuela, Nigeria and Iraq) may be in deeper trouble. Russia as well could get squeezed. And many doubt the economic viability of North American oil at current prices.

So the Saudis may benefit more by letting other producers suffer. Perhaps that strategy will strengthen its hand in the long term. But in the meantime, the oil rout could get very ugly for a lot of producers – and investors.

2. Further problems in China

Remember, another main cause of lower oil prices has been slowing growth in China. And the country's economic problems could get a lot worse.

What makes China scary is its reliance on debt. In fact, private debt has grown by 80% per year from

2007 to 2013. Bad loans have already risen by over 20% in 2014. Frankly, this sounds more like a story from Southern Europe.

If China suffers further, this could be disastrous for the oil market. China has likely become the world's largest oil importer this year, and eventually will become the largest oil consumer. So energy companies, beware.

Buy CNQ instead of Suncor

Let's suppose you're still insistent on some exposure to Canada's energy sector. Where should you look?

Well, you should go with a company like **Canadian Natural Resources Ltd.** ([TSX: CNQ](#))([NYSE: CNQ](#)). CNRL has shown an ability over the years to allocate capital effectively, and keep costs under control. It's probably the company best-positioned to survive a war of attrition.

Meanwhile, **Suncor Energy Inc.** ([TSX: SU](#))([NYSE: SU](#)) has improved greatly in this area, and is much more disciplined than in years past. Its balance sheet is also strong, a big plus in this environment. But Suncor is not as disciplined as CNRL – just look at the Fort Hills project, which the company is ploughing ahead with, despite marginal economics.

Then again, given the macro winds that are swirling, I wouldn't blame you for avoiding the sector altogether.

CATEGORY

1. Energy Stocks
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2. NYSE:SU (Suncor Energy Inc.)
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