



Why Oil Prices Could Plummet by US\$5 This Week

Description

If you look at the stock prices of Canada's major oil producers, you'd think an oil recovery is imminent. After all, **Canadian Natural Resources Ltd.** ([TSX:CNO](#))([NYSE:CNO](#)) shares are down only 8% in the last year, even though oil has declined by about half. Or look at **Imperial Oil Limited** ([TSX:IMO](#))([NYSE:IMO](#)), whose shares are off just 2%.

Clearly, these stock prices reflect some optimism that Canadians have for future oil prices. Just how reasonable is this optimism? Well, this week there are reasons to be seriously worried. Iran is on the cusp of a new nuclear deal, one that would allow the country to export more of its oil.

So, what are the chances of a deal being reached, and what effect will this have on the oil market? Most importantly, what should you do as an investor? We take a look below.

A deal should be reached

The general consensus is that a deal will be reached, and I agree. After all, a deal makes sense for both sides. From Iran's perspective, the sanctions have absolutely crippled the country's economy, and getting them lifted could help the country grow by 5-8% per year.

The United States is also interested in a deal, and for good reason. While sanctions have played havoc on Iran's economy, they haven't stopped the country's nuclear ambitions—the country now has 20,000 centrifuges. A deal would likely bring that number down to 6,000 and would also include a tight inspections framework. Ideally, it will make Iran's path to making a nuclear bomb much more difficult.

The deadline for a deal is fast approaching (midnight on Wednesday morning). However, even if an agreement isn't reached on time, we will likely see an extension to the deadline. So, a deal should come sooner or later.

This is the last thing the oil market needs

Currently, the world oil market is oversupplied by 1.5 million barrels per day. If a deal with Iran is reached, that oversupply will only grow. In fact, the International Energy Agency estimates that Iran

could easily increase production by 750,000 barrels per day. That number may be conservative—Iran's oil minister said exports could rise by 1 million barrels per day "within months."

So, oil investors should understandably be very worried. Analyst Michael Wittner at Societe Generale said oil prices could plummet by US\$5 just on news of a deal. Given how volatile this market can be, I wouldn't doubt him.

How should you respond?

If oil does recover, there is some serious money to be made, and it can be tempting to try to buy at the bottom. That said, this sector remains extremely risky, and stock prices simply haven't fallen far enough. I would wait before jumping in.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CNQ (Canadian Natural Resources)
2. NYSEMKT:IMO (Imperial Oil Limited)
3. TSX:CNQ (Canadian Natural Resources Limited)
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Author

bensinclair

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