3 Reasons Why $50-60 Oil Is the New Normal

Description

After oil prices bottomed out in March, they rebounded by about 40%, and even exceeded US$60 per barrel in the United States. This happened for three main reasons. First, American energy companies cut back on drilling, which even led to a slight decline in U.S. production. Second, fighting in Yemen has prompted fears of a wider Middle East conflict. Finally, demand has slowly started to pick up.

But more recently, prices have started to come back down, which brings up a very obvious question: Is US$50-60 oil the new norm? Such a scenario would be bad news for shareholders of **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), Canadian Natural Resources Ltd. (TSX:CNQ)(NYSE:CNQ), and **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG). All of these companies have fairly pricey shares, and there's plenty of downside if oil doesn't recover.

Well, there's a real possibility we could see these prices for a long time. Below are three reasons why.

1. Saudi Arabia isn't backing down

When Saudi Arabia decided to keep production levels constant in late November, it faced opposition from a majority of OPEC members. Yet the kingdom held firm, claiming that it shouldn't cut production just so higher-cost producers could benefit.

Fast forward to today, and the strategy seems to be working. As mentioned, American producers have cut back on drilling, leading to a rebound in prices. So, it's extremely unlikely that Saudi Arabia will back down now.

We'll find out more on June 5th when OPEC holds its semi-annual meeting. Of note, all but one of 34 analysts surveyed by Bloomberg think that OPEC will maintain current production levels. That doesn't bode too well for long-term oil prices.

2. Neither are the American producers

As oil prices have fallen, America's shale oil drillers have not stood idly by, just waiting to lose money. Instead, they have stepped up their own game, by cutting costs and drilling in more prolific areas.

Remember, these companies had little incentive to cut costs when oil prices were high, so these recent efforts are long overdue. And for that reason, there's probably still more that can be done.

Second, as oil prices have recovered, these producers are planning to turn the taps back on. We've already seen such comments from companies like **EOG Resources Inc.** and Pioneer Natural Resources Co. Once again, that's a very bearish signal.

3. Demand growth simply isn't strong enough

As it stands, the world oil market is oversupplied by roughly two million barrels per day. And it's hard to see demand catching up. According to International Energy Agency, global oil demand growth is projected at only 1.1 million barrels per day—by comparison, supply has grown by 3.2 million b/d over the past year.

For this reason, the price of oil will mainly be determined by how much it costs to get it out of the ground. That number has been decreasing, and could easily fall farther.

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