3 Ominous Signs That Crude Prices Will Remain Low

Description

If investors have been feeling the bite of sharply lower crude prices, then they better brace themselves for even tougher times ahead. The sharp collapse in oil prices has hit Canada's energy patch hard and there are signs that the current harsh operating environment created by weak crude prices will continue for some time.

Now what?

In the last week alone we have witnessed the emergence of three headwinds that are set to keep prices low despite some pundits claiming the recent oil rally will continue.

Firstly, OPEC recently decided to maintain its oil output and continue flooding the market with crude, despite the global supply glut. This is part of its strategy aimed at regaining market share by keeping prices low so as to force higher cost U.S. shale oil producers out of the market.

Even after the recent rally that now sees WTI at US$60 per barrel, it is still below the breakeven cost for many shale oil projects.

However, it is not shale oil producers who are the most vulnerable, it is Canada's oil sands, with many projects having breakeven costs well in excess of the current price. For example, **Husky Energy Inc.'s** (TSX:HSE) Sunrise oil sands project has breakeven costs of $82 per barrel, while **Imperial Oil Ltd.'s** (TSX:IMO)(NYSE:IMO) Kearl expansion has breakeven costs of US$95 per barrel.

Secondly, U.S. oil output recently hit a new record and its highest point in 43 years despite falling rig counts and investment.

Hard to believe isn't it?

You see, even with the U.S. rig count declining by 55% from its October 2014 peak to its lowest level in 12 years, U.S. oil output continues to grow. This is because while oil producers are shutting rigs and closing wells, they continue to boost production at lower cost operations in order to maintain cash flow.

Lower prices have also compelled U.S. oil producers to focus on finding efficiencies and slashing costs in order to make their operations sustainable. This means that many are now finding they can remain profitable even at lower oil prices.It is therefore unlikely that there will be the reduction in output that is required to eliminate the global supply glut and boost prices.

Finally, the ever present threat of the Fracklog has again reared its ugly head. It is estimated there are now over 4,000 oil wells in the U.S. that have been drilled but not completed. These are estimated to hold an additional 500,000 barrels of daily oil production and now with WTI at US$60 per barrel it is approaching the point where it is economical for producers to turn on the spigot.

With this representing a fifth of the current global supply glut, the introduction of this volume of crude would have a dramatic impact on prices.

So what?

The threat of yet another drop in crude prices is quite real, but even if this doesn't occur it is hard to see oil prices rallying any higher over coming months. This isn't such a problem for integrated energy majors like Husky or Imperial Oil, which can offset lower oil prices with higher margins from their refining operations. But it could be the death knell for deeply indebted and troubled smaller upstream producers like **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE).

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