



Oil Is Back Under \$50. Will We See \$40 Next?

Description

When the West Texas Intermediate (WTI) oil price reached US\$60 in June, investors wondered if it was the start of a long oil recovery. Those questions now seemingly have been answered.

On Monday the WTI price sunk back below US\$50 per barrel, which is not good news for Canadian producers like **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)), **Canadian Natural Resources Ltd.** ([TSX:CNQ](#))([NYSE:CNQ](#)), and **Canadian Oil Sands Ltd.** (TSX:COS). Where will the oil price go from here?

Unfortunately, we can't answer this question with certainty, and no one else can either. But we'll take a look at some of the reasons why oil has sunk this far, and ask if US\$40 is a possibility.

Why oil has sunk back down

In recent weeks there have been a number of factors pushing down the price of oil. The turmoil in Greece is a negative for oil demand, and a positive for the U.S. dollar. The nuclear deal with Iran could add another one million barrels per day of supply in a year. But the most important factor has been the resilience of American shale oil producers.

To put this into proper perspective, let's take a look at the prevailing wisdom in late 2014. At that time, oil prices were falling off a cliff. Producers responded by cutting their drilling plans, and the rig count fell.

Most analysts agreed that reduced drilling wouldn't have an immediate effect, but would affect production in the second half of 2015. A *Reuters* poll on December 22nd predicted that U.S. crude would trade at an average price of US\$68.70. According to ANC analyst Natalie Rampono, "In terms of the floor price, we think \$60 per barrel will be the level at which fast-rising U.S. shale oil producers will feel the pinch." Her beliefs were widely shared.

But to the oil producers' credit, they have responded decisively to low oil prices. They have cut costs and focused on only their most prolific plays. And they've managed to keep production numbers relatively steady, which few people predicted back in December.

Where does oil go from here?

For gold prices to rebound back to US\$60, you'll need to see some serious disruptions to U.S. supply. This could come in the form of bankruptcies, or canceled projects, or major declines in individual companies' production numbers. Such a thing is feasible, but not likely to happen any time soon.

It's much more likely that we'll see US\$40 oil. Prices have already neared that level once this year before rebounding sharply. And the supply/demand picture hasn't really changed since then. So, if oil prices sink back into the low US\$40s, there's very little stopping a further decline.

Thus, if you hold Suncor or CNRL, or especially Canadian Oil Sands, now may be the time to sell your shares before it's too late.

CATEGORY

1. Energy Stocks
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