



3 Reasons Why Sub-\$50 Crude Is the “New Normal” for the Energy Patch

Description

It was only 18 months ago when OPEC embarked on a campaign to keep oil prices low and force higher-cost U.S. shale oil producers out of the industry as a means of regaining market share. At the time, industry insiders claimed that oil would soon rebound, but this has yet to occur, and the price of crude remains under US\$50 barrel.

This has had a sharp impact on the energy patch: it has forced oil companies to slash dividends, capital expenditures, and costs as they battle to survive.

Now what?

There are now a range of indicators that sub-US\$50 oil is here to stay. Let's take a closer look at three of the most important.

Firstly, U.S. oil production continues to grow despite a marked decline in the rig count.

The latest data from the U.S. Energy Information Administration shows that for the last week of October 2015, U.S. oil output shot up by just over 50 basis points and remains 2% higher than it did a year ago. This is despite the U.S. rig count plunging by almost two-thirds over the last year to be at its lowest level since 2002.

Secondly, OPEC's oil production continues to grow.

The Saudi's and their Gulf State allies have invested heavily in boosting their productive capacity and growing production despite prices being sharply lower. It is likely that they will continue to do so for as long U.S. oil production remains high. By boosting output, they can also manage the revenue shortfall created by weak oil prices.

Then you have OPEC member Iran, which is set to boost its oil production by up to 500,000 barrels daily once trade sanctions are lifted in early 2016 as part of the deal over its nuclear program.

Finally, U.S. commercial oil stockpiles at the end of October hit their highest level in five months.

This indicates that there is a considerable amount of crude to enter the market once prices rise. This is acting as a cap on oil prices and will do so for the foreseeable future.

Clearly, all of these factors don't bode well for crude in a world with a supply overhang of 200 million barrels, or possibly more.

So what?

The fundamentals for crude remain weak and they will continue to do so until there is a significant uptick in global demand or a sharp decline in supply. This is highly unlikely with global economic growth declining and the Saudis remaining wedded to their plan to keep prices low. As a result, sub-US\$50 crude is now the new normal for the energy patch, and this will have a considerable impact on energy companies that are banking on higher crude prices in order to survive.

Among these are **Canadian Oil Sands Ltd.** (TSX:COS), which continues to bleed red ink in the current operating environment because of the high costs associated with the Syncrude operation. For it to survive, WTI would need to return to about US\$60 per barrel or higher.

Then you have **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), which also needs crude to be at US\$60 per barrel or higher if it is to have any realistic chance of survival. With sub-US\$50 crude as the new normal, it is increasingly appearing to be a bankruptcy candidate because it is still battling to reduce its \$1.8 billion pile of debt.

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Author

mattdsmith

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