



## Will 2016 Be the Year of \$20 Oil?

### Description

The outlook for crude remains grim as a number of analysts have predicted that it could fall as low as US\$20 per barrel before the oil crash is over. With a range of indicators highlighting that this is a distinct possibility, it is time for investors to accept that there will be further carnage in the energy patch during 2016.

In fact, I would not be surprised to see a further round of dividend and capital-spending cuts as energy companies adjust to the “new normal” of sharply weaker prices.

### Now what?

Saudi Arabia is determined to keep the spigots open and dump crude in to an already saturated global market in an attempt to boost market share. This is despite the fact that many OPEC members, including the Saudis, are feeling the pain of markedly soft crude prices; many are now grappling with large funding gaps in their budgets.

Then there is the prospect of Iran boosting its output by up to one million barrels daily once trade sanctions are lifted in 2016.

Meanwhile, a number of non-OPEC states such as Russia remain determined to grow oil production despite oil prices being at their lowest level in over a decade. In October 2015 Russian oil output hit a post-Soviet record of just over 10 million barrels daily. This number will continue to grow because of Moscow’s dependence on oil revenue.

These factors alone could push the global supply surplus to 3.5 million barrels daily or higher, which would weigh heavily on oil prices over the course of 2016.

It is also difficult to perceive any notable decline in U.S. oil output during 2016. Despite crude now being at its lowest price in over a decade and the number of U.S. oil rigs, which has fallen to a 14-year low, shale oil producers are still pumping crude at near-record levels.

And they will continue to do so even if crude falls further.

This is because these companies need to pump crude to generate cash flow in order to survive the oil crunch.

Furthermore, one of the most significant costs in the industry is drilling wells, thus once a well is completed it makes sense for a company to open the spigots and pump crude in order to recoup at least some of that cost.

Then it is worth considering that the ongoing cost cutting among shale oil producers is causing the breakeven costs for many shale oil plays to fall.

An example of this is the prolific Eagle Ford shale.

At this time, Eagle Ford has a breakeven cost of US\$54 per barrel, but thanks to cost-cutting efforts analysts expect this to fall to US\$41 per barrel in coming months. This, along with many companies having even lower breakeven costs, will see shale oil companies continue to pump crude even if prices fall further.

As a result, not only are weak crude prices the new normal, but US\$20 per barrel is a real possibility.

### **So what?**

If crude falls under US\$30 per barrel it will have a decisive impact on the energy patch. It would mean that companies will be forced to slash their dividends yet again or even end them altogether. Then companies such as **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), **Lightstream Resources Ltd.** (TSX:LTS), and **Pacific Exploration and Production Corp.** (TSX:PRE), which are struggling with considerable debt burdens, would be forced into bankruptcy.

For these reasons, investing in the energy patch remains unattractive, at least until there are signs that crude is on the cusp of recovering.

### **CATEGORY**

1. Energy Stocks
2. Investing

### **TICKERS GLOBAL**

1. TSX:FEC (Frontera Energy Corporation)

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