Will This Disaster Light a Fire Under the Price of Crude?

Description

The devastating wildfires in western Canada are serving as a wake-up call to the oil industry at just how fragile the market is these days. An oil market that was once oversaturated by more than one million barrels of crude per day has quickly seen its glut evaporate after producers in the region, including **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), **ConocoPhillips** (NYSE:COP), and **Husky Energy Inc.** (TSX:HSE) have shut down roughly one million barrels per day of production.

This shutdown is coming at a time when global oil supplies are already under a lot of pressure due not only to underinvestment after nearly two years of weak oil prices, but to growing geopolitical unrest in Libya, Nigeria, and Venezuela.

Western Canada ablaze

As of last Friday, the raging wildfires in Alberta impacted nearly 1,000 square kilometres of land and was poised to double due to the conditions. It has already led to the evacuation of more than 80,000 people, including those working on the various oil sands projects in the region.

So far the fires have spared those facilities as well as the associated pipelines; however, wild fires were said to be "at the gate" of **CNOOC Ltd.'s** (NYSE:CEO) Long Lake production facility, causing it to be shut down and evacuated. Likewise, Suncor's Syncrude, MacKay River, and Firebag facilities were all at least partially shut down, as were ConocoPhillip's Surmont and Husky Energy's Sunrise facilities. Add it up and more than one million barrels were taken offline–a staggering 40% of the region's oil-production capacity.

The worst might not be over with projections that this could end up being the worst natural disaster to ever hit Canada with insurance losses potentially climbing past $9.4 billion. There's so much uncertainty right now that the **Bank of Montreal** cut its second quarter GDP estimate from 1.5% growth all the way down to zero due to the expectations for severe disruption in oil production.

Disruptions are mounting

With one million barrels already offline and more production potentially being shut down in the future, it has quickly and dramatically shifted the fundamentals of the oil market. That's because Canada is far from the only hotspot right now.

Oil production in Nigeria recently hit a two-decade low after attacks on that country's oil infrastructure continue to take crude supplies offline. Just last week, an attack on a **Chevron Corporation** (NYSE:CVX) crude platform shut down 90,000 barrels per day of output, which is after an earlier attack on a crude oil pipeline in the country that prevented a key export terminal from exporting 200,000 barrels per day.

Combined, these attacks have pushed Nigeria's production down to just 1.7 million barrels, which is well off its peak of more than 2.4 million barrels and the country's lowest rate since 1994.

Meanwhile, the civil war in Libya continues to impact that country's supplies. According to OPEC's most recent oil-market report, Libyan oil production fell by 41,400 barrels per day last month to 345,000 barrels per day, which is also well below its former peak of more than one million barrels per day before the Arab Spring in 2011.

Then there's Venezuela, which is starting to see its production slip due to the devastating impact that low oil prices are having on its economy. That country's output is already down 188,000 barrels per day this year, having fallen to an average of 2.59 million barrels per day.

That's on top of the fact that oil production in the U.S. continues to slip. Since peaking last spring, crude supplies in the U.S are down roughly 600,000 barrels per day. However, due to significant capex cuts, it is expected that U.S. production will fall by another 900,000 barrels per day by the end of this year.

Investor takeaway

Global oil supplies could be under significant pressure if the wildfires in western Canada continue to keep oil production offline. That's because supplies have already come under some pressure due to geopolitical issues and underinvestment. As such, there is the potential for significantly higher oil prices if Canada's oil stays offline for any length of time, or if one of its key export pipelines is damaged.

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