4 Reasons Why Oil Prices Are Plunging Yet Again

Description

The outlook for commodities remains highly uncertain, and it appears that the optimism that pushed oil from its February 2016 lows to over US$52 per barrel is over. Oil is now under US$42 per barrel for the first time in over two months. In fact, it appears that a range of fundamentals have finally caught up with the market and will keep oil prices lower for at least the foreseeable future.

Now what?

Firstly, despite the optimism expressed by analysts and industry insiders earlier this year, the world is still caught in the midst of a massive supply glut.

It is estimated that global oil supply exceeds demand by almost two million barrels daily. The supply glut will remain for as long OPEC and some non-OPEC members keep pumping crude at near record rates. Already, Russia is on track to export record amounts of crude; its exports are up by over 5% for the first half of this year compared with the same period in 2015.

Meanwhile, after igniting the price war that triggered the collapse in crude, Saudi Arabia can't afford to reduce production in an attempt to boost prices because a number of producers, including U.S. shale oil companies, are poised to fill the gap.

Then there's Iran. Economic sanctions were lifted, and Iran is determined to boost oil output in order to increase government revenues and reinvigorate its sagging economy. As a result, Iran's oil shipments have more than doubled to two million barrels daily since the sanctions were lifted earlier this year, and it is planning to boost shipments to four million barrels daily by early 2017.

Secondly, many of the outages that helped to boost oil prices earlier this year were only temporary in nature.

These include Canada's wildfires, which forced **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), among others, to halt production in the affected areas. Nonetheless, energy companies are focused on returning output to pre-crisis levels.

Also, Nigeria's oil output fell to a two-year low in June because of attacks by militants. This production is coming back online and recently rose to 1.5 million barrels per day.

Thirdly, the demand for crude is expected to remain flat for some time.

You see, the global economic outlook remains volatile and uncertain. China's growth has slowed to its lowest level in over two decades, and the Eurozone is caught in a deep economic slump that has no end in sight. A number of emerging markets are experiencing their own economic declines because of weak commodities and their dependence on the extraction and export of crude, metals, and other commodities as a key driver of growth.

Finally, global oil inventories continue to grow at levels not seen since the global financial crisis in 2009.

In fact, global floating oil storage is at its highest level since 2009, while U.S. oil stores have expanded to now be at their highest level ever. This certainly isn't good news for oil prices. It's feared that a deluge of crude will hit global markets once storage capacity tops out.

So what?

A lack of demand coupled with growing supplies, oil prices are destined to remain lower for far longer than expected. This certainly isn't good news for those smaller, heavily indebted upstream oil producers, but it will have little impact on integrated energy majors such as Suncor.

Not only do lower oil prices mean greater profitability for Suncor's downstream business, but the company stands to benefit from weak oil prices by using its financial strength to acquire more assets at bargain-basement prices, especially after having bolstered its balance sheet with a $2.5 billion equity raising.

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