Should Energy Investors Worry About the Latest Bad News for Oil?

Description

Oil is gyrating wildly yet again because of the growing uncertainty surrounding its demand. The prices of the North American benchmark blend West Texas Intermediate and European benchmark oil blend Brent are rising and falling with surprising frequency as the market reacts to contradictory data and forecasts.

This certainly isn't good news for an industry that has been reeling under the weight of a prolonged slump in crude since 2014. The latest data indicates that sharply weak oil prices are here to stay for far longer than many industry insiders and market pundits originally predicted.

Now what?

The key the reason for the recent pessimism is the latest report from the International Energy Agency, or IEA. In it, the agency predicts that the global supply glut will last into 2017 and possibly longer. It has formed this bearish outlook from the belief that Asian energy demand will decline further than originally expected and European consumption will remain weak.

As a result, the IEA dialed down its forecast growth in the demand for oil during 2017 by 200,000 barrels per day. It now expects it to grow by 1.2 million barrels daily over the year. This is predicated on increasing uncertainty over global macro-economic conditions, China's slowing economy, and fears that the Eurozone's economic health could deteriorate further.

There are also considerable supply-side pressures with signs that global oil supplies are unlikely to fall in the near future.

Not only does U.S. oil production remain well above where it was when the oil crash began in late 2014, but a number of OPEC members are determined to grow production. Both Saudi Arabia and Iran, despite agreeing to hold talks over implementing production caps, have recently hiked their oil output.

Then there is Iraq, which is desperate to expand government revenues through increased crude production, so it can rebuild its war-torn economy. In recent weeks it boosted oil exports by 5% after being able to resume shipments from three oilfields in Kirkuk.

As a result, OPEC is now pumping out over 33 million barrels of crude daily, which is close to its highest level ever.

Nonetheless, I don't expect this to have a significant impact on the energy patch because the majority of companies have adjusted their operations to remain viable in the current harsh operating environment.

Beaten-down **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE), which, until recently, some analysts feared would not survive, has implemented a range of strategies that allow it to continue operating. Key among them has been its decision to shutter uneconomic heavy oil production and focus on its Eagle Ford acreage, where it receives a higher average price per barrel of crude produced. It has also slashed costs, causing combined second-quarter 2016 operating and transportation expenses to fall by 25% compared with a year earlier.

Penn West Petroleum Ltd. (TSX:PWT)(NYSE:PWE) also appears destined to survive after its surprising $975 million asset sale, which allowed it to restore its balance sheet and reduce debt to manageable levels. It too has sharply reduced its cost structure, reporting second-quarter operating and transportation costs that were just over a quarter lower than they were for the same period in 2015.

So what?

It now appears that substantially lower oil prices are the new norm, and while this isn't good news for the energy patch, it is not calamitous. There are signs that the majority of companies have successfully adjusted to the harsh operating environment now in play. More surprisingly, some are even on their way to restoring profitability now that they have cast off the excesses of the boom years.

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TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

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