



## 3 Things You Need to Know About Oil Prices

### Description

After hitting US\$50 a barrel, crude prices are falling again. The drop has stemmed from record OPEC production and weak demand growth, which was offset a bit by falling North American output.

Here are the three things you need to know about the oil markets today, along with two stocks worth buying.

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#### 1. Demand growth is surprisingly weak

The International Energy Agency (IEA) recently released a report outlining an unexpected trend: demand growth hasn't kept up its historical pace. While growth was expected to ease over the next few decades, it's now slowing at a pace faster than previously thought.

"For 2016, a gain of 1.3 million barrels a day is expected," the IEA report said. That's a downgrade of 100,000 barrels a day from its previous forecast. "Momentum eases further to 1.2 mb/d in 2017 as underlying macroeconomic conditions remain uncertain." That would represent the lowest growth figure since the oil price downturn began.

#### 2. North American supply has been curbed, but risks remain

After maintaining record output in the face of falling prices, the market has finally seen a meaningful reduction in North American oil production. The U.S., by far the biggest contributor to the continent's output, has seen daily production fall to just 8.5 mbpd.

However, production declines seem to be bottoming out already. This likely has to do with the restart of several cheap shale projects.

According to a report by the Bloomberg Intelligence, nearly half of the wells located in the Permian Basin and Eagle Ford can remain profitable even when crude prices fall below US\$30 a barrel. A whopping 85% can maintain profitability with prices at US\$50 or below.

With shale production costs consistently lower than the market expects, don't count on U.S. crude production to continue falling at current price levels. It's very possible we'll see sustainable oil production growth at or even below US\$50 per barrel.

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### 3. OPEC and others continue to pump aggressively

Outside the United States, oil production has been unrelenting despite very low oil prices. In February, we saw Iran reset its production to pre-sanction levels (two mbpd to four mbpd). This summer, both Saudi Arabia and Russia posted all-time highs in production (10.5 mbpd each).

OPEC doesn't see the situation remedying itself quickly. According to a report released on September 12, the cartel believes that the market will see a larger surplus next year due to new fields in non-member countries. U.S. shale drillers are also proving more resilient than expected to cheap crude, OPEC said.

### What's an energy investor to do?

If you're insistent on investing in energy, consider a company that has tailwinds beyond simply the rising price of oil. **Husky Energy Inc.** (TSX:HSE), for example, just settled a contract dispute with **CNOOC Ltd.** (NYSE:CEO) and is looking to grow substantially over the next year or two. Even if oil prices weaken, free cash flow will likely rise.

### CATEGORY

1. Energy Stocks
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