



## Why the Optimism Surrounding Oil Is Massively Overblown

### Description

The optimistic outlook for crude created by OPEC's historic agreement to cut oil production continues to ebb and flow because of contradictory indicators as to the state of global oil markets. Not only are there rumours that the deal may not unfold as presented, but recent data from the U.S. indicates that the supply glut could be far from over.

### Now what?

Crude inventories continue to rise because of weak demand. For the week ending October 7, 2016, the U.S. Energy Information Administration reported that crude inventories shot up by 4.9 million barrels compared to a week earlier.

Meanwhile, demand from U.S. refineries weakened with oil inputs falling by 480,000 barrels daily.

Then you have the International Energy Agency, or IEA, which poured cold water on oil's latest rally earlier this month by proclaiming that the global supply glut will continue into 2017. The IEA blamed ever-weakening growth in demand because of China's sharp economic deceleration.

For these reasons, the IEA expects global oil production to exceed consumption until at least the end of 2017.

This certainly isn't good news for oil prices, particularly when the tempo of operations in the U.S. shale oil industry continues to rise.

The U.S. rig count for the first week of October grew by two rigs, putting the rig count at its highest point since February and 120 rigs higher than the bottom witnessed in late May. This highlights that U.S. oil producers are ramping up operations in order to take advantage of higher prices.

The end result is that U.S. oil output can only grow, adding to an existing supply glut that has been estimated to be as much as 1.5 million barrels of crude daily.

If OPEC is capable of actually implementing its much-vaunted plans to curb production, then that glut

would only fall to about 800,000 barrels daily, still leaving a considerable supply overhang. Along with waning demand because of anemic global economic growth, this is weighing heavily on oil prices and will prevent a full-blown recovery for at least the foreseeable future.

### So what?

While oil has moved higher in recent months, it is unlikely that prices will recover to the highs witnessed before the emergence of the global supply glut in late 2014.

This will negatively affect the degree of optimism surrounding heavily indebted energy companies such as **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE). It may have restarted the heavy oil wells it shuttered because they were uneconomic to operate when West Texas Intermediate was below US\$45 per barrel, but it still remains under considerable pressure.

In order to shore up its balance sheet and preserve much-needed cash flows, it has taken a knife to its capital expenditures. This means that Baytex is not investing nearly enough in drilling and exploration in its existing acreage to ensure that it has sufficient production coming online to replace that lost through natural decline rates. It is unlikely that it will be able to boost investment to the required level until oil returns to US\$60 per barrel, which, for the reasons discussed, is unlikely to happen anytime soon.

### CATEGORY

1. Energy Stocks
2. Investing

### TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

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