Cracks Are Appearing in OPEC's Ground-Breaking Deal

Description

Industry insiders and market pundits are becoming increasingly skeptical that OPEC can make the production cuts agreed on in its historic September agreement. This is applying considerable pressure to the price of crude; both West Texas Intermediate and Brent slipped to under US$50 per barrel in recent days.

It also has taken the gloss off North America's energy patch. The rally for one-time investor darlings **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) and **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) has come to an abrupt end.

Recent events have left many pundits skeptical that the agreement can work.

Now what?

Back in September, OPEC hammered out a deal that would implement production cuts in an attempt to buoy oil prices and keep them above US$50 per barrel.

Fissures are now appearing in the agreement as a few members of the cartel have applied for exemptions. Nigeria and Libya are already expecting to be exempted as they seek to boost oil revenues that are vital to funding the suppression of violent internal conflicts and enhancing government stability.

And Venezuela is stuck in a serious economic crisis because of government malfeasance and its dependence on oil revenues. In fact, crude exports are responsible for generating about a quarter of gross domestic product and over 40% of government revenue.

Caracas, like Nigeria and Libya, is pushing for an exemption from the any production cuts as it seeks to repair the nation's shattered economy.

Now another crack has appeared in the deal.

Iraq is demanding that it be excluded from any production cuts. Baghdad is citing its costly campaign against Islamic State and the need to restore its war-torn economy as the key reasons for an exemption. Oil exports are the only genuine means of generating government revenue in the oil-dependent nation, which has had its economy shattered by years of conflict.

There is a very real chance that Iraq could receive this exemption. The campaign against Islamic State has become the only means of eradicating the threat that it poses to regional stability and global security.

Iran has also sought to be excluded from the cuts, and non-OPEC oil producer Russia, while publicly supporting the deal, appears to be privately committed to boosting oil output.

These factors, according to energy analysts, could push the price of oil back down to the US$46 per barrel mark in coming weeks.

So what?

If this were to occur, it would be a blow for the energy patch and those heavily indebted, higher-cost oil producers, such as Baytex, which need crude to be at about US$50 per barrel just to survive. It would nonetheless have little impact on Penn West, which, after aggressively paying down its debt to manageable levels, appears ready to grow in an operating environment where US$50 crude is the new normal.

This uncertainty highlights just how risky investing in the energy patch can be along with the need for investors to focus on those energy companies with low production costs and strong balance sheets.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

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