



## Is a New Oil Price War About to Emerge?

### Description

Crude has once again plummeted below the US\$50-per-barrel barrier, and there are signs that a new price war is on the horizon. This certainly doesn't bode well for energy stocks for the foreseeable future.

### Now what?

The key reason for the recent price crash was a significantly larger than expected inventory build in what are already swollen global oil stock piles. U.S. oil inventories alone grew by 8.2 million barrels during the first week of March 2017 — the single largest increase since 1982.

Even a recent surprise draw from U.S. oil stocks has failed to lift the price above US\$50 per barrel.

There are signs that U.S. oil production will continue to grow.

Since West Texas intermediate (WTI) reached \$50, there has been a significant uptick in activity in the U.S. energy patch. The tempo of drilling activity intensified as beaten-down operators moved quickly to boost output to take advantage of higher prices.

This is evidenced by the growing onshore rig count which, for the second week of March, grew by nine and a massive 293 compared to a year earlier.

The level of activity will only keep rising.

The oil slump was a blessing in disguise for the shale oil industry. It forced companies to reappraise their operations and trim the fat so as to make them as lean as possible to survive the protracted downturn.

Now, many U.S. shale oil companies have cut costs to the point where they are free cash flow positive with WTI around US\$50 per barrel. One of the largest independent players, **Continental Resources Inc.** ([NYSE:CLR](#)), has slashed expenses to the point where it has forecast 2017 operating expenses of less than US\$30 per barrel. This allowed it to double its 2017 capital spending so as to fund the drilling

of 178 wells, which should give oil production a 29% boost by the end of 2017.

Other major U.S. oil producers are in a similar position, creating considerable impetus for them to ramp up drilling and production, even with WTI at less than US\$50 per barrel.

The incentives don't stop there.

President Trump's ambition to make the U.S. energy independent by reducing taxes and industry regulations will add further impetus to the plans of oil companies to ramp up activity.

If U.S. oil production keeps growing, it will reduce OPEC's incentive to maintain production cuts.

You see, OPEC and key non-OPEC oil-producing states agreed to slash output by 1.8 million barrels daily in an effort to boost prices because of growing fiscal pressures which, in many cases, were responsible for fomenting economic and social unrest.

If the U.S. shale industry steps in and fills the gap, causing prices to weaken yet again, those participants will be forced to increase output to generate greater oil revenues to fill the shortfall in government income. Saudi Arabia has already eased its own cuts, causing February 2017 oil production to expand by 263,000 barrels daily.

This rational could explain why the OPEC secretary general has stated that it is too early to tell whether the agreement will remain in place or not after the OPEC May 2017 meeting.

### **So what?**

Another oil slump would hit Canada's energy patch hard, especially heavily indebted operators, such as **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH), which have banked on crude rising to US\$55 per barrel. This would force them to wind back capital spending, causing production, and hence cash flow, to fall.

### **CATEGORY**

1. Energy Stocks
2. Investing

### **TICKERS GLOBAL**

1. NYSE:CLR (Continental Resources)

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