



3 Reasons Why Higher Oil Could Be Here to Stay

Description

For some time, I have been [bearish](#) on the prospects for crude. Even after the ground-breaking OPEC production deal, wherein the Kingdom of Saudi Arabia managed to corral disharmonious OPEC members and key non-OPEC oil-producing nations into agreeing to production cuts, the price of crude barely moved an inch. Much of that can be blamed on rising U.S. shale oil production and growing oil output from OPEC, despite the caps that were established.

Nonetheless, in recent weeks, oil has rallied quite strongly to see West Texas Intermediate, or WTI, trading at over US\$55 per barrel and Brent at over US\$60. Despite the uncertainty surrounding the OPEC deal and U.S. shale oil production numbers, there are signs that higher oil could be here to stay.

Now what?

Firstly, a key driver of the latest surge in crude has been a sharp drop in the number of operational oil rigs in the U.S.

The latest data from energy consultancy Baker Hughes shows that the U.S. rig count has fallen for the last five consecutive weeks to be at its lowest point since the second week of May 2017. That means one thing: U.S. oil production will not grow as fast as many pundits were predicting earlier this year. There are in fact signs that the rig count could even decline further, despite the recent recovery in oil.

Secondly, the latest results from the U.S. energy patch show that shale oil companies are not as profitable as many analysts were claiming, and breakeven prices for shale oil are not as low as many claimed.

For the second quarter 2017, many U.S. shale oil companies reported losses, despite WTI averaging US\$48 per barrel and claims that the average breakeven price for each the major shale oil plays was under US\$40 per barrel. This has triggered a major revision of breakeven prices with many analysts concluding that they now average around US\$50 per barrel.

That concurs with oil magnate and CEO of **Continental Resources Inc.** ([NYSE:CLR](#)) Harold Hamm's views that WTI needs to be above US\$50 for the shale oil industry to be sustainable. In spite of

Continental being one of the largest and lowest-cost operators in the Bakken shale, it reported a second-quarter loss of US\$1.8 million.

Finally, new crises have erupted in that cauldron of geopolitical tensions the Middle East.

Less than a month ago, Trump [decertified](#) the nuclear deal with Iran and threatened to reinstate sanctions, endangering Teheran's ability to keep expanding oil production. Then there was the open conflict between Iraq's military forces and Iraqi Kurds over the control of the city of Kirkuk, which is located in one of Iraq's most important oil-producing regions. While that has ended, the tensions continue to bubble in wake of the Kurd's vote for independence in September.

Those two crises alone threaten around 1.3 million barrels of regional oil production, and there are other crises still simmering, such as the one in Qatar as well as the ongoing battle between Riyadh and Teheran for regional supremacy, which continues to endanger supplies.

So what?

This is good news for Canada's beaten-down energy patch. Many upstream producers, such as **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) and **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH) budgeted for an average WTI price of US\$55 per barrel over the course of 2017. The sharp dip in prices in the middle of this year brought into question their ability to survive. While WTI won't meet their projections for 2017, the latest rally will grant them some relief, buying them more time to reduce the massive debt piles they accrued when times were good.

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