Oil at $70: Could We See an Early End to the Supply Cuts?

Description

Oil prices are approaching $70, and while that might be good news for the oil and gas industry, it could also present a problem. There are least a couple of reasons why the supply cuts, which were supposed to go until the end of 2018, might end early.

Brent oil is near $70, and West Texas Intermediate (WTI) is at $64. Prices have not been this high since late 2014, when the crash in oil was well underway.

Russia looks to begin talks about exiting the deal

Although Russia is not part of OPEC, it had agreed to reduce its production in an effort to reduce the excess supply of oil and push prices up. Russia's energy minister Alexander Novak said, "We see that the market is becoming balanced. We see that the market surplus is decreasing, but the market is not completely balanced yet."

Novak is going to bring these issues up at an upcoming meeting in Oman. It's unlikely that Russia is the only country that is anxious to ramp up its production, and we could see others follow suit.

However, it still may be several months before we see countries bail on the supply cuts, given that oil prices have just barely started to scrape $70, and it's not yet clear how much support there is at that price.

Rig counts are up — a lot

The number of active rigs in the U.S. was 939 as of last week, which is an increase of more than 40% from a year ago. In Canada, however, the number of active rigs was 276, and that is 12% less than the number that were active a year ago. The U.S. gains vastly outweigh the declines in Canada, and that could have an adverse impact on the price of oil.

The danger has been that despite ongoing supply cuts, production has been increasing in North America and has limited the impact that the supply cuts have had. Without the cuts, we could have seen an even lower price of oil.

There is a very real possibility that when we get to the point that supply cuts are halted, supply will continue to outpace demand, and we'll end up back in the exact same dilemma, where we need to limit production to support a high price of oil.

Rising oil prices haven't helped stocks

The assumption that rising oil prices would help companies in the industry simply hasn't come to fruition, and it could be that investors are concerned that these prices cannot be sustained.

In the last six months, we've seen the price of WTI rise by more than 30%, but that hasn't been the case for some oil and gas stocks. **Inter Pipeline Ltd.** (TSX:IPL) has seen its share price increase just 4% during that time, while **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) has actually declined 3%.

Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE) is one exception, as its share price has risen more than 45% in the last six months. However, Cenovus had many things weighing it down in the past year, which resulted in its share price hitting a new all-time low in 2017, and that left the stock with nowhere to go but up.

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