Will Supply Constraints Push Crude to US$100 Oil a Barrel?

Description

In a surprise move, Brent continues to rally, fast approaching the psychologically important US$80-per-barrel mark, despite OPEC and Russia pledging to open the spigots and add one million barrels daily back to global energy markets. This saw a variety of economists and analysts revise their 2018 oil price forecasts upwards. According to that *Reuters* poll, Brent will average US$72.58 a barrel, which is US$0.90 higher than an earlier survey.

Much of the recent rally can be attributed to growing supply constraints, which analysts believe will outstrip production growth, even after allowing for OPEC's and Russia's planned additions. That is good news for Canada's energy patch, which has been labouring under a combination of the prolonged slump in oil and the deep discount applied to Canadian heavy oil.

The scale of current supply shortages is believed to be far greater than initially anticipated, sparking considerable conjecture that crude will top US$100 per barrel before the end of 2018.

Now what?

Many market watchers were surprised that oil rallied after OPEC and Russia agreed to bolster production but the reason for this is relatively simple to understand. Since as early as April, global energy markets have been anticipating that OPEC would boost production but were nervous that the cartel and Russia would move to unwind the historic production deal**,** which has been in place since November 2016.

The late June decision had already been priced in by markets with a production increase of 800,000 to one million barrels daily expected. It also alleviated fears that OPEC and Russia would tear up the production deal and go their separate ways, which could have triggered a massive surge in supply. It is speculated by oil analysts that the cartel and Russia are incapable of increasing production by the full one million barrels stated. This is because Venezuela's oil output is deteriorating markedly, and other members, such as strife-torn Libya, are experiencing production outages. There are also Trump's plans to cut off Iran's oil exports from global markets.

Then there was the unexpected outage at Canada's Syncrude facility, which has taken up to 335,000 barrels daily offline potentially until the end of July, straining North American supplies. Pipeline bottlenecks in the Permian are also constricting supplies of tight light oil, preventing the much-vaunted expansion of U.S. shale oil to fill the supply shortfall. These North American supply constraints are responsible for the price differential between Brent and WTI narrowing materially.

So what?

While each of these factors points to firmer oil and the likelihood of the WTI Brent differential narrowing further, which will be a boon for Canadian upstream oil producers such as **Crescent Point Energy Corp.** (TSX:CPG)(NSYE:CPG), it doesn't indicate that Brent will reach US$100 a barrel by the year's end.

The International Energy Agency believes that demand growth will be materially curtailed once Brent reaches US$80 per barrel. There is also the chance that Saudi Arabia, which analysts estimate has spare capacity of around two million barrels daily, could further boost production if Brent climbs to US$80 or more a barrel for sustained period. Once the kinks in U.S. energy infrastructure, particularly in the Permian, are ironed out, it is likely that shale oil production will once again expand at a furious pace.

These would all place considerable pressure on oil prices.

Nonetheless, one thing is undeniable: higher oil is here to stay, and that will be considerably beneficial for Crescent Point, which has lagged behind crude, falling by 7% over the last month compared to West Texas Intermediate's 9% gain. This has created an opportunity for investors seeking to cash in on higher crude. Crescent Point's market value is less than the value of its oil reserves, its production is steadily growing, and the driller has implemented a strategy to unlock value for investors. This should bolster market confidence in the company, giving its stock a solid boost.

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