Will Oil Prices Reach Triple Figures by the End of 2018?

Description

A weak weekly oil report released by the U.S. EIA coupled with the risk of an emerging market crisis and a full-blown trade war have sparked concerns that the oil bull market could have come to an abrupt halt. In response to these and other concerns, oil has pulled back sharply in recent days; West Texas Intermediate (WTI) is trading around US$65 a barrel, and the international benchmark Brent is just over US$72 per barrel. This highlights the considerable volatility surrounding oil, particularly when it is considered that only three months ago Brent was trading at well over US$80 per barrel.

While the bulls and bears debate the outlook for crude, what is undeniable is that prices will remain extremely volatile for some time to come.

Now what?

A key driver of oil's volatility is the extreme uncertainty that now exists within the global economy along with growing geopolitical disturbances that are sparking extreme reactions in global energy markets. Some analysts, along with the Russian Finance Ministry, believe that oil will plunge again, potentially falling to as low as US$45 a barrel, whereas the bulls are claiming that emerging supply constraints and stronger economic growth will lift it to US$100 a barrel before the end of the year.

Despite the weak EIA report and concerns voiced by the International Energy Agency that US$80 Brent will cause demand to decline, it is difficult to see oil falling below US$60 a barrel. Even after the considerable uncertainty triggered by Trump's hardline stance on trade as well as the growing threat of a trade war, which could crimp global growth and consumption of commodities, the economy remains strong.

The emerging threat of a crisis among developing economies, which could spark a world-wide economic downturn, is having little impact on demand for energy. That is because economic growth in the world's largest consumer of fuels and other petroleum products remains firm and could initially receive a healthy bump from Trump's protectionist approach to trade.

Then there is the looming threat of peak oil demand and falling consumption because of the push to renewable sources of energy and the faster-than-expected uptake of electric vehicles.

While there are plenty of immediate supply constraints surfacing, it is unlikely that they will have the impact that some pundits are claiming and certainly won't create a large enough deficit to push oil prices to triple figures. Saudi Arabia, other OPEC members, Russia, and U.S. shale oil producers can ramp up production to make up for any production lost because of Trump's Iran sanctions, Venezuela's collapsing oil industry, and a lack of investment in greenfield oil projects.

Technological improvements have also caused field decline rate to fall sharply and made it more economic to extract crude from unconventional sources, such as shale and Canada's oil sands. That, along with the prolonged slump in crude, which forced drillers to make their operations more efficient, has significantly reduced breakeven costs for many forms of oil extraction.

According to *Reuters*, US$50 a barrel is the magic number for U.S. shale oil producers. Industry consultancy Wood Mackenzie claims that offshore oil production breaks even at less than US$50 per barrel. This means with oil trading at over US$65 a barrel, there is an incredible incentive for upstream producers to ramp up activity and bolster production before weaker prices return.

So what?

For these reasons, it appears that oil prices won't reach triple figures during 2018 and will likely remain highly volatile and range bound for the remainder of the year. That shouldn't deter investment in energy stocks. Many drillers with quality assets, low costs, and growing production have failed to keep pace with oil's unanticipated rally.

A driller that stands out is **Parex Resources** (TSX:PXT), which is focused on Colombia, where it operates a quality portfolio of low-cost, low-decline oil assets. Parex can access Brent pricing, giving it a financial advantage over its North American peers. For the second quarter, it reported an impressive netback of US$44.93 per barrel sold, which is higher than many of Parex's competitors. Even if oil remains range bound, it is easy to see Parex delivering solid financial results over the remainder of 2018, which should give its stock a solid boost.

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Date
2025/08/20
Date Created
2018/08/21
Author
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