Will Oil Prices Ever Recover?

Description

After oil prices collapsed in 2014, many analysts were calling for a lower-for-longer scenario. That is, prices would remain depressed for years to come.

While there have been some bumps and dips along the way, this prediction largely came true.

From 2009 to 2014, oil prices averaged roughly US$90 per barrel. Since 2015, they've averaged closer to US$50 per barrel.

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Today, opinions on the future of oil have never been more divided. Some expect the current status quo to become permanent. Others foresee 50% declines or 100% upside.

What's the truth? Let's find out.

Understand the past

Before we predict the future, we must understand the past.

Oil markets have always been prone to boom-and-bust cycles. In the 1970s, an energy crisis forced oil to rise from US$2 per barrel to more than US$30 per barrel. By the 1980s, a supply glut caused prices to collapse by 70%.

Fast forward to 1999 when oil prices were just US$20 per barrel. The rise of China and increasing extraction costs fueled by deepwater exploration pushed oil prices above US$160 per barrel in 2008.

While that high watermark didn't last, oil prices still averaged above US$90 per barrel between 2009 and 2014. By 2015, everything had changed. In February of 2016, prices touched US$35 per barrel, averaging just US$55 per barrel since.

We're still dealing with the aftermath of the latest collapse, so what happened?

Major growth economies like China began to slow. Falling populations and energy efficiency measures were reducing demand in many developed countries. Meanwhile, fracking created a massive supply surge throughout most of North America, allowing major importers like Canada and the U.S. to essentially cease net international purchases.

Analyze the present

Why does the past matter? It does because it entirely explains our current predicament.

Many investors have been betting on higher oil prices for years. In 2018, prices touched US$70 per barrel, only to collapse yet again to its multi-year average of US$50-$60 per barrel.

The past informs us that this is likely the price range oil will stick to for another five to 10 years, barring any large exogenous shocks like a global recession or war.

That's because the same causes that created the 2014 collapse still persist today, namely a slowing China, reduced consumption growth in developed nations, and elevated fracking supply in the U.S.

If you understand the past, the present makes a lot of sense.

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Peer into the future

For energy investors, the most important question is whether oil prices will ever exit their US$50-$60-per-barrel price range.

Short-term blips may occur, but don't bet on a long-term recovery.

Last quarter, China's GDP grew at its slowest rate in nearly 30 years (apart from the 2009 financial crisis). Developed countries continue to search for ways to reduce domestic oil consumption, while regional production is on the rise.

In fact, **Chevron** (NYSE:CVX), **Royal Dutch Shell** (NYSE:RDS-A)(NYSE:RDS-B), and **Exxon Mobil** (NYSE:XOM) are all actively developing North American projects that could reach breakeven points of just US$15 per barrel. According to *Bloomberg*, that's a level "only seen in the giant oil fields of the Middle East."

If you're a high-cost oil sands producer like **Canadian Natural Resources** or **Suncor Energy**, this is terrifying news.

If you're invested in the oil sector, difficult times may be ahead.

If you stick with your investments, make sure you're betting on companies that can survive a lower-for-longer pricing environment that may persist for a decade or more.

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