Will Another Oil Price Collapse Occur?

Description

After spiking discernibly in the wake of the attacks on Saudi Arabia's oil infrastructure, which saw the kingdom lose roughly half of its productive capacity, oil has pulled sharply to see the international benchmark Brent down by 11% to be trading at just over US$60 per barrel. This decline occurred despite pundits claiming that the latest events in the Middle East indicate that oil supplies are insecure, and a geopolitical risk premium is now being priced in by energy markets. In fact, there signs that crude could fall even lower, and new price collapse could emerge.

Declining demand

A major risk weighing on energy prices is the ongoing trade war between the U.S. and China. The International Energy Agency (IEA) recently identified that global demand for crude is growing at its slowest rate since the Great Recession of just over a decade ago. The Agency went on to state that for the first five months of 2019, demand growth was roughly half of what it was a year earlier.

A key driver of this has been the ever-escalating U.S. China trade war and lower-than-expected global economic growth. Even recent events in Saudi Arabia and the ongoing standoff between Iran and the U.S. in the strait of Hormuz have been unable to lift crude for a sustained period.

There are signs that prices will fall further in coming weeks with the Organization for Economic Cooperation and Development (OECD) claiming that the global economy is growing at a far slower pace than anticipated. The OECD believes that world gross domestic product will expand by 2.9% for 2019, which is 1.1% lower than an earlier forecast of 4%, and the weakest rate of growth since the 2008 Great Recession.

Then there is the impact of a softer U.S. economy to consider, especially because it is the world's single largest consumer of crude. For the second quarter 2019, U.S. GDP grew by 2% on an annualized basis compared to 3.1% for the previous quarter. There are fears that the U.S. economy will keep slowing and enter a recession by 2020.

Growing supply

Weaker demand for energy isn't the only risk. There are signs that global oil supplies are growing at a steady clip. The U.S. shale oil boom continues to gain momentum and has been responsible for a 40% production increase since 2016, which saw it overtake Saudi Arabia and become the world's largest oil producer.

Improved infrastructure in the U.S. oil patch will lead to higher oil exports, causing global energy markets to be flooded with even more crude. Citigroup believes that the U.S. will add up to one million barrels a day to its oil exports in 2019 and another one million barrels daily in 2020. That will make up for any supply decline caused by the collapse of Venezuela's oil industry and further sanctions against Iran.

This doesn't bode well for oil prices and could see Brent give up its gains since the end of 2018 and fall to as low as US$50 per barrel, which would push the North American benchmark West Texas Intermediate (WTI) to under US$50 a barrel.

What does it mean?

This bodes poorly for oil stocks, particularly those such as **Baytex Energy** (TSX:BTE)(NYSE:BTE), which have large debt piles and are facing significant near-term debt maturities. Even after repaying US$150 million of notes this quarter, Baytex still has net debt of around $1.8 billion and near-term maturities in excess of $833 million.

If WTI falls to US$50 per barrel, Baytex's adjusted funds flow would decline by up to 35% from current guidance of $875 million, making it nearly impossible for it to generate enough funds to meet those financial obligations. That could have a significant impact on Baytex's finances, because its long-term notes have a covenant which restricts it from raising additional debt beyond existing facilities and notes.

For these reasons, despite Baytex's attractive assets, including its light oil operations in the Eagle Ford Shale, which are responsible for around 38% of its oil output, the driller is a highly unappealing play on oil.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred

4. Sharewise
5. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date
2025/08/23
Date Created
2019/09/25
Author
mattdsmith