Will the Next Oil Price Collapse Occur in 2020?

Description

The geopolitical risk premium attached to oil in the wake of the attacks on Saudi Arabia's oil infrastructure and rising tensions in the Middle East has all but disappeared. The kingdom has essentially brought its productive capacity back online and the threat of all out war with Iran has all but diminished.

Indeed, it appears that the considerable optimism for higher oil created by the attacks was considerably overblown and the threat of another oil collapse is emerging.

The North American benchmark West Texas Intermediate (WTI) has pulled back sharply in recent weeks having lost 27% over the last year to be trading at around US$54 per barrel, while the international Brent price has lost 29% to be US$59 a barrel.

Even after the latest modest rebound, there are signs that the WTI Brent differential will narrow and that WTI will slide below US$50 a barrel.

What will trigger the next price collapse?

If WTI remained below that price for a sustained period it will have a sharp impact on my many Canadian energy stocks with the most vulnerable being those that are heavily levered and have large looming near-term debt maturities.

By the end of 2019 industry consultancy Rystad Energy anticipates that U.S. oil production will reach a record 13.4 million barrel daily, cementing its place as the world's leading oil producer and adding to an already burgeoning global oil glut.

This along with every growing global oil inventories, fears that OPEC may not renew its production cuts when they expire and the winding down of Alberta's production cuts will weigh on oil prices.

The U.S. EIA expects oil inventories to continue growing between now and the first half of 2021, which will push petroleum prices lower.

Burgeoning global oil supply isn't the only issue; demand for crude continues to weaken. OPEC again recently trimmed its forecast demand growth by 29% to less than one million barrels of crude daily, while **Citigroup** recently stated that demand growth since March 2018 has declined by 800,000 barrels daily, or almost half.

The ongoing trade war between the world's two largest economies the U.S. and China continues to cloud the global economic outlook, weighing further on energy prices. Softer growth in the Eurozone and weaker manufacturing activity across all major developed nations is also applying considerable pressure to the price of crude.

It's expected that demand growth will slow further during 2020 as the global economy moves ever closer to recession; this will be the catalyst that triggers the next oil price collapse, causing WTI to fall below US$50 per barrel.

Foolish takeaway

That would be a significant blow for many Canadian energy stocks, with one of the most vulnerable being **Baytex Energy** (TSX:BTE)(NYSE:BTE). The heavily indebted upstream oil producer, even after recently repaying US$400 million of notes, still has $1.4 billion of debt outstanding, with near-term maturities totaling $909 million, including its revolving credit facility due over the next three years.

If WTI falls below US$50 per barrel for a sustained period, it doesn't bode well for Baytex to meet its financial obligations, particularly with it needing WTI to average US$50 per barrel during 2019 to be cash flow neutral.

That would force the driller to make further assets sales to raise the capital required, which would further impact Baytex's ability to grow oil production. There is also the risk that Baytex could be forced to shutter part or all of its heavy oil production, as it did during the last sustained price collapse, further impacting its oil output and ability to generate cash flow.

For the aforementioned reasons, there are far better stocks for investors seeking to bolster their exposure to crude and bet on higher oil.

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