Why Oil Prices Crashed 9.5% Last Week

Description

The price of WTI crude oil (North America's most popular oil benchmark) fell 9.5% last week, going from US$97.88 to US$88.55. It was one of the biggest drops of the year. Oil has been pretty volatile in 2022 but, until recently, was mostly trending upward. The latest drop challenges that.

WTI crude started the year at US$76. The fall to $88 puts it within $12 of where it was at the beginning of the year. It would only take a 15% price drop for oil to erase its gains for the year.

In this article, I will explore some reasons why oil prices crashed 9.5% last week — and how investors can respond to the correction.

Petroleum reserves being depleted

One of the big reasons why oil prices fell last week is because countries have been releasing their petroleum reserves. Many countries have emergency stockpiles of oil that they sell when there's an energy crisis. Some countries are selling theirs this year. For example, the United States is releasing one million barrels per day from its Strategic Petroleum Reserve (SPR).

The U.S. consumes 20 million barrels of oil per day, so the SPR release didn't singlehandedly cause the 9.5% crash. But other countries are doing the same thing, so it stands to reason that reserve releases collectively are having an effect.

Interest rates rising

A second factor pushing oil prices down is rising interest rates. Central banks like the Bank of Canada are raising interest rates this year, and it's making asset prices go down. When interest rates go up, borrowing money gets more expensive, so people tend to spend less. Oil is one of the goods that people spend large percentages of their incomes on, so it stands to reason that its price would fall with rising interest rates. Last month, the Bank of Canada raised interest rates by a whopping 100 basis points, or 1%.

1% might not sound like a lot, but remember that we're talking percentage of the loan's value, not the percentage change. When you raise the interest rate on a $10,000 loan from 1% to 2%, the interest goes from $100 to $200 — a 100% increase. Anybody in Canada who borrows money to gas up their car is likely to drive less after that kind of rate hike.

Are oil stocks good buys now?

Having looked at the factors driving oil prices lower, it's time to ask: are oil stocks still good buys?

In past articles about **Suncor Energy** (TSX:SU)(NYSE:SU), I've commented that the stock was still cheap even if oil prices went down. At $88 oil, companies like SU will still produce overwhelmingly positive earnings growth and will be able to pay down debt. The highest oil price in all of 2021 was about US$77, so even if oil goes to $78, Suncor's earnings will likely grow.

In general, analysts seem to be neglecting the earnings impact of oil above $80. For most of this year, SU and other oil stocks have simply moved in tandem with the price of oil, ignoring the fact that their earnings will rise, even with oil lower than it is today. Just recently, **Occidental Petroleum** put out a release that vastly beat analyst estimates, and the stock rallied afterward. Once investors realize that it was not just OXY whose earnings power was being underestimated, but most of the oil sector, stocks might start rising again.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. andrewbutton
2. kduncombe

Category

1. Energy Stocks
2. Investing

Date
2025/07/19
Date Created
2022/08/09
Author
andrewbutton