Economic News

Desjardins Economic Studies
www.desjardins.com/economics

May 24, 2016

INTERNATIONAL

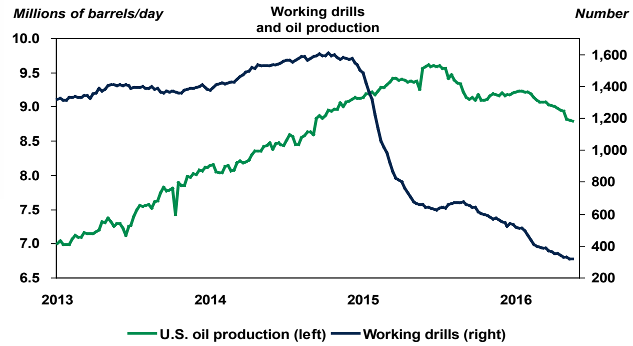
Recent oil price increases not enough to jump-start production

After a tough start to the year, oil prices have posted impressive advances in recent months. The price of WTI (West Texas Intermediate) has almost doubled, from a cyclical low of US$26 a barrel on February 11, 2016, to close to US$50. Several factors contributed to this rebound, including an increase in investor confidence, a drop in the U.S. dollar and temporary output stoppages in several countries, including Canada. Other than these short-term factors, the sharp drop in U.S. output is the main driver behind the crude oil price recovery. This, coupled with fairly robust growth in the demand for oil, suggests that the current significant oil surplus on global markets will soon give way to a balanced market.

If crude oil prices were to recover too quickly, however, U.S. producers could start increasing their production once again. If this materializes, the global surplus could linger for some time and prices could potentially fall back to new lows. Such a scenario is unlikely in our opinion. Oil producers know that oil prices are very volatile. Producers will tap into the futures market before they make any investments to protect themselves from a price relapse and make sure they can sell their oil at a profit. As shown in graph 2, futures prices have not recovered to the same extent in recent months. A producer who wishes to freeze the price of WTI in a year would have to sell it at a futures price of US$50 a barrel, or just US$6 a barrel more than the futures price at the beginning of 2016. In our opinion, a significant rebound in drilling and by U.S. production is unlikely as long as the futures price for WTI does not exceed US$60 a barrel.

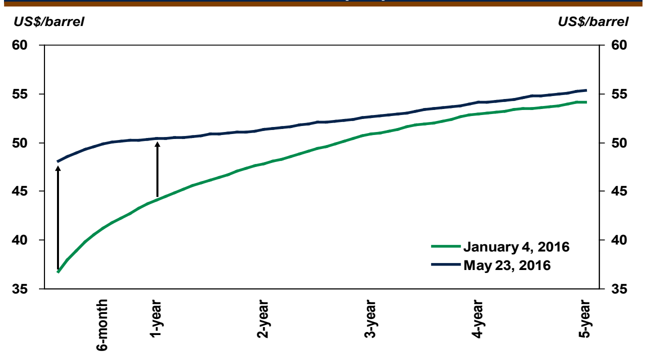
Implications: The recent rebound in oil prices is not threatening the rebalancing expected to take shape in the global market. Nothing thus suggests that oil prices will go back to around US$30 a barrel, and the outlook for the medium term remains favourable. A rebound by the U.S. dollar and the resumption of production in Fort McMurray could, however, cause a slight pullback in oil prices in the short term.

Graph 1 – Oil output and drilling continue to fall in the United States



Sources: Baker Hughes, Energy Information Administration and Desjardins, Economic Studies

Graph 2 – The increase in oil futures prices is not as sharp as the rise in spot prices



Sources: Bloomberg and Desjardins, Economic Studies

Mathieu D'Anjou, CFA
Senior Economist

François Dupuis
Vice-President and Chief Economist

514-281-2336 *or* 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

Mathieu D'Anjou Senior Economist
Benoit P. Durocher Senior Economist
Francis Généreux Senior Economist
Jimmy Jean Senior Economist
Hendrix Vachon Senior Economist