# BLOG POST

Q&A Part 1
4/27/2020

**Q: How low can oil go?**

**Brian Lockhart, CFP®:** Energy markets are notoriously volatile and are made up of near equal parts speculators and hedgers. Oil prices are a function of supply and demand, as nearly any product or service in a free market, but the forces that influence the supply and demand is what really drives prices higher or lower. Let's start with a look at the supply side of the equation. Oil prices plunged 24% in a single day on March 8th, following the failed meeting between OPEC and Russia, and represented the 2nd worse day since trading on the NYMEX in 1983 (only the start of the gulf war in January 1991 was worse). Russia's unwillingness to cut production to support higher prices is an attempt to hurt U.S. shale producers who have dramatically increased market share. The Saudi response to raise supply from 9.5 to 12 million barrels per day is seen as a way to put additional pressure on the Iranian regime. The resulting glut of oil supply drove WTI prices down over 60% in less than a month. The demand side of the equation shows COVID-19 has been just as damaging. IHS Market estimates that reduced demand just in the U.S. takes global oil demand from 100 million barrels a day to 92 million. Once the virus is resolved, demand will return and rig counts indicate supply will shrink but expect low oil prices to remain.

**Clint Pekrul, CFA:** It's impossible to know with any degree of certainty, but I've seen forecasts as low as $10 per barrel. Ultimately, I think this is about Saudi Arabia trying to undermine U.S. shale producers. Even at $50 per barrel, there were signs of stress for domestic production. Now, with WTI trading around $20 per barrel and highly leveraged balance sheets, the future does not look that bright for U.S. shale. Saudi leaders decided to flood the market with supply at a time when global demand was already weak due to COVID-19.

To be sure, Russia has played a role in all of this as well. The Russians and Saudis formed an alliance years ago as the U.S. ramped up its own oil production. The Saudis were prepared to curtail production at the OPEC meeting earlier this month to stabilize prices, but the Russians pushed to maintain current output. The subsequent fallout resulted in the Saudis reversing course and pushing output to 12.3 million barrels per day by April.

I think OPEC can smell blood in the water with respect to U.S. shale producers. By keeping prices suppressed, coupled with the COVID-19 outbreak, OPEC can put the squeeze on an already stressed U.S. shale market.