TD Economics

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Commentary: Crude oil price rally halted by bearish US storage report

- Crude oil prices were jolted higher over the last four days, pushing WTI up 19% to US$53 per barrel. But the rally has proven to be short-lived, with prices back down below US$50 per barrel today.
- The rebound in prices was triggered by the weekly rig count report in the US, which showed the largest drop (94 rigs) on record. However, a bearish EIA US storage report released this morning has brought markets back to the reality that a supply glut is still building.
- Inventories in the US rose by 6.9 million barrels last week, much higher than the 3.7 million barrel increase expected by markets, putting total inventories at record levels for this time of year. What's more, crude oil production remains well over 9 million barrels per day, with the upward trend solidly intact.

Key Implications

- The downward trend in US rig counts that has taken place over the last couple of months – in addition to several announcements regarding the scaling back of capital spending plans – shows that producers are responding to the low price environment. However, it has yet to translate into lower crude oil production. That is to be expected, as it typically takes 2-3 quarters for lower rig counts to show up in output numbers. Indeed, given the efficiencies gained in recent years, the drop in rig counts does not have the same impact that it once did. Moreover, current rig count numbers – at just over 1200 – are still nearly 3 times higher than the level seen in 2008 when the oil market was tight and are quite capable of increasing domestic production. In order to have a material impact on output, these rig counts would likely have to fall much further. As such, the uptrend in US crude oil production is likely to continue in the coming months, with the rate of growth expected to decelerate in the second half of this year and into 2016.
- Globally, the supply glut appears to be growing, as preliminary estimates suggest OPEC output jumped to 30.9 million barrels per day in January – up from 30.5 mbd in December and far exceeding the 30 million bpd quota – driven by increases in Iraq and Saudi Arabia.
- Overall, we expect the supply-demand imbalance to grow in the first half of the year, before beginning to narrow thereafter. As such, there is likely more downside in store for oil prices over the next 6 months. We continue to expect WTI prices to trade below US$50 per barrel in the near term, before beginning a slow recovery in the second half of the year and into 2016.

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