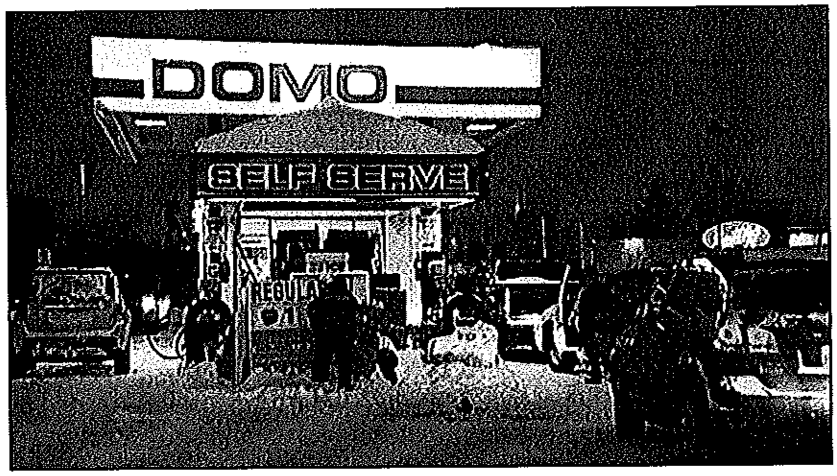
OIL PRICE PLUNGE

MINDS ON



Canada is the 5th largest producer of natural gas, crude oil and energy in the world. In fact, the petroleum sector employs 550 000 Canadians (either directly or indirectly) and accounts for $18 billion in revenue for Canada's federal and provincial governments.

How would a drastic drop in the price of oil mean affect people relying on this sector of the economy?

SETTING THE STAGE

Nobody saw this one coming. After reaching a high of $107 a barrel in the summer of 2014, oil prices plunged more than 50 per cent, closing at just under $50 a barrel by early 2015. And as the price plummeted, nervous energy sector workers looked on in shock, wondering what the future had in store for them. The free fall in the price of oil became the business story of 2014.

Too much oil

It is naïve to think that oil prices could either remain stable or even keep going up. History has been very clear: oil is a commodity and responds to the business cycle like any other commodity. Supply and demand will either drive the price of oil up or down depending on how much crude is available. In the fall of 2014, it became very clear that there was a glut of oil on the market and the price of crude spiralled downward.

Definition – Glut
An excessive quantity, surplus or oversupply.

Why the glut?

One of the contributing factors to the emergence of the oil glut has to do with countries like Canada and the United States finding ways to enter the oil game. Canada has managed to tap into the huge supply of oil sands crude in Alberta and exploit oil reserves off the coast of Newfoundland. In the United States, hydraulic fracturing (fracking) and horizontal drilling have allowed our neighbour to the south to extract their own oil and become major oil producers. Thus, the era of importing oil has been replaced by an era of extraction and self-sufficiency. Similar enterprises have emerged around the world, creating an oil glut as too many sellers appeal to too few buyers.

Another factor is the push towards sustainable energy. Cars and trucks have become more fuel efficient. Many nations are replacing coal power with more environmentally friendly alternatives, with some investing heavily in wind and solar power. This has created less need for crude as we move to a greener approach to energy consumption — a prospect that will continue to grow as we head deeper into the 21st century.

Losers

The oil glut has created an energy market with very low crude prices. This stands to have a negative effect on the Canadian oil industry. Oil sands extraction in particular is costly, with the breakeven point hovering around $60 a barrel (the price of oil was under $50 a barrel on January 6, 2015). A sustained dip below the breakeven point will mean job losses and shutdowns in Alberta and, to a lesser extent, Saskatchewan. Meanwhile, offshore drillers in Newfoundland and Labrador will also have to buckle in for a bumpy ride if prices don't go up. Just to be on the safe side, many oil sector companies have already put projects on hold and some subsidiary businesses have started to lay off employees.

Winners

The manufacturing and service-based economies of Ontario, Quebec and British Columbia stand to gain the most from low crude prices. Some financial analysts believe that these provinces may even outpace Alberta in terms of economic growth in 2015.

Other winners include anyone who has to put fuel into their vehicle. According to Statistics Canada, Canadians pump 41 billion litres of gas into their cars and trucks every year. A price drop of 20 cents a litre frees up $8 billion for consumers to spend. The question is: will they spend that money? With the per capita debt load of Canadians at record levels, will consumers be more inclined to bring what they owe under control rather than buy more goods and services?

To consider

1. Why was the falling price of oil the business story of 2014?
2. What factors contributed to the emergence of an oil glut?
3. a) Who stands to suffer the most if oil prices remain low?

   b) Who stands to gain the most if oil prices remain low?