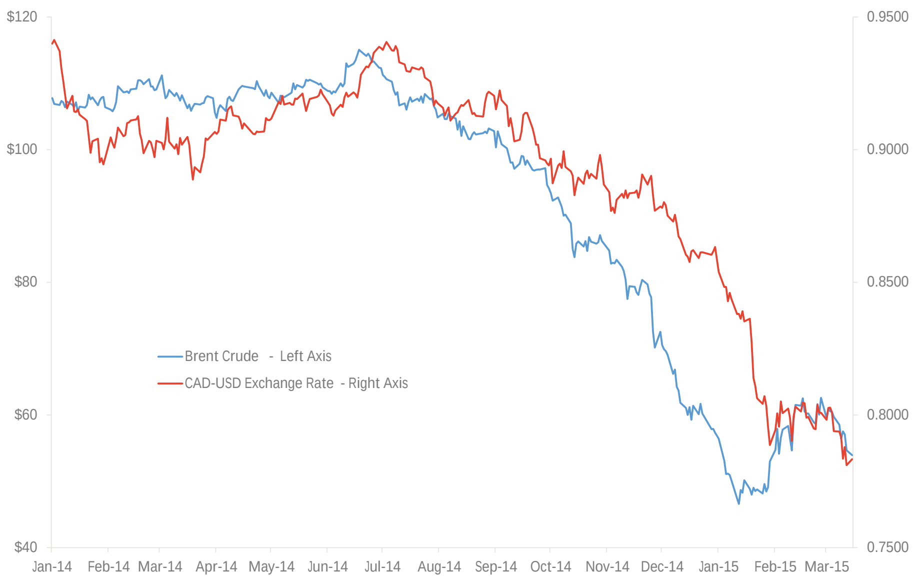
PORTLAND MARKET REPORT

CANADA – 13% OF THE WORLD'S OIL RESERVES – THE THIRD LARGEST IN THE WORLD

April update

Brent Crude Oil Price in US$ per Barrel vs CAD – USD Exchange Rate



Whilst the world looks on amazed at the durability of America's shale oil industry, another major oil producing sector of North America is faring considerably less well.

Prior to the 2014 price crash, Canada's tar sands were happily producing 1.5m barrels of oil per day (about 2% of global oil production), but fast-forward 6 months to March 2015 and we see the price of Western Canadian Select (a bench-mark grade for the Albertan heavy oils) dipping below $30 per barrel and that is no price to prosper or perhaps even survive in the cold, frozen plains of the North. Moreover, unlike shale oil, this is absolutely not an industry that can be switched on and off when prices are unattractive (see our last report). Shutting down means shutting down for good…

Canadian tar sands have always been an unloved method of oil production. Firstly vast open pit-mines are required to access the underground tar. Then the world's largest dump-trucks (pretty cool machines it has to be said) transport tar infused "tailings" (rubble) to separation plants that require vast amounts of energy, water and chemicals to create a bituminous sludge that is "ready" for refining. To get to the deeper tar reserves (further below the surface), constant steam is required to melt the tar, before it is suction pumped upwards for extraction. Environmentalists hate the tar sands with a vengeance, and in fairness if you are going to be against anything from an environmental perspective, then the tar sands probably deserve their place at the top table! The landscape created by tar sand extraction could be generously described as bloody awful and the industrial process involved in stripping the product down (so that it is ready for the standard refining process, ie, pre-refining-refining) is a huge CO_2 emitter.

It shouldn't surprise us then that opposition to the tar sands has been significant and there are already several US States (eg, California) which ban the use of tar sand oil in their refineries. Perhaps the most publicised example of opposition to the tar sands is President Obama's refusal to sanction the Keystone XL pipeline, which would transport Albertan tar sand oil to US Gulf Coast refineries. The President has been unusually vocal in his opposition to the pipeline on two counts; firstly that it is filthy stuff (this tends to win over the Green wing of the Democrat party) and secondly, a slightly more nuanced view that argues the provision of a route for tar sands to travel from Canada to the US Gulf refineries will do little to directly benefit US consumers, as most of the product will simply hit world markets via export.

So the tar sands were already on the back foot when oil prices started plummeting and do remember that this type of oil trades at significant discounts to the widely published benchmark grades. When WTI is worth $50 per barrel, then the tar sands have to trade at a very heavy discount – such is the poor quality of the product when compared to the lighter US crudes – to attract refinery buyers. Add to that the logistical problems in getting the product thousands of miles across the US continent without a significant pipeline and therefore requiring dedicated rail trucks (once used for tar sand oil, the trucks cannot easily be switched to other products), then it should be no surprise that West Canadian Select is hitting such low prices and pushing operators (particularly smaller ones) over the edge.

Most Canadians however are unlikely to get over-concerned by what many will see as a short-term blip in oil prices. Yes, the falling value of oil has certainly hit parts of Canada hard, but the corresponding drop in the value of the Canadian $ (see graph above) will see Ontario's long-suffering manufacturing base grow as their goods become significantly cheaper for export.

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