ALBERTA'S SILVER LINING IN THE OIL PRICE DROP

A Cushman & Wakefield Edmonton Topical Paper

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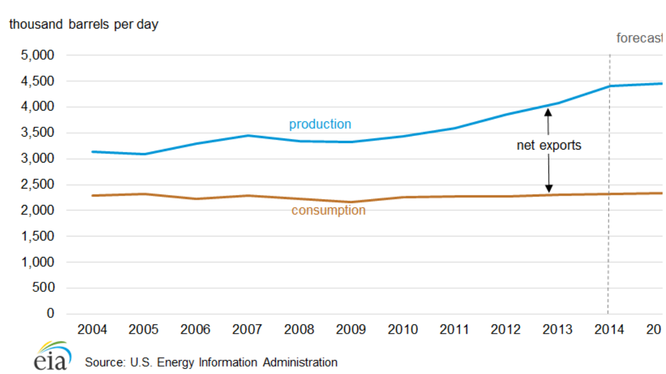
With the continuous slide of oil prices, a gloomy picture has been painted for the Alberta economy. This pessimistic forecast has created unnecessary unrest among the consumers, businesses and the government. The effect is gradually felt as government and businesses announce cut backs and the consumers start holding onto their cash. While it is wise to face the current market situation head on, it is irrational to approach it with the 'sky is falling' mentality and make impulsive decisions that will impede economic activity and inhibit business growth.

CANADA'S OIL PRODUCTION & CONSUMPTION



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Oil prices began to slump in the third quarter of 2014. At the time of writing this paper, crude oil is trading at $47.59/b[1]. It is at its lowest price since the Global Financial Crisis. Several factors have contributed to the current price of crude oil, and it takes us back to basic economics, the law of supply and demand.

THE LAW OF SUPPLY AND DEMAND

The world is oversupplied with oil. New crude oil supply has been coming from the U.S. mainly due to hydraulic fracturing and horizontal drilling. The U.S. has increased oil production from 5.64Mbbl/day in 2011 to 8.67Mbbl/day at the end of 2014[2]. This increase in domestic oil production affected U.S.'s oil imports overseas. In addition to the U.S. oil boom, OPEC members did not reach consensus on oil production. Saudi Arabia insisted on producing 9.5Mbbl/day[3] despite lower market demands. There have been several speculated reasons for the oil-rich kingdom to proceed with this move. However, whether it was done to push Russia, Iran and the U.S. out of business or simply to preserve their market share in Asia. One thing is for certain, Saudi Arabia will continue its policy of maintaining the same levels of crude output even with a recent change of leadership. King Salman bin Abdulaziz Al Saud, successor to the late King Abdullah, had already announced that he will keep the current Oil Minister, Ali Al-Naimi, in his post.[4].

Lower market demand stems from a weakened global economy. Europe is still on the cusp of the Eurozone crisis. Coupled with China's economic slowdown resulting in a cut in their oil imports and emerging markets such as India, Indonesia, Vietnam, Thailand and Malaysia's cut in fuel subsidies[5]. These lower market demands further exerted pressure on the already low oil prices.

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U.S. CRUDE OIL PRODUCTION

YEAR	U.S. OIL PRODUCTION (THOUSAND BARRELS/DAY)
2008	5,000
2009	5,350
2010	5,482
2011	5,645
2012	6,497
2013	7,452
2014	8,670

Source: U.S. Energy Information Administration

KEEP CALM & CARRY ON

Alberta has been affected more by the heightened media attention and speculation of a possible recession, than the actual effect of low oil prices. Businesses have started to hover over the panic button. Worse, some of Alberta's major decision makers already made 'early calls' that further unnerved the market. If there was one lesson learned from the past Global Financial Crisis is that, it's all about the market's perception. Albertan stakeholders should remain calm, stay informed and be positive of what the future may bring. There is a silver lining in the current market condition.

With the lower oil prices, consumers will be having extra cash in their pockets that would then boost retail spending. A recent report stated that if oil prices average at $.98/litre throughout 2015, Canadian drivers could save $12B at the pumps, a weekly savings of $25/household[6]. In the case of Alberta, that's $1.6B for the 4.1M[7] population in the province. With that much additional disposable income, the consumers will not let it sit idle in their purses.

Though energy and energy-related companies have taken a back seat with revenue growth for 2014 and possibly for 2015. It is interesting to note that as of January 2015 in the Government of Alberta's published Status Summary Report, only 9 ($16,319M) out of the 742 ($206,293.6M) projects across the province were put on hold. The rest maintained a positive outlook. They understand the volatility of the oil prices and have based their projects on long-term prices. On another positive note, businesses that use oil as part of their input will benefit from the drop in oil prices. This saving translates into increased profits and possibly lower prices for the consumers.

ALBERTA STATUS SUMMARY REPORT

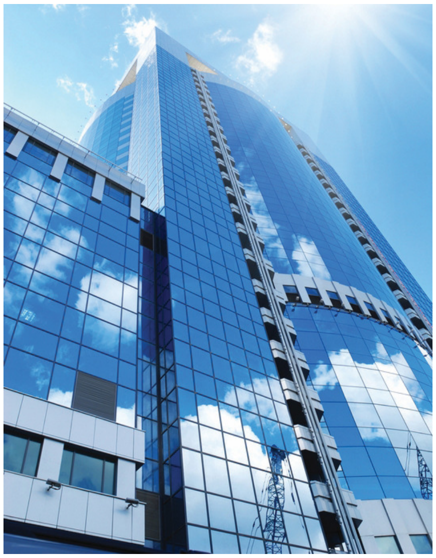
STATUS	NO. OF PROJECTS	TOTAL VALUE OF PROJECTS
ANNOUNCED	110	$18,466.6M
COMPLETED	23	$2,413.4M
NEARING COMPLETION	24	$5,938.1M
ON HOLD	9	$16,319M
PROPOSED	365	$87,068.8M
UNDER CONSTRUCTION	211	$76,087.7M
TOAL	742	$206,293.6M

Source: AlbertaCanada.com

In response to the argument of the *trickling effect of job layoffs to consumers*. This oil price drop may be what is needed to close the labour shortage that Alberta is experiencing. Based on the April 2014 report released by the Petroleum Human Resources Council of Canada there will be 31,850 job vacancies in the oil sands by 2022[8]. 50% of it is due to retiring employees and the other half to industrial expansion[9].

The credit watchdog Moody's stated that Alberta's low debt and enhanced creditworthiness reflects the province's financial reserves and will allow it to weather the slump in oil prices[10]. In addition, Alberta has already shown its resiliency back in 2009 when natural gas royalties dropped to $1.5B after averaging nearly $6B per annum from 2001-2008[11]. The natural gas revenue contribution since then never recovered, but the Alberta economy rebounded.

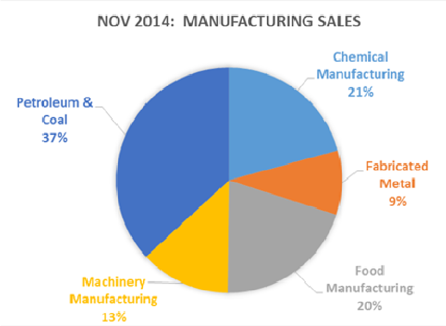
Alberta's major manufacturing exports recorded by the government for the past year were chemical manufacturing (21%), fabricated metal (9%), food manufacturing (20%), machinery manufacturing (13%) and petroleum and coal (37%). These industries had total sales of $58B by November 2014. With a weaker Loonie working in their favour, the food manufacturers and chemical manufacturers had sales growth by 13.5% and the latter 1.5%[12]. Furthermore, a weak currency makes domestic products more affordable and lessens product imports. More money is then circulated locally. This is a positive indication that Alberta is headed down the right path in diversifying its economy. While oil revenue is nice, it's not a solution for the ages as it is an exhaustible resource. The government should take the drop in oil prices as an opportunity to further encourage diversification. The government needs to urge the non-energy manufacturers and exporters to regain their strength similar to their performance in 2002 to create a balance in revenue contribution. Alberta cannot control the external forces in the market. It can only structure itself to be a nimble player on the global stage.



31,850

JOB VACANCIES IN THE OILSANDS BY 2022. 50% OF IT IS DUE TO RETIRING EMPLOYEES AND OTHER HALF TO INDUSTRIAL EXPANSION.

ALBERTA MANUFACTURING SALES



Chemical Manufacturing	$	11,926,333,000
Fabricated Metal	$	5,313,127,000
Food Manufacturing	$	11,621,030,000
Machinery Manufacturing	$	7,450,274,000
Petroleum & Coal	$	21,196,192,000
TOTAL	**$**	**57,506,956,000**

Source: AlbertaCanada.com

In summary, consumer spending is up, non-energy based business spending is up. Most of the energy based businesses are moving forward with their projects. Even if the government will be spending less, exports are up and imports are down. With the basic equation of economics: $Y = C\uparrow + I\uparrow + G\downarrow + (X\uparrow - M\downarrow)$, it's telling the story that the picture is not as bad as the media paints it.

IT'S AN OPPORTUNITY, NOT A CRISIS

The oil price slump should be considered as an opportunity instead of a crisis. With the Bank of Canada dropping the interest rate by .75%[13] and 'early callers' pulling back on their business growth and investment, particularly in the commercial real estate sector. This is an ideal time to proceed with long-term investments and grow businesses.

With interest rates in an all-time low, more selection of locations, rental rates that are affordable, labour cost that are cheap and competitors withdrawing. Businesses that are in good financial position should take advantage of the opportunity to take up their competitor's market share. Lastly, the market should be reminded that this is an issue of oversupply, which can be corrected by cutting production, it's not the breakdown of the financial system or the end of the world.

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ENDNOTES

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