Diverging Crude Oil Prices in North America–the Implications for Canada's Trade Balance

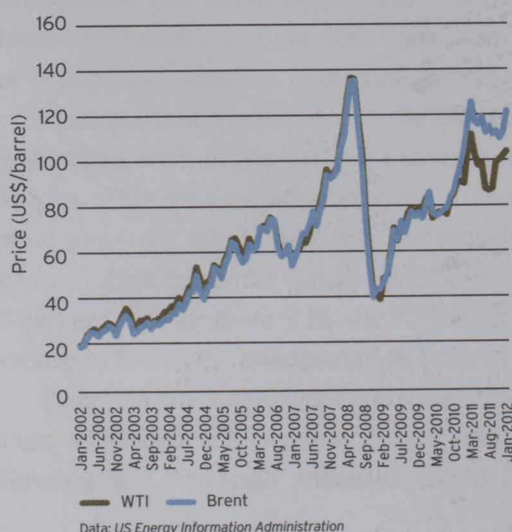
The price of oil is subject to large, short-term fluctuations, but has been trending upward overall since 2002. As Canada is a net exporter of oil, this upward trend has had a positive effect on terms of trade and national income and has notably helped increase the profitability of developing the oil sands.

However, a new phenomenon has been observed since the end of 2010. For one thing, while the prices of Brent and West Texas Intermediate (WTI) were essentially identical historically, an increasingly pronounced gap has been observed between them (Figure 1). According to the Bank of Canada, the gap can mainly be explained by an excess crude oil supply in the United States at Cushing, in Oklahoma. This surplus is notably the result of technical problems related to pipeline transportation and refining, and of the new shale oil developments, which can be found all over North America, including in regions that have not produced oil historically. The arrival of shale oil has resulted in greater diversification in production sources and an increase in North American supply. This excess supply and the inadequate transportation capacity are driving down WTI prices relative to the price of Brent.

Furthermore, the difference in processing costs between Western Canadian Select (WCS) on the one hand and WTI and Brent on the other explains the negative price differential between these products on the world market. As WCS is heavier, there are higher production costs and the resulting products are generally less valuable.[1] However, since mid-2011, the price difference has grown wider with WTI (Figure 2). According to Scotia Economics, the insufficient

FIGURE 1

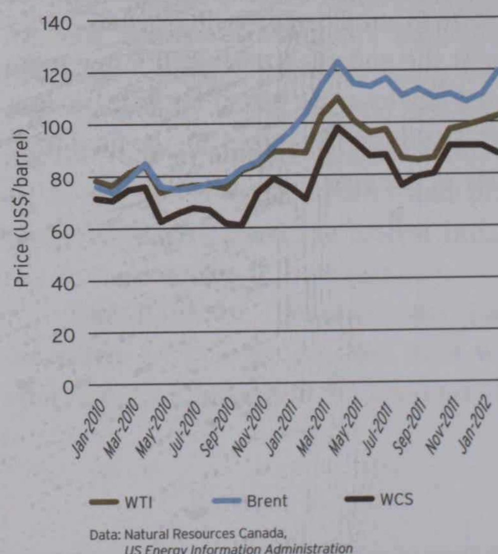
Brent and WTI Crude Oil Prices



Data: *US Energy Information Administration*

FIGURE 2

Brent, WTI and WCS Crude Oil Prices



Data: Natural Resources Canada, *US Energy Information Administration*

1 Government of Canada, Natural Resources Canada