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UNITED STATES

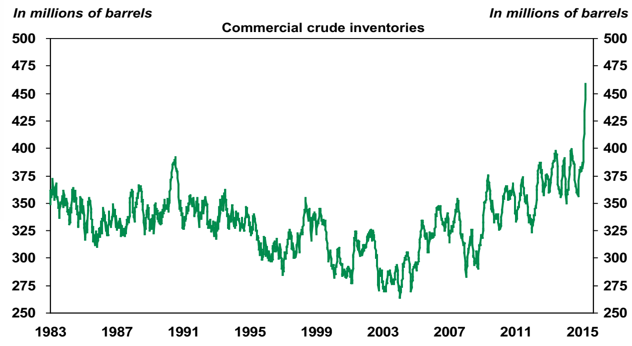
Expanding inventories weigh oil prices down

In a recent study,[1] we had concluded that oil prices had reached levels that were unsustainable in the medium term, and that they would likely climb back, sooner or later, to within a range of US$70 to US$90 per barrel, in order to avoid an oil shortage. Nonetheless, we were expecting crude prices to remain very low in the first half of 2015, while a continued surplus in the global market will lead to the expansion of oil inventories in the member countries of the Organisation for Economic Co-operation and Development (OECD).

The boom in oil inventories has been particularly striking in the United States, where they recently reached an 80-year peak. Apart from the existence of a substantial global oil surplus, accelerated U.S. imports of crude and a slowdown in refining operations have contributed to this spectacular ballooning of inventories. Some observers are beginning to worry that the maximum storage capacity in the United States might be reached. Such a situation could theoretically cause oil prices to collapse, if no one wanted to buy oil for lack of a place to store it.

However, this risk would appear to be very slim. A few weeks ago, the Energy Information Administration estimated that the oil storage capacity was only 60% full. Therefore there was space remaining to store approximately 200 million additional barrels, i.e. twice the spectacular increase that has been recorded since last fall. Moreover, since the United States is still consuming far more oil than it produces, a cut in oil imports would be a quick way of halting the build-up of inventory, should it become necessary. A foreseeable increase in demand from refineries, the continued development of new storage capacity and the possibility of storing oil in ships are other factors that greatly reduce the risk of facing a situation where there is really no place left to store oil.

U.S. oil inventories are expanding at a spectacular pace



Sources: Energy Information Administration and Desjardins, Economic Studies

While an absolute shortage of storage space appears unlikely, temporary problems could arise in certain regions. This is especially true at Cushing, in the Midwest, where WTI (West Texas Intermediate) futures are settled. The considerable spread between the current price and the futures price of WTI is currently encouraging speculators to hold as much oil as possible at Cushing, and the storage costs already seem to have started rising. If this trend continues, it could intensify downwards pressure on oil prices in both Canada and the United States.

Implications: We are still calling for oil prices to remain relatively stable in the short term, and to start rising significantly around mid-2015. However, potential oil storage problems in some parts of the United States could temporarily drive the price of WTI below US$40 per barrel in the months ahead. This would amplify the challenges facing the Canadian economy and could induce the Bank of Canada to lower its key interest rates once again.

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[1] Desjardins, Economic Studies, *Economic Viewpoint*, "Where will oil prices go now?," February 16, 2015, www.desjardins.com/ressources/pdf/pv150216-e.pdf?resVer=1424111285000.

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