Gas prices recently climbed near $1.50 per litre in some areas of Quebec. It's surprising to see prices at the pump return to their historic high, as oil prices are still well below the peaks reached in the summer of 2008. This primarily reflects the loonie's slide and higher fuel taxes, as well as seasonal factors that are inflating North American refiners' margins. Gas prices are likely to edge down over the next few months, but everything suggests that prices at the pump will stay relatively high.

**GAS RETURNS TO $1.50 PER LITRE**

Many Quebec motorists, especially in the Montreal region, were unpleasantly surprised as gas prices recently climbed back over $1.50 per litre. With all this talk about an “energy revolution” and U.S. oil production posting a spectacular surge (graph 1), we can understand motorists’ frustration at seeing gas prices near 2008 peaks, at a time when global oil shortages were feared.

Retailers are often first to get the blame when gas prices surge suddenly. True, when gas recently jumped to $1.53 a litre at some Montreal gas stations, this was partially caused by some retailers’ greed: they had suddenly increased their margins to more than 10¢ per litre over the floor price. Such exaggerated margins never last long, however, and prices at the pump quickly fell closer to $1.45 per litre. More generally, we could assume that the lack of competition in Quebec’s gas market is leading to higher prices for motorists. However, this situation has been ongoing for several years now and does not, in our opinion, explain the growing spread between prices at the pump and WTI (West Texas Intermediate) oil prices (graph 2).

**OIL PRICES REFLECT THE GLOBAL CONTEXT, NOT JUST THE SITUATION IN NORTH AMERICA**

The main determinant for prices at the pump remains the cost of crude oil. In recent years, non-traditional crude production has boomed in North America. However, oil is a resource whose price reflects the global, not the local situation. This is especially true for areas like the

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As we discussed last year in a previous Economic Viewpoint, to date, the energy revolution is a North American phenomenon, not a global one. Tapping unconventional deposits has helped to ease most fears of a global oil shortage, but it has not created a real surplus. This is particularly true as problems in several Middle Eastern countries (Libya, Iran, ...) limited growth in the global oil supply. If we add a relatively large geopolitical premium, reflecting the considerable tensions with Iran and Russia, it is not surprising that international crude prices remain high.

**A WEAK CANADIAN DOLLAR**

It is Brent oil prices that are currently influencing Quebec’s gas prices. While this oil remains quite expensive from a historic standpoint, at around US$110 per barrel, it is well below its peak of over US$145 per barrel in summer 2008. That was the first time that prices at the pump reached C$1.50 per litre in some areas of Quebec. Even in April 2012, the other moment when gas prices neared C$1.50, Brent prices were substantially higher, at around US$125 per barrel.

A major difference with summer 2008 and spring 2012 is that the Canadian dollar was close to parity against the greenback at that time. The situation is different today, with the loonie down to around US$0.90. This has a major impact on gas costs. As shown in graph 4, the Brent price per barrel in Canadian dollars is currently around $120.

**RISING TAXES**

The fact remains that $120 per barrel is still well below the peak above $145 seen in summer 2008. Why, then, are gas prices so similar? The culprit here is easy to identify. One striking difference from 2008 is the marked rise in Quebec’s fuel taxes. In response to deteriorating public finances, a result of the 2008–2009 recession, the Quebec government ordered four consecutive 1¢ per litre increases in the provincial excise tax. The tax to finance public transportation in the Montreal metropolitan area was raised as well by 1.50¢ per litre. A 2% increase in the QST (Quebec Sale Taxe) also had a direct effect on prices at the pump. Montreal’s price of $1.45 per litre therefore includes nearly 51¢ in taxes today, compared to around 43¢ in 2008, a considerable difference (graphs 5 and 6 on page 3).

**SEASONAL EFFECTS**

Even when we include higher gas taxes and calculate crude prices in Canadian dollars, some of the recent upswing in prices remains hard to explain. This part of the increase can also be seen in U.S. gas prices, which have gone from US$3.30 to US$3.70 per gallon since mid-February, despite stable crude prices. The main reason is that seasonal factors tend to temporarily boost refiner margins and, consequently, gas prices toward the end of winter (graph 7 on page 3). Accelerating demand for gasoline as “driving season” approaches, the temporary closure of several refineries for

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maintenance and the shift to summer gasoline production tend to drive refiners’ margins up each year between February and May.

**SOME UPSIDE PRESSURES WILL DISAPPEAR, BUT NOT ALL**

To summarize, gasoline prices are near their historic peak for the following main reasons: oil prices in Canadian dollars are up, fuel taxes have been raised, and seasonal factors are affecting prices in both Canada and the United States. For motorists, the driving question is whether or not these factors will keep gas prices high over the coming months.

The good news is that the seasonal factors currently inflating refiners’ margins should reverse soon. This could bring gas prices per litre down a few cents over the next few months. Conversely, nothing suggests that taxes on gasoline will go down. The challenge of public finances remains acute in Quebec and at best motorists can expect fuel taxes to remain stable over the next few years.

The answer is less clear for crude prices in Canadian dollars. Our scenarios call for oil prices to edge down over the coming months, followed by a gradual convergence of Brent and WTI prices toward US$100 per barrel. The Canadian dollar should tick up, reaching US$0.925 by late 2014, which could also bring gas prices down slightly.

Even if our relatively favourable scenarios come true, motorists will only catch a limited break, as Montreal’s gas prices, for example, should not fall durably much below $1.35 per litre. As Quebec’s market will still be highly taxed, oil prices would have to plummet significantly for gas prices to return to the levels we saw as normal a decade ago.

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