

## Oil tethered to fundamentals



Canada's economy is still reeling from the Great Recession of 2008-09, particularly goods producers like the resource industries. To be frank, we need all the help we can get.

And help is arriving. Crude oil — for which Canada is a major producer and exporter — is seeing better prices these days. The benchmark price for West Texas Intermediate crude rose to nearly US\$80 per barrel in mid-October. But the big questions on everyone's mind are: What's driving the price increase? And, is it sustainable?

One big factor has been the depreciating US dollar. The greenback is slipping against all major global currencies, making US-dollar-denominated commodities like oil and gold more affordable for investors and consumers buying in other currencies (like euros or yen).

The talking heads on the news will surely bring up "the fundamentals" — a phrase that's thrown around like confetti any time there's a question of commodity prices rising too high, or falling too low.

Do the fundamentals support the price at US\$80? Probably not. Or, at least, not yet.

For one thing, the market fundamentals are determined by the cost of the marginal barrel of oil coming out of the ground. That is, how much does it cost producers to extract the last barrel that goes onto the market? Given the wide range of types of projects currently producing oil — from

the mature, low-cost oil fields in the Middle East to the high-cost projects like offshore oil and oil sands — experts estimate that the "marginal cost" is presently around US\$65-\$70 a barrel. Oil at nearly US\$80 is clearly getting out of that range.

Secondly, traders seem to be anticipating that global consumption and demand are about to pick up quite a lot. But will they? For sure, the American economy has grown much more stable over the past several months, but it's still a long way from posting good, solid economic growth. Unemployment has not yet peaked in the US, and consumer confidence remains moribund. If demand for oil is about to take off, that demand isn't likely to come from the US.

China? India? Certainly these are better bets for growing oil demand. But even here, it seems a bit overblown to suggest that these emerging economies can, on their own, lift oil prices from US\$33 to nearly US\$80 in less than a year.

But the single most important reason why we shouldn't get too excited about rising oil prices is that this is simply the nature of commodity market movements. Prices regularly overshoot on the way up and undershoot on the way down. Speculators do play a part, but they really just tend to exaggerate the trends the market is already displaying. If market forces of supply and demand are moving prices higher, speculators tend to push them much higher; and if market prices are moving lower, speculators will move them much lower.

This is what we are seeing at the moment. Global supply and demand fundamentals are, indeed, moving prices gradually higher. But commodity traders are sniffing the trend, and are moving the market price ahead of itself.

Think of global oil prices like a tetherball, where the position of the ball represents current price, and the position of the post represents the underlying global fundamentals. The ball will swing to and fro, and at times the size of those swings will be very dramatic (think of oil at US\$147 in July 2008!). The ball may never actually be at rest with the post, but the position of the ball will always tend to move back toward the position of the post. The ball is tethered to the post, just as oil prices are tethered to global supply and demand.

It's very probable that the steep gains posted in mid-October were being driven more by psychological factors (like market sentiment and speculation about economic recovery in the US). So some pullback in oil prices could be expected in the weeks to follow.

Yet global supply and demand fundamentals do point toward gradually rising oil prices in the future. A depreciating US dollar, limited supply of low-cost oil and an inevitable recovery in the global economy will bring prices higher. The tetherball may swing back and forth around the pole, but if the pole itself is moving, the ball has no choice but to gradually move with it.

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# Concours de dissertations sur les questions constitutionnelles de la revue *Options politiques*



Avec le soutien du cabinet Ogilvy Renault s.r.l. et du Congrès canadien des affaires constitutionnelles (CCAC), la revue *Options politiques* publiée par l'Institut de recherche en politiques publiques (IRPP) lance le Concours de dissertations sur les questions constitutionnelles. Ce concours annuel vise à stimuler le débat constitutionnel au Canada en publiant des textes d'étudiants sur le sujet et en récompensant financièrement leurs auteurs. Il a été créé dans la foulée de la conférence nationale du CCAC tenue à Québec en 2008 à l'intention des étudiants en droit et des spécialistes des questions constitutionnelles. Consacrée à l'étude du fédéralisme canadien et des questions d'identité, cette conférence se voulait une occasion d'encourager le débat sur ces enjeux et d'en enrichir la qualité parmi les étudiants de tout le Canada.

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Le concours est ouvert à tous les étudiants de premier cycle inscrits à temps plein dans une faculté de droit canadienne. Les dissertations peuvent être écrites en français ou en anglais, et ne doivent pas compter plus de 2 500 mots.

Les dissertations peuvent porter sur n'importe quel aspect de la question constitutionnelle canadienne. Les textes seront évalués selon les critères suivants :

1. **Exactitude** des informations relatives aux questions et au droit constitutionnels ;
2. **Pertinence** par rapport à l'évolution actuelle des questions constitutionnelles au Canada, en ce qui a trait notamment aux enjeux du fédéralisme et de l'identité nationale ;
3. **Originalité** du raisonnement ou de l'approche.

Le texte gagnant sera publié dans la revue *Options politiques* de l'IRPP et vaudra à son auteur un prix de 1 500 \$. Le texte retenu en deuxième place sera également publié dans *Options politiques* et vaudra à son auteur un prix de 500 \$.

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**31 mai 2010**

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