

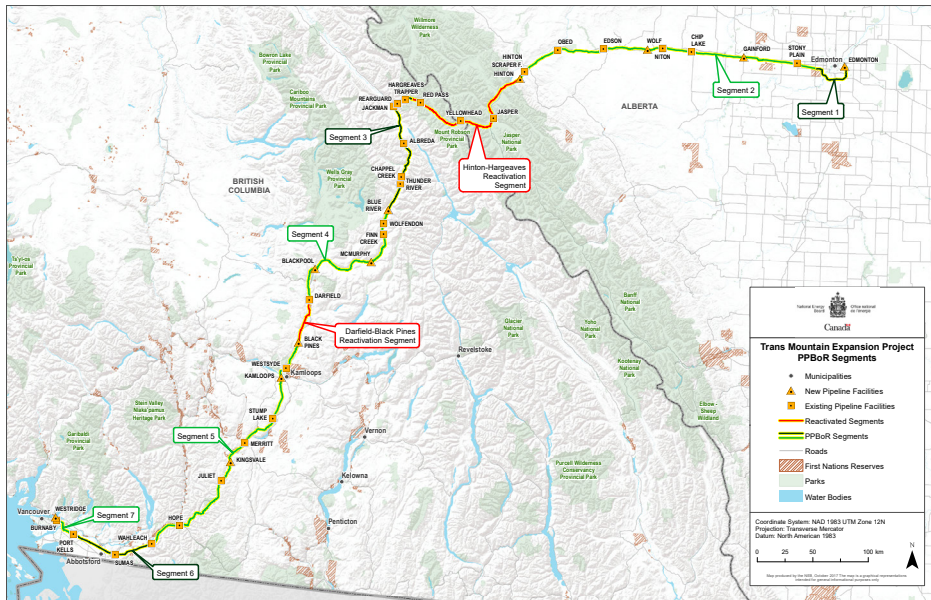
ECONOMIC VIEWPOINT

Trans Mountain Expansion: What's the Impact on the Canadian Economy?

By Marc-Antoine Dumont, Senior Economist, and LJ Valencia, Economic Analyst

Highlights

- ▶ The Trans Mountain Expansion pipeline officially started operations on May 1, 2024, and spans 1,150 kilometres from Edmonton in Alberta to Burnaby in British Columbia. At full capacity, it will nearly triple the capacity of the old conduit from 300,000 barrels per day (bpd) to 890,000 bpd.
- ▶ This should result in higher oil production in Canada over time and a subsequent reduction in the WTI–WCS spread. As 95% of Canada's crude oil exports go to the United States, this new route to the West Coast will also allow Western Canadian producers to reduce their dependence on US refineries.
- ▶ However, using this newly available export capacity will likely take years. As such, the uptick in June's crude oil exports is probably mostly due to an inventory drawdown rather than an increase in production, meaning the strength in recent exports may be unsustainable. As a result, the impact of the new pipeline on real GDP should be moderate in the near term and well below the Bank of Canada's ambitious growth projections.



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Impacts on Canada’s Oil Industry

Higher Export Capacity Means Lower WTI–WCS Spread

The Trans Mountain Expansion (TMX) adds new export capacity as well as new possible destinations for Canadian barrels, which should reduce Canada’s dependency on US refineries and lower the WTI–WCS spread.¹ This alternative route gives access to the US West Coast (PADD 5)² and the rich Asian market. While it is too early to know where the bump in June’s energy exports went as there is a decent lag before the data is published, China is likely to be a key destination in the months ahead. That said, China is still importing discounted Russian crude, which Canadian producers will have a hard time displacing.

Although the WTI–WCS spread began narrowing late last year as the market was pricing in the imminent opening of the TMX pipeline and the additional export capacity it would create, the spread started increasing after hitting a low of US\$13.66 in May 2024 (graph 1). One reason for the recent spread widening is that OPEC+ is bringing cheaper supply to market before the announced phase-out of [its voluntary cuts](#) takes effect, while oil demand surprised to the downside, notably in the United States and China. This is working to reduce the attractiveness of Canadian crude, which is more costly to refine. On top of that, US crude oil production rose to a new record of 13.3 million barrels per day (mbpd), which exacerbated competition between US and Canadian oil for access to limited North American refinery capacity. Against this backdrop, the TMX has likely prevented the WTI–WCS spread from widening further. We expect the spread to remain relatively stable in the coming months. In a nutshell, the larger the capacity room, the smaller the WTI–WCS spread, as it reduces transport costs.

Graph 1
The New TMX Pipeline Should Narrow the WTI–WCS Spread

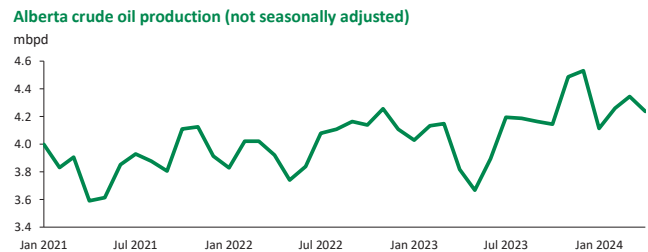


TMX: Trans Mountain Expansion; WTI: West Texas Intermediate; WCS: Western Canadian Select
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Oil Production Is Not There Yet

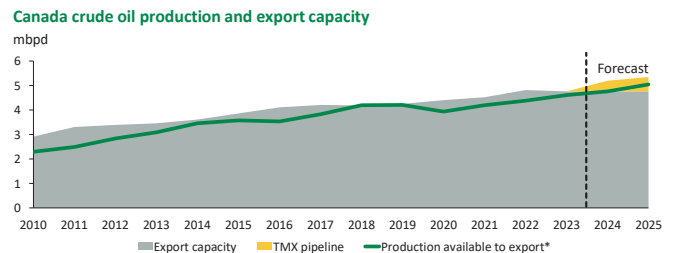
While Alberta’s oil production began to rise in late 2023 as producers prepared for the opening of the TMX pipeline, the gain remains marginal (graph 2). Using the latest projection from [Alberta’s Energy Regulator](#) to forecast Canada’s oil production available to export,³ we see that output is set to rise by less than 0.2 mbpd on average in 2024 (graph 3), representing only about a third of newly available export capacity. By the end of 2025, production should increase by an additional 0.2 mbpd, but could still underutilize the TMX pipeline’s capacity.

Graph 2
Alberta Crude Oil Production Started Increasing in Late 2023



TMX: Trans Mountain Expansion; mbpd: million barrels per day
Canada Energy Regulator and Desjardins Economic Studies

Graph 3
Utilizing the New Export Capacity Will Likely Take Years



*Based on Canada’s Energy Future 2023 but using the Alberta Energy Regulator forecast for 2024 and 2025.
mbpd: million barrels per day; TMX: Trans Mountain Expansion
Canada Energy Regulator, Alberta Energy Regulator and Desjardins Economic Studies

In the meantime, the anticipated ramp-up in production should stimulate investment in the sector. We expect the seasonally adjusted Canadian rig count to moderately increase in the second half of this year and in 2025 (graph 4 on page 3). Oil sands output is also set to rise as the TMX pipeline originates near the oil sands fields around Edmonton. That said, the wildfire season is still raging and could undermine the logistics of oil production

¹ The WTI–WCS spread refers to the difference between the West Texas Intermediate price and the Western Canadian Select price. A larger spread is usually seen as worse for Canadian oil producers and the economic outlook in general.

² [Petroleum Administration for Defense Districts](#) (PADDs) are geographic aggregations of the 50 US States and the District of Columbia into five districts: PADD 1 is the East Coast, PADD 2 the Midwest, PADD 3 the Gulf Coast, PADD 4 the Rocky Mountain Region and PADD 5 the West Coast. Historically, Canada has mainly exported crude oil to PADDs 2 and 4 due to the higher export capacity (by pipeline and railcars) toward these regions.

³ Oil available to export refers to oil production in the Western Canadian Sedimentary Basin.

Graph 4
The Rig Count Should Moderately Increase from the Current Level



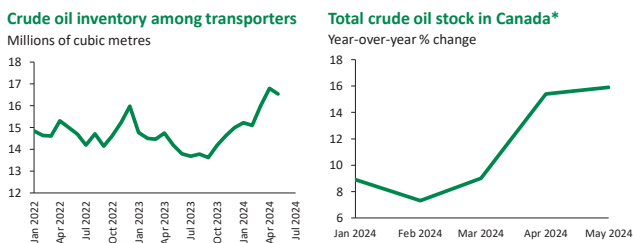
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in Alberta. But the impact so far has been manageable, and the early July estimate from the International Energy Agency is pointing to a recovery in production.

What Happened in June?

Despite the June 2024 merchandise trade release from Statistics Canada highlighting strong exports driven by oil products and the new TMX pipeline, there are signs that this surge may be inventory-driven. Data points to oil [inventory accumulation throughout 2024](#), as [production rose](#) steadily in anticipation of the TMX pipeline coming online (graph 5). This could explain the significant export boost seen in the June 2024 data without a corresponding sharp move in production. As inventories are depleted, the strength in oil exports could taper off. Overall, the recent export volume may be unsustainable at the current production level, signaling that the TMX pipeline's impact on trade may be more gradual.

Graph 5
Producers Responded to the New Pipeline by Increasing Inventory



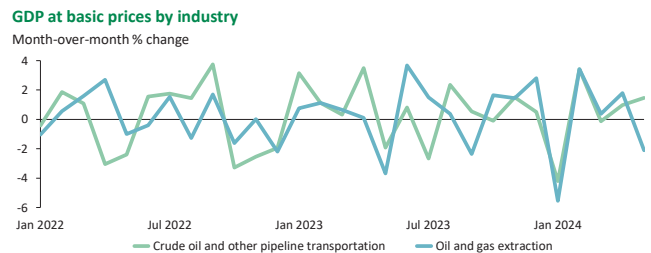
*In millions of barrels expressed as a year-over-year % change. The total crude oil stock is the total amount of crude oil available at any given time (including pipeline and entrepôt stocks).
Statistics Canada, International Energy Agency and Desjardins Economic Studies

Implications for Real GDP and Real Exports

Implications for Monthly Real GDP Growth

The TMX pipeline is already having positive impacts on real GDP by boosting crude oil transportation (graph 6). The May 2024 GDP by industry release showed 1.5% m/m growth in the crude oil and other pipeline transportation subsector. In contrast, oil and gas extraction declined 3.5% m/m due to seasonal maintenance across upgrading facilities. In the coming months, we expect slow growth in production as maintenance in upgrading facilities reaches completion and firms draw down their crude oil inventories. That said, new transport capacity should continue to positively impact crude oil and pipeline transportation.

Graph 6
The TMX Has Given the Crude Oil Transportation Industry a Small Boost

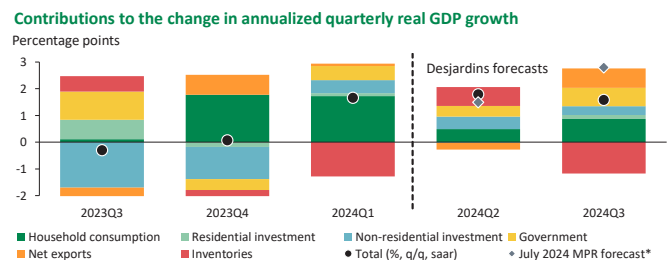


Statistics Canada and Desjardins Economic Studies

Implications for Quarterly GDP

On the expenditure side of real GDP, we anticipate respectable inventory growth in the second quarter, partially driven by an increase in crude oil inventories due to the TMX pipeline (graph 7). However, weak net exports in Q2 should offset a portion of oil's inventory-driven gains. In the third quarter, net exports should advance significantly, with at least a full quarter of the additional capacity coming from the new pipeline. But the

Graph 7
The TMX Will Have Modest Near-Term Impacts on Real GDP Growth



*MPR: The Bank of Canada's Monetary Policy Report
Statistics Canada and Desjardins Economic Studies

drawdown in crude oil inventories is expected to put downward pressure on overall growth, offsetting net export gains. That said, oil production and energy exports are set to gradually rise in the second half of the year and in 2025, supporting stronger business investment.

Implications for Monetary Policy

In contrast to the Bank of Canada's rosy real GDP projections in its July 2024 Monetary Policy Report, we expect moderate real GDP growth in the coming months despite the new TMX pipeline. That's because higher energy exports are likely to be offset by lower inventories. As a result, we're tracking real GDP growth in Q3 that's roughly half the pace of the Bank's 2.8% annualized forecast. Furthermore, high interest rates and a cooling labour market should continue to dampen consumer spending, resulting in slower economic activity. Overall, weaker economic growth than expected by the Bank will provide more motivation for it to proceed with 25-basis-point cuts at each of the upcoming rate announcements through the end of the year. The longer-term implications of TMX on growth and monetary policy should be positive but marginal, with little meaningful impact on interest rates over the medium term.

Conclusion

Canada is already reaping the benefits of the new TMX pipeline, which should moderately bolster third-quarter real GDP growth. It also seems to have shielded the oil and gas industry from a stronger increase in the WTI–WCS spread, as it gave Canadian oil producers additional export destinations and transport capacity to reduce their dependence on US refineries. However, the uptick seen in June's exports was likely inventory-driven as production has yet to match the new pipeline's capacity. Therefore, while we expect investment in the sector to fuel a gradual increase in the rig count and Canada's total oil output this year and next, the near-term growth impulse should not be overstated.