Gas Prices Are Down, But Should You Celebrate?

Description

This week, Canadians are celebrating after gasoline prices fell significantly in July. Last week, *CBC* reported that gas prices fell by 12 cents per litre in Ontario; similar price action was observed in other provinces. Oil prices are going down in the futures markets, and gasoline is following suit.

If you drive a lot, you might be feeling cheery about this. It is nice to save money on the price of gas or at least pay less than you were paying a few weeks ago. However, lower gas prices may not be good news for Canada's economy. Oil is the second-biggest sector in Canada after financials, and it creates a lot of jobs for Canadian workers. Potentially, lower oil prices could send Canada into a recession, as they would take a bite out of economic output.

Why gas prices are down

Gas prices are currently trending down because oil is trending down. Oil is the main commodity used to produce gasoline, and the two goods are closely correlated with one another. Generally, when oil prices fall in the futures market, oil companies and gas stations start charging less for gasoline.

Consider **Suncor Energy** (TSX:SU)(NYSE:SU) for example. It's a company that extracts oil and sells gasoline. The lower the global price of oil goes, the less SU can sell crude oil for. The same usually goes for gasoline. While the correlation between oil and gas is not one, it is fairly strong. If the supply of crude oil is increasing, then the supply of gasoline probably will too. The U.S. is currently working hard to increase the world's oil supply by releasing oil from the strategic petroleum reserve. It isn't keeping all of that oil at home; it's selling a fair bit of it on the world market. That's putting downward pressure on crude, which puts downward pressure on gasoline. So, now, Suncor is charging consumers lower prices at its Petro-Canada gas stations.

Is it good for Canada's economy?

Having looked at the factors behind the fall in the price of gasoline, it's time to ask the question: Is this good for Canada's economy?

To really determine the net effect of lower gasoline prices on Canada, we'd need an in-depth economic study that put a precise dollar value on all the variables (money saved by consumers, lower oil company revenue, job losses, etc.). That's beyond the scope of this article. However, we know that when oil prices go down,

- Canadian oil firms make less money;
- Oil stocks go down;
- Oil exports to the U.S. generate less revenue; and
- Provinces that depend on oil royalties have worse public finances.

Additionally, if the low prices persist for a long time, then oil and gas workers may be laid off. So, it's not unambiguously true that lower gasoline prices are good for Canada. They may be good for the individual consumer, but they aren't necessarily good overall for an economy that's so dependent on oil. Most likely, Canada's oil companies will remain very profitable at today's oil prices. Suncor is pumping out profits like never before, and that won't stop even if oil falls to $90. But prices lower than that could cause problems for the economy.

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