ECONOMIC BRIEFING

TD Economics

August 1, 2013

ASSESSING THE IMPACT OF THE BREAK UP OF THE BPC CARTEL ON SASKATCHEWAN'S ECONOMY

- On Tuesday, Russian potash producer OAO Uralkali announced that it would break away from Belarusian Potash Co. (BPC) – the marketing organization that previously exported potash for Uralkali and Belarusian producer Belaruskali. Uralkali has alleged that Belaruskali violated the export agreement by making deliveries outside the BPC. Uralkali will now export its products independently – thus, breaking up the potash cartel. Prior to the split, BPC had marketed around 43% of global potash exports compared to Canpotex's 25% (the international marketing arm owned by Saskatchewan potash producers). The two agencies had accounted for almost 70% of total global potash exports giving them pricing power in world markets.
- There are several possible outcomes that could unfold as a result of the split. First, we certainly cannot rule out that the parties within BPC will resolve their recent differences or generate some kind of renewed relationship that could return the situation to the status quo. This is because of the mutual benefits to producers of elevated and stable pricing.
- However, in the event that Uralkali sticks to its guns, the global potash sector could shift to a model based on competitive pricing and volumes rather than price in a market that is currently amply supplied. Uralkali has predicted that efforts by itself and other competitors to raise production could trigger a 25% price decline, to about US$300/tonne. Keep in mind that this widely-cited price is merely this producer's opinion. That said, even a price decline of 10-15% would leave a significant mark on the market and Saskatchewan economy.
- In the near term, global production will likely decline as customers wait for prices to fall and settle before making purchases. However, production would merely be delayed until later this year or into 2014, after which time volumes would likely rebound. Looking even further out, lower prices would reduce the incentive for producers to add capacity, thus placing downward pressure on volumes and potentially upward pressure on prices.

The impact on Saskatchewan

- Saskatchewan is the world's second largest producer of potash. Real output in the potash mining industry accounts for about 2% of the Saskatchewan economy. However, there are a number of other channels that the potash industry influences within the Saskatchewan economy.
- In terms of investment, potash industry capital expenditures are estimated to be around $2.5 billion in 2013, accounting for roughly 10% of total capital expenditures intentions for the year. A lower price environment would put new investment intentions at risk and dampen medium-term prospects

Jonathan Bendiner, Economist, 416-307-5968
Derek Burleton, VP & Deputy Chief Economist, 416-982-2514
Dina Ignjatovic , Economist, 416-982-2555

for the sector. In particular, any significant decline in prices would create further doubt around development of the $14 billion BHP Jansen mine – a project that has already been subject to delays.

- Saskatchewan would also experience large negative effects through lower exports. Potash exports accounted for approximately 18% of Saskatchewan's total nominal international merchandise exports in 2012. Further, on a year-to-date basis, potash exports were up around 13% over the first five months of 2013 and they are one of the leading contributors to export growth for the province so far this year. A pullback in production and demand in the near term will hamper export performance in 2013 and detract from economic growth. Looking forward to 2014, larger export volumes would likely be more than offset by lower prices.
- From a fiscal perspective, the government also stands to miss out on potential royalty and tax revenues. The 2013 Budget estimated royalty revenues from potash at $520 million for fiscal year 2013-14 – about 4.5% of total anticipated revenues. The Province's own sensitivity analysis shows that a US$50/tonne change in the average realized 2013 price of potash results in an estimated $130.6 million change in potash royalties. A back of the envelope calculation that assumes a US$300/tonne price for potash for the remaining eight months of the fiscal year, implies royalty revenues coming in around $150 million below forecast. Government revenues will also be impacted through other nominal means. Taxation revenues for the current fiscal year would likely be lower, as both corporate profits and labour income would be adversely affected due to lower prices and reduced activity. Under this scenario, Saskatchewan's position as one of the few provinces in a surplus position would be put at risk.
- Although the potash sector will stand to suffer, the agricultural sector could benefit from the reduced potash pricing environment. A decline in potash prices could lead to increased fertilizer use in the province's crop sector, and could potentially increase yields and supply in an area of the economy that is currently enjoying good growing conditions. Moreover, other sectors in the Saskatchewan economy are also expected to put in strong performances in the near term, helping to counter-balance weakness in potash. Oil production is expected to increase 8% (volumes) in 2013. In addition, uranium activity is also poised to benefit from the new uranium royalty system, which has been modernized in the hope of drawing in more investment.

Downside risk to forecast

- In July, TD Economics projected that Saskatchewan would record solid real economic growth of 2.6% in 2013 and 3.0% in 2014. Data released over the past few months have been consistent with this forecast.
- In light of this week's announcement, a downward revision to this forecast appears to be warranted. However, given uncertainties surrounding these developments – and notably the risk that Uralkali's decision may merely represent posturing – we are inclined to take a wait and see approach over the next few weeks in order to better gauge what magnitude of adjustment is most appropriate. At a minimum, this week's events will likely weigh on near term potash demand and have some longer-lasting impact on confidence within Saskatchewan's key potash industry.
- The next TD Provincial Economic Forecast – scheduled for release in mid-September – will provide a complete update to our medium term view on the economy.