



## Impact of Significantly Lower Potash Prices on the Canadian and Saskatchewan Economies

The announcement today that OAO Uralkali was pulling out of the Russian potash marketing group BPC has sent stock prices for potash producers dramatically lower. This reflected the view that, operating on its own, the low-cost producer Uralkali could significantly increase production thus weighing on prices. The company itself has speculated that its increased production could cut the price of potash by 25% dropping from a June average of \$392/tonne to slightly under \$300/tonne. These developments are not inconsequential to the Canadian economy as the province of Saskatchewan has the world's largest reserves of potash. A lion's share of Canada's production comes from that province with the residual being supplied by the province of New Brunswick.

In terms of sizing the impact of recent developments, potash mining accounts for only about 0.1% of the overall Canadian economy though a larger 2% of the Saskatchewan economy. Saskatchewan represents about 4% of the overall Canadian economy. In terms of potash exports, in 2012 they accounted for about 1.3% of overall Canadian merchandise exports. This is not small for any single commodity, though it compares to a larger share for natural gas of 2.3% and a crude oil share of 16.4%. If we assume that 90% of those exports come from Saskatchewan, it would account for a more significant 17% of that province's overall nominal merchandise exports.

Obviously today's developments will have a more significant impact on the province of Saskatchewan rather than the overall Canadian economy. The two main direct impacts on the province will be through lower mining and construction activity. Through May 2013 potash production was up a very strong 18.9% which implied the province was well on its way to reversing the 15.1% plummet that occurred in 2012. For the year as a whole, our forecast had assumed that the non-metallic mineral mining and quarrying component, which largely reflects potash production, would rise 13% in 2013. If we were to assume double digit declines in potash production for the remainder of this year resulting in this mining component showing no growth for the whole year, it would reduce Saskatchewan GDP by 1.0 percentage point. Our current 2013 GDP growth forecast for Saskatchewan is 2.9%. This calculation helps size the potential impact of a sharp reduction in Canadian production though there remains considerable uncertainty as to how the Canadian producers may respond to foreign producers attempting to increase market share. Production numbers through the second half of this year will obviously be monitored closely.

In terms of the potential impact on construction through lower investment, the recent Statistics Canada survey of capital expenditure implied a relative conservative increase in spending in the provincial mining sector (excluding oil and gas) of only 3.6%. This resulted in our forecast for construction spending in the province rising a modest 1.1% in 2013. If we assume a more dramatic falloff in construction spending this year of 5%, this would reduce GDP growth in the province by 0.5 percentage points. Thus combined hit to mining and construction has the potential to halve growth in Saskatchewan this year though firmer estimates will await indications of how the industry responds both in Canada and globally.

Growth in the province will also be impacted by lower prices and attendant downward impact on incomes. However, this impact is more difficult to size though it would clearly provide another downward hit to provincial and, to a smaller degree Canadian, growth. Lower potash prices could have an additional impact on the Canadian economy via a downward impact on the Canadian dollar. Most modellings of the Canadian currency allow for some impact from both energy and non-energy prices. Potash prices account about 10% of the Bank of Canada's measure of non-energy commodity prices in Canada. If we assume a permanent 25% drop in potash prices it lowers this index by a not insignificant 2.5%. However, it is energy prices that have the more dominant impact on the Canadian dollar (they carry 61% of weight in the Bank of Canada's overall commodity price index) with this reduction in non-energy commodity prices only implying a 0.3% depreciation of the Canadian dollar over the next year.

On net, with the magnitude of today's news on the Canadian and Saskatchewan economies along with the Canadian dollar hard to quantify exactly, the direction of the impact is clearly downward.