Bank of Montreal stress testing assets for $25 per barrel oil

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Bank of Montreal Chief Executive Officer Bill Downe announced last week that Canada's fourth largest bank is stress-testing its oil and gas portfolio to determine the impact on the bank's balance sheet of oil prices of US $25 per barrel.

At a press briefing, Downe bluntly stated, "You've got to ask yourself, how low could it go?" The bank has predicted average oil prices for 2016 of US $35 per barrel.

Although Canada's major lenders have yet to suffer significant losses from their energy portfolios, concerns are mounting as oil prices tumble below US $30. *Maclean's* magazine recently noted that reduced earnings due to slow economic growth prompted a slew of job cuts in the last quarter, including close to 200 by the Canadian Imperial Bank of Commerce (CIBC), 500 by the Royal Bank of Canada and 800 by TD Bank.

An analyst with Scotiabank Wealth Management, Andrew Pyle, said in a recent interview that "all bets are off the table" and warned that most banks had only performed stress tests to $30, believing several months ago that this would be sufficient to reassure investors. "I think investors [will] have to pay closer attention to credit quality in the oil patch, and obviously the credit quality of loans that are on the books of the banks," he added.

Other Canadian financial institutions are offering equally gloomy projections on the years ahead for the energy sector. CIBC revealed that should oil prices remain around US $30 for three years, it would suffer losses in its loan portfolio of $650 million, three-quarters of which would come from business loans.

Although this was not spelled out, the likelihood is that the overwhelming majority of these losses would come from the oil and energy sector. Oil companies operating in Alberta's tar sands deal with some of the highest production costs in the world due to the technological procedures required to extract oil and the difficulties of shipping it to market. With oil prices having collapsed from over $100 per barrel over the past 18 months, many companies have seen profits turn to losses and a series of bankruptcies have occurred.

According to press reports, 18 percent of downtown Calgary office space is now unoccupied, and the price of renting space in the city that is headquarters for most of the province's oil companies has dropped by 42 percent since the oil price collapse.

Collectively, Alberta's oil industry lost $1.5 billion in the first half of 2015. The number of abandoned oil wells in the province has already jumped from 160 at the beginning of last year to over 700.

The drop in oil prices to $25 a barrel would result in thousands of additional workers joining the unemployment lines along with the tens of thousands who have already lost their jobs in the province. In the first eight months of 2015, 63,500 Albertans lost their jobs, the overwhelming majority in energy and related sectors.