RICHES FLORES RESEARCH

GLOBAL MACRO & THEMATIC INDEPENDENT RESEARCH

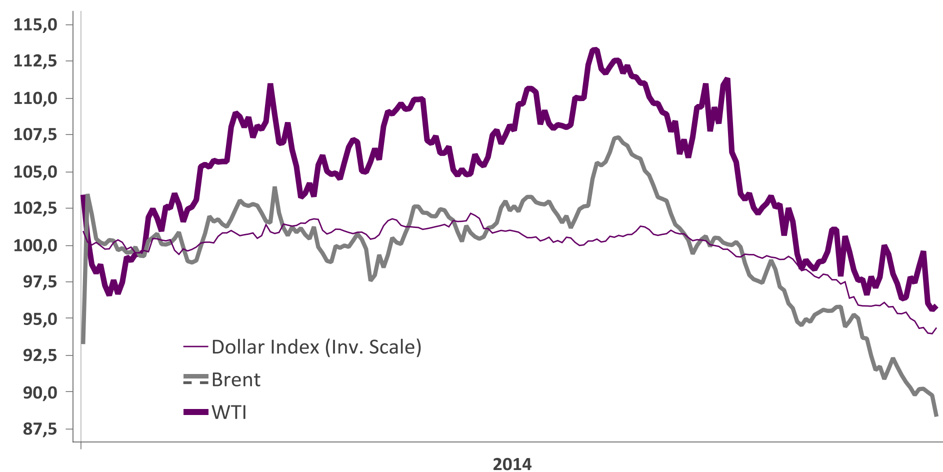
October 3, 2014

GLOBAL MACRO

Cheaper oil, a stabilizing force for growth

Our forecast for a sharp drop in commodity prices seems to have materialized since the summer. Despite a tense geopolitical situation, the fall in the price of oil has already reached 15% and, helped by sagging consumption, the global oil price tag has contracted by 1 GDP point since the start of the year. Each country has different exposure to this adjustment but, generally speaking, it has been more favorable for developed economies than emerging markets. Regardless, lower oil prices have maintained a stabilizing effect that could provide vital support given the present situation.

Oil Prices and The Dollar Index Jan. 2014=100



Sources: RichesFlores Research, Macrobond

-15% in 4 months, the movement could continue

Our forecast from last May stated that Brent would shrink to $90/barrel on a 2015 horizon with a risk zone of as low as $75 (see: "*Clouds gathering on risky assets*" from 23 May). Abundant supply and expectations of softer demand (as suggested by both developments in the economic situation and anticipations of a widespread drop in the price of industrial commodities) justified this radical change in our forecasts.

Despite the poor geopolitical situation, the drop in the price of oil, which began in the early part of the summer, has picked up markedly in the past few weeks. By the end of September, the price of the WTI had plummeted to $91/barrel from $107/barrel (its mid-June high) and North Sea Brent to $96.5/barrel from $115/barrel. For both of these markets, prices have thus fallen by around 15% in less than four months. Such a movement is hardly exceptional given the volatility of prices and, coinciding with a stronger dollar, has called into question its origin. Notwithstanding geopolitical risk, the chances of the downtrend continuing – amid persistent economic disappointment and lower Chinese demand – are high in our opinion.

The price tag for global oil has already shrunk by 1 GDP point

The economic implications of a long-term drop in oil prices are potentially very important. According to our estimates, the global oil burden, which was around 5.6% of GDP on average between 2011 and 2013, has already fallen by 1pt since the start of the year. At 4.6% of global GDP, it is now estimated to be hovering around lows not seen since end-2010. Assuming consumption and nominal GDP growth stay the same, an additional decline in average prices of $10 could send this figure to under 4%, which would be a low since 2009. Such a development would start to have a sizeable impact.

Global Oil Burden

Based on Global Consumption and Oil Prices

Sources: RichesFlores Research, Macrobond

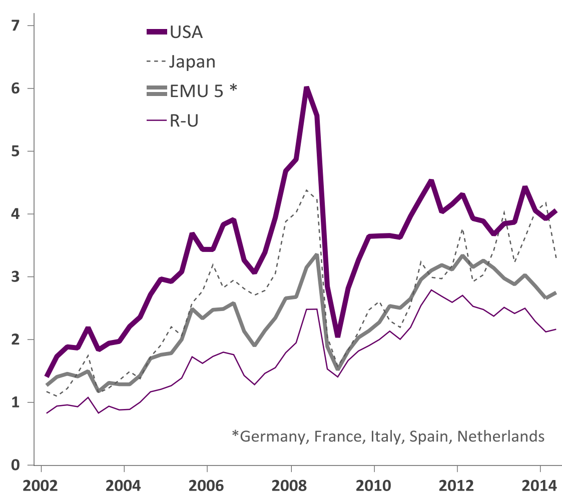
October 3, 2014

A falling euro would erode the benefits of cheaper oil…

Exposure to falling prices varies tremendously from one country to the next depending on forex changes, the effective purchase price of oil as well as legislation, taxes and other regulatory factors. In addition, demand trends have been highly disparate in previous quarters, though the broader picture on a global scale has been one of stagnation.

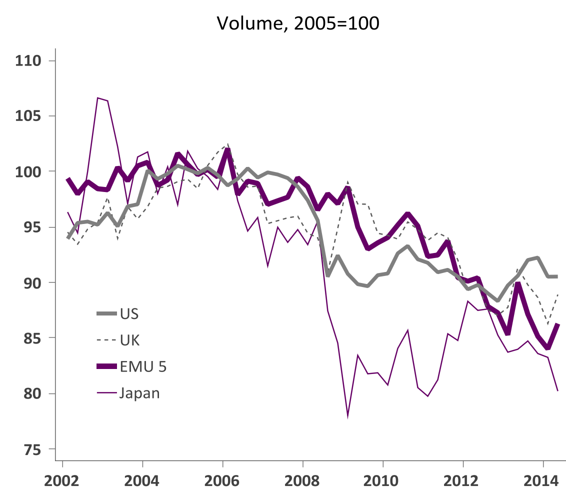
- In the United States, oil expenditure as a percentage of GDP has more or less stabilized since 2010, in the wake of stabilizing consumption. The drop in crude oil prices therefore has a directly proportional effect on household purchasing power and companies' energy costs.
- In Japan, oil consumption has just about returned to its pre-Fukushima level, but the plummeting yen has nevertheless continued to make the country's energy bill more expensive, which recently flirted with highs last seen in 2008. The country's economic difficulties and the strategy by the Abe government have prevented the country from taking advantage of cheaper oil. The situation could continue, judging by developments currently underway, particularly the vertiginous freefall of the yen.
- In the euro area, slack in demand has sent the oil/GDP ratio down by one half point in recent months. Indeed, lower oil prices are being passed on to the domestic market but it is plain to see that amid such a backdrop, the recent fall in the euro could deprive the region of the benefits of the favorable change in global oil prices. A drop in energy prices could help fight deflation by stimulating demand. Therefore, while international trade has ground to a halt (see Weekly from October 2nd), which reduced the positive effects of a depreciating euro for companies, a stabilizing euro could be more effective for the euro area economy given that energy prices are currently easing.

Oil Bill as % of Nominal GDP



Sources: RichesFlores Research, Macrobond

Supply of Crude Oil & Petroleum Products



Sources: RichesFlores Research, Macrobond

October 3, 2014

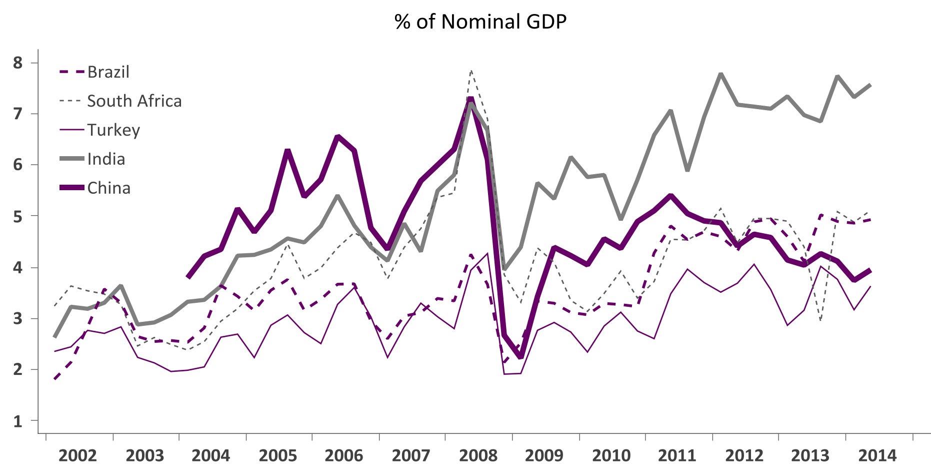
Except Chinese consumers, EMs not benefiting as much

The situation in emerging markets varies more than in the developed world. While many countries' currencies have fallen versus the dollar, which has made oil more expensive, consumption has continued to rise rapidly for a vast number of countries. India, for example, has seen its oil bill jump by more than 3 GDP points since the mid-2000s and has suffered in recent quarters from the side effects of the falling rupee. The drop in the price of oil has in effect enabled the country to avoid its oil expenditure from increasing but has not been enough to provide a marked lift in growth.

Most major emerging countries are in the same situation, with the notable exception being China, which has been accumulating the positive effects of both stagnant demand since 2010 and a much more stable forex environment than its emerging partners. According to our estimates, China's reduced reliance on oil to drive its economy has sent the country's oil expenditure-to-GDP ratio to less than 4%, well down from 5.5% in early 2011. This is a meaningful contribution at a time when the Chinese economy is struggling and has undoubtedly helped in propping up consumption. In particular, it appears to have helped the country's automotive sector sustain momentum, which is one of the only industries that has been spared from the slowdown in recent quarters.

Oil Bill of Main Emerging Countries

% of Nominal GDP



Sources: RichesFlores Research, Macrobond

Even though it reflects a dimmer outlook for demand, cheaper oil continues to play its role as a growth stabilizer, particularly in the developed world. The current trend is unequivocally a positive one, amid the current climate, and could prove to be a foothold for growth in the next few months.

Véronique Riches-Flores
contact@richesflores.com

RichesFlores Research is an economic and financial research provider. We produce international economic analysis and forecasts, as well as research on broader short-, medium-, and long-term trends in the global economy.
As an R&D entity certified by the Ministry of Higher Education and Research, RichesFlores Research is eligible for the research tax credit (Crédit d'Impôt Recherche) for the years 2013, 2014 and 2015.
RichesFlores Research is a transparent company, with the databases and information resources we need to remain fully independent and objective. Because RichesFlores Research is not an investment service provider and does not sell financial products, we can offer clients added confidence in the independence and objectivity of our assessments, recommendations, and advice.
This document is provided for information purposes only. It is not and should not be construed as investment advice, or as an offer or solicitation of an offer to buy or sell securities. It contains strictly confidential information intended only for the use of the individual or entity to which it is addressed. This document may not be disclosed to any third party without the express written consent of RichesFlores Research.
This research and its content are the sole property of RichesFlores Research. They may not be reproduced without the express consent of RichesFlores Research and without indication of the source and date thereof.
RichesFlores Research makes no warranty, express or implied, nor assumes any legal liability or responsibility for the accurateness, completeness, or usefulness of the research, conclusions, data, and assessments available on this website.
The content of this website does not constitute a contract and is non-binding. It is not and should not be construed as investment advice or as an offer or solicitation of an offer to buy or sell securities.
Véronique Riches-Flores, contact*@richesflores.com*