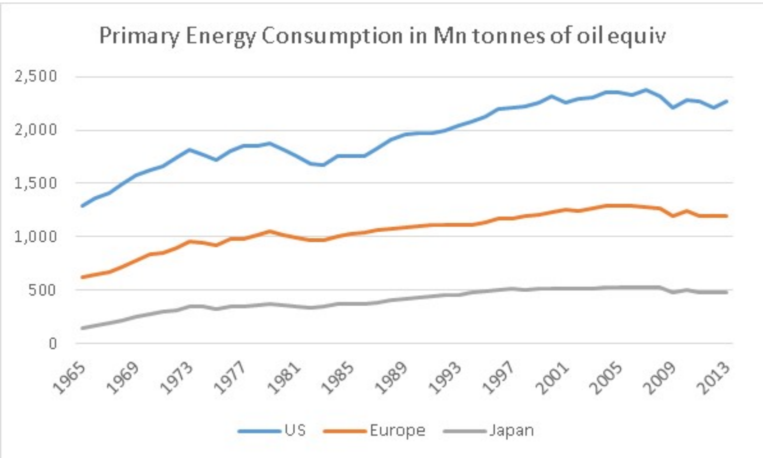
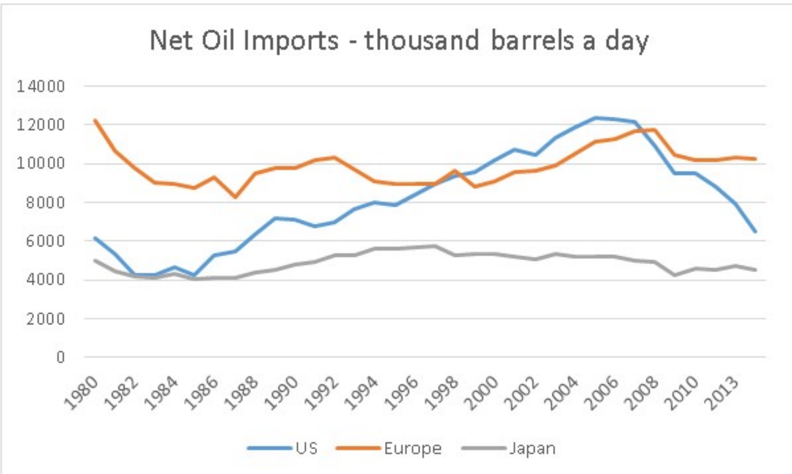
ARE LOWER OIL PRICES STILL DOLLAR BULLISH?

A received wisdom in financial markets is that a strong dollar implies a lower oil price and vice versa.



The US has always been a much larger consumer of oil than either Japan or Europe, and when we adjust for GDP, we tend to find that Europe and Japan produce about 30% more GDP per unit of energy used. That the US is both the largest consumer of oil and less efficient than Japan or Europe in its consumption would indeed imply that the US economy would benefit the most from lower energy prices.

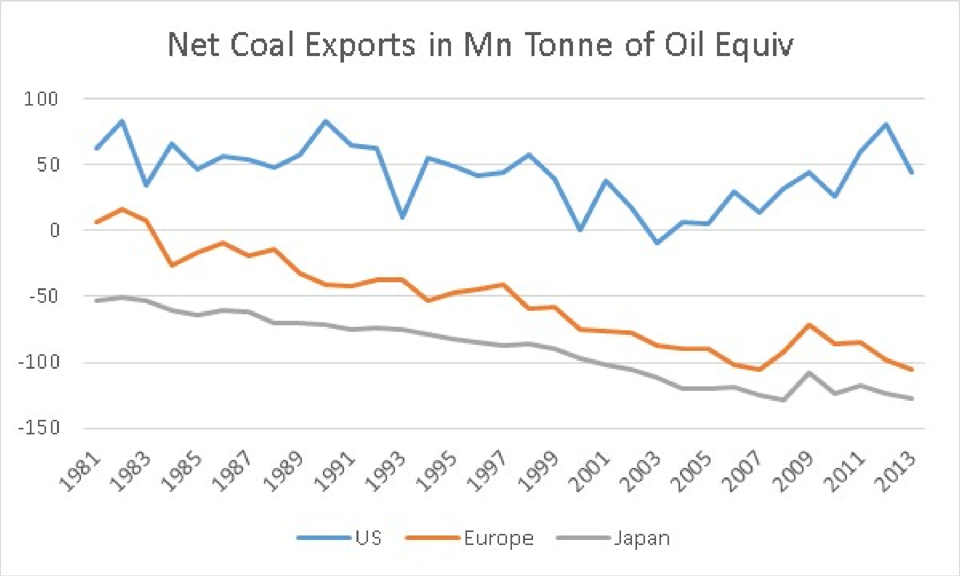
However the large increase in US energy production since 2007 means that the US is well on the way to becoming energy self-sufficient.



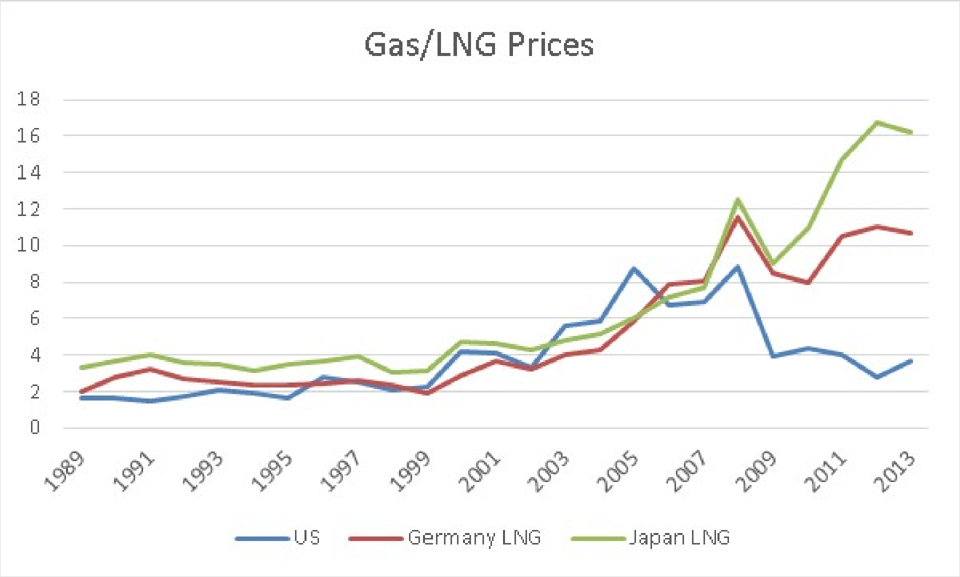
The continued increase in US oil production this year would suggest that US net oil imports may soon be less than Japan. Natural gas is similar with net imports to the US falling.

Net Gas Imports (pipeline and LNG)				
Bn Cubic Mtr	2010	2011	2012	2013
US	74	56	43	37
Europe	334	327	310	308
Japan	95	107	119	119

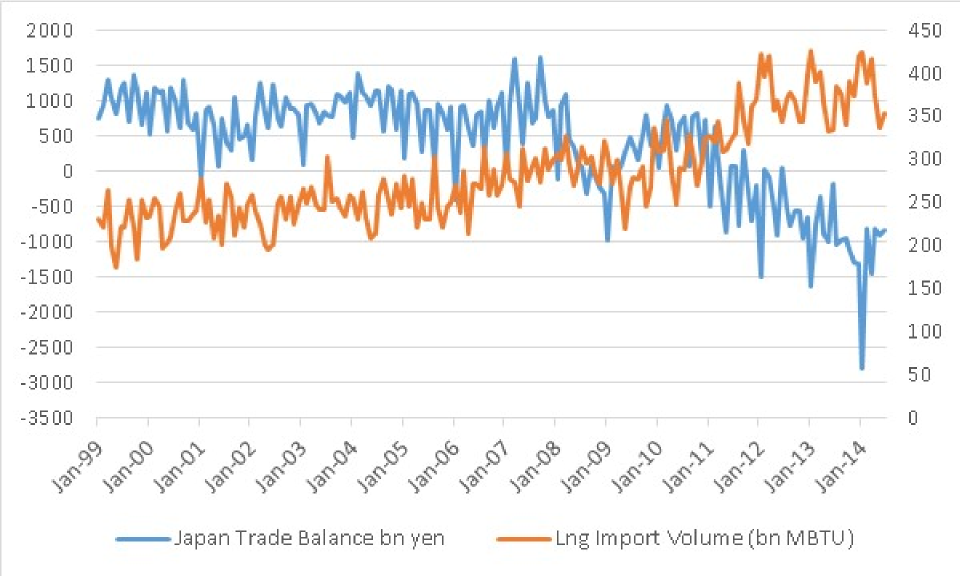
The increase in US natural gas production has also displaced coal consumption leading the US to be a net coal exporter – with much of its coal exports going to Europe. Both Japan and Europe have increased their reliance on coal in recent years.



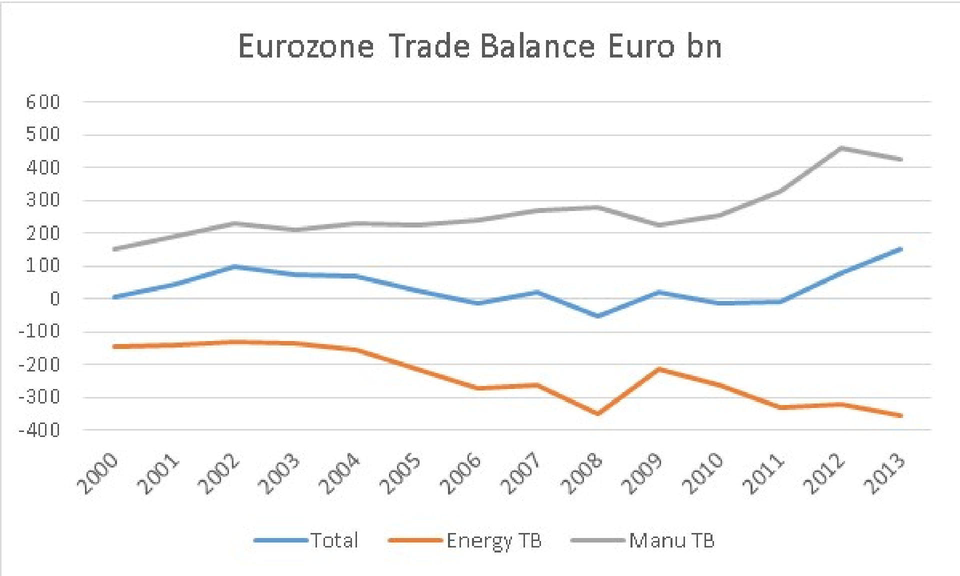
The massive increase in energy supply in the US has also led to much lower prices, particularly in natural gas.



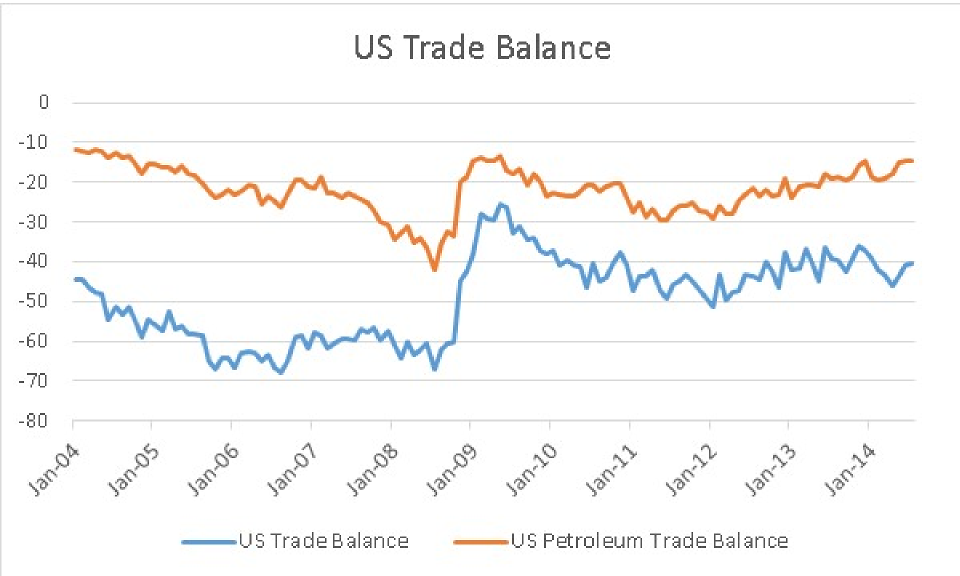
As can be seen, Japan faces the highest cost for natural gas, a situation that has been compounded by the Fukushima disaster, which forced the closure of most of Japan's nuclear industry and forced a large increase in LNG imports. This has been detrimental to Japan's trade balance.



In the case of the Eurozone, despite no increase in energy consumption, the trade balance for energy has worsened while its manufacturing trade balance has surged higher.



This is in stark contrast to the US that now has the lowest petroleum trade deficit since 2004.



Should the oil price halve from here, I calculate that the US import bill would fall by 90bn, assuming no increase in consumption or imports. This would be 0.5% of GDP improvement in net exports. For Europe, in 2013 the energy trade deficit was roughly 380bn Euros, so a 50% fall in price would imply a fall in their import bill of 190bn Euros, or nearly 2% improvement in their trade position. Japan would also see a 2% improvement. For both Europe and Japan the improvement is probably an understatement, as energy prices are higher in both regions, and for Japan in particular a fall in energy prices would probably coincide with a fall in most commodity prices, leading to an even bigger improvement in the trade position. It seems to me that if oil price weakens, then the euro and the yen have a strong chance of appreciating versus the dollar.

INFORMATION

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Investor Relations:	Samantha Dunn
Email:	info@russellclarkim.com
Telephone:	+44 (0)20 7838 7580
Website:	www.russellclarkim.com

Business and registered address: Russell Clark Investment Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

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