Our View: Low Crude Oil Prices Required for Global Economic Survival

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Analysts following any market are like photographers using telephoto lenses to focus on a specific person or bird or whatever, ignoring the surroundings. Economists, on the other hand, emulate photographers using wide-angle lenses to take in the entire street or forest. This author is an economist, not an analyst. At one point as a professor, I taught students who became analysts, although all had the common sense not to specialize in oil.

Today, oil market analysts and historians such as Daniel Yergin have aimed their telephoto lenses squarely at the actions of a few producers. Some, such as the hedge fund manager Pierre Andurand, seem to be using extraordinarily long lenses. Andurand, at times, has predicted $140 per barrel crude.

If one looks at the wider market picture, one sees that the global economy cannot tolerate $140 oil. Such a rise would result in substantial increases in US energy exports and a rise in the dollar's value that would precipitate depression across much of the world, particularly in emerging market nations.

In 2019, Donald Trump trumpeted the United States' transformation into an energy-exporting country during his presidency.[1] Unlike many of his statements, his boast was not a lie. The expansion of US exports has continued under President Biden. However, Biden's pause on approving new LNG export facilities and tougher enforcement of environmental regulations have slowed the growth of energy production and exports.

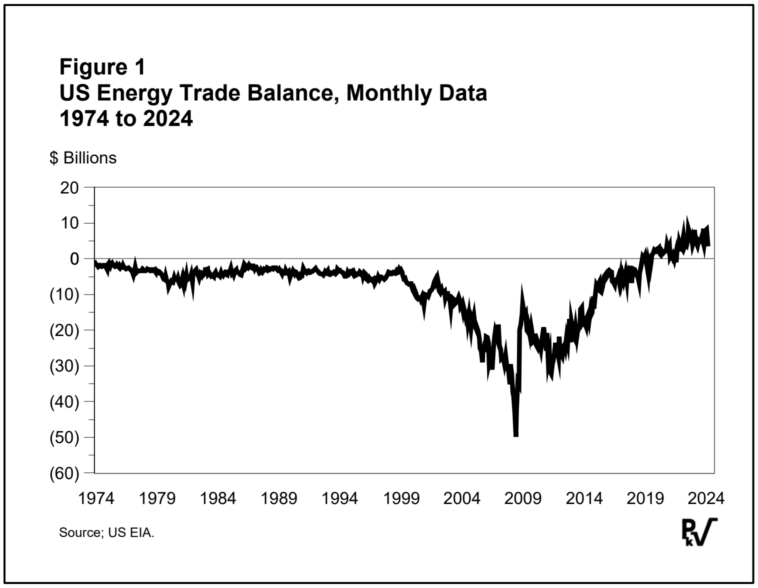
The situation will probably reverse in the coming years after Supreme Court rulings restrict the power of administrative agencies such as the Environmental Protection Agency. Should Donald Trump be reelected, the LNG facilities will likely go forward, and the EPA's environmental protections will be relaxed or eliminated.

At the same time, US fossil fuel consumption will slow. Gasoline use is particularly vulnerable because electric vehicles (EVs), while hated by Trump, offer consumer savings. Although EV sales have fallen off in recent months, their popularity will increase, especially as prices decrease, more charging facilities become available, and more homeowners adopt another popular source of energy savings: home electricity generation from solar power.

US fossil fuel exports will grow as oil and gas production rises and consumption drops, as will the positive US energy trade balance. Figure 1 presents the EIA's tracking of the trade balance from 1974 to April 2024. Note the balance was negative from January 1974, when the data were first

[1] John Kruzel, "Donald Trump exaggerates US energy independence," POLITIFACT, September 13, 2019 [https://tinyurl.com/5bhx5s7y].

reported, until December 2018, at one point falling to negative $50 billion for a single month in 2008. Since October 2021, it has been positive.



The reversal of the US energy trade balance has a direct impact on the dollar's exchange rate. Historically, the exchange rate and oil prices have been negatively related. Since 2021, the inverse relationship between oil prices and the exchange rate has reversed. My simulation of a Brent price rise impact on the dollar exchange rate makes clear that Brent prices of $120 or $140 per barrel would likely bring the dollar back to levels last observed more than twenty years ago, during the Asian debt crisis.

Morgan Stanley economist Lisa Shalett addressed the issue of a strong dollar and rising oil prices in an October 2023 analysis, although she did not tie the correlation to the rising US energy trade surplus. In the article summary, she noted the following:

> US markets are currently seeing an anomaly that may prove challenging for global economies. The US dollar and oil prices, which historically have an inverse relationship, have both been surging: the US Dollar Index, which tracks the value of the dollar against a basket of major world currencies, has risen to its highest level since November, while West Texas Intermediate, the main US oil benchmark, recently pierced the $95-per-barrel mark for the first time in about a year. [2]

Shalett observed that the stronger dollar would have three effects:

> US exports would become less competitive, and US firms would be less able to compete on price. Roughly one-third of the companies in the S&P 500 would be adversely affected.
>
> The strong dollar would affect the attractiveness of US goods abroad. US consumers would benefit from lower-cost imports, assuming that tariffs were not imposed.
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> Emerging market countries would be negatively affected. Shalett identified a "dual blow" in emerging market countries from the higher cost of oil and increased debt payments for many countries that have borrowed in dollars.

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[2] Lisa Shalett, "Double Trouble: A Stronger Dollar and Rising Oil Prices," Morgan Stanley, October 4, 2023 [https://tinyurl.com/49j2pe49].

Increased protectionism will prevent US consumers from benefiting from a stronger dollar. Donald Trump declared that he was the Tariff Man in 2018. He has since made the claim repeatedly, most recently declaring, "Tariff wars are good and easy to win."[3]

High oil prices will likely strengthen the dollar, prompt increased US and other non-OPEC production, create recessions or debt crises in emerging market nations, and reduce oil use substantially. From our wide-angle view, we see a strengthening dollar tied to the surge in the US energy trade surplus with rising oil prices. Feedback from the stronger dollar will force many nations with dollar-denominated debt to adopt austerity measures as they attempt to negotiate loans from the World Bank. The austerity moves will depress energy consumption in these nations, with oil use dropping quickly.

At the same time, rising prices will prompt greater investment in oil (and natural gas) exploration by private firms outside of OPEC. The increase could be particularly noticeable in the United States, with firms no longer constrained by the EPA pushing to maximize output. A significant surplus will develop. Only aggressive action by key OPEC+ members will keep prices from falling.

There is a warning here, then, for those desiring higher oil prices that goes back to Aesop's "The Herdsman and the Lost Bull" fable: "Be careful what you wish for; your wish may be granted."

[3] Ana Swanson and Allen Rappeport, "Trump Eyes Bigger Trade War in Second Term," *The New York Times*, June 27, 2024 [https://tinyurl.com/2a53mhhj].