Capital Daily | 17th September 2019

Global economic and market analysis from Capital Economics

Potential winners and losers from an oil shock

- We think that Japan’s export values dropped by more than 10% y/y in August (08.50 BST)
- The FOMC will probably cut rates by 25bp for the second time in a row (19.00 BST)
- Brazil’s central bank is also likely to lower its main policy rate

Key Market Themes

News that Saudi output will allegedly get back to normal fairly quickly has driven Brent crude lower today but had a minimal impact on equity markets. Although most equities would probably fall sharply if tensions escalated to an outright conflict in the Middle East, the stock markets of countries which are net exporters of oil and those with a high concentration of energy stocks would probably hold up comparatively well.

The Saudi oil minister is scheduled to give an update on the severity of the damage and the length of time it will take to return to full capacity later today. But media reports have already suggested that output will return back to normal in two-to-three weeks, which has driven oil prices down by 5% at the time of writing. As we noted in yesterday’s Daily, the general market fallout from the attacks on Saudi Aramco’s facilities over the weekend was fairly muted, with most equity markets moving by less than 2% in either direction. As such, it is not surprising that the latest news has had little effect on equity markets either. We continue to think that US-China trade tensions and the outlook for Fed policy remain more important drivers of oil prices.

Nonetheless, we would not rule out entirely the possibility of an escalation in tensions, leading to an outright conflict in the Middle East. In that case, we would not be surprised to see oil prices reach, and perhaps even rise above, $150 per barrel by end-2019. (See our Energy Update, 16th September.)

In that instance, most equity markets would probably fall sharply as the conflict triggered a general bout of risk aversion. However, the stock markets of countries which are net exporters of oil and those with a high concentration of energy stocks would probably hold up comparatively well in the event of a sharp rise in oil prices. Indeed, ten out of the fifteen top performers of the MSCI ACWI Index since Friday belong to one or more of those categories. (See Chart 1.)

In contrast, most of the worst-performing equity markets in the past few days have been those with a high weight in cyclical sectors. (See Chart 2, in which the weights for the MSCI indices are shown in brackets.) This makes sense, as those tend to be most affected by changes in the business cycle and a full-blown conflict could trigger another leg in the global downturn. We were already quite bearish on the prospects for the global economy and growing tensions in the Middle East are another headwind in already uncertain times. (See our Global Economics Update, 16th September.)

Simona Gambarini

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Selected Data & Events

<table>
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<tr>
<td>Wed 18th US Fed Policy Announcement</td>
<td>19.00</td>
<td>2.0-2.25%</td>
<td>1.75-2.00%</td>
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* m/m/y/y) unless otherwise stated; p = provisional
**Key Data & Events**

**US**

The 0.6% m/m rebound in *industrial production* in August, which was driven by manufacturing, on the face of it suggests that the drag on US producers from weaker global demand may be starting to fade. But with the manufacturing surveys pointing to continued weakness and global manufacturing activity still subdued, we doubt that the recovery will be sustained.

We expect a small rise in *housing starts* in August, helped by the recent upturn in new home sales. Otherwise, it will be all eyes on the Fed, with a 25bp rate cut widely expected at the conclusion of the two-day *FOMC* meeting. Given the generally-positive tone of the recent activity data and signs that core inflation is rebounding, the policy statement and updated economic projections probably won’t send a strong signal of further loosening to come. That said, we still think that a further gradual slowdown in economic growth will prompt one final 25bp rate cut in December. *(Andrew Hunter)*

**Europe**

The *Swedish krona* tumbled on Tuesday on the back of the release of *unemployment data* for August. The sharp rise in the seasonally-adjusted unemployment rate, to 7.4%, serves as further evidence that the *Riksbank* is unlikely to tighten policy later this year, as it currently forecasts.

UK MPs could yet return to Parliament before 14th October, if the *Supreme Court* hearing (which started on Tuesday) rules that the prorogation of Parliament was unlawful. The hearing is expected to last for three days, with the verdict likely on Friday or early next week. Meanwhile, *inflation* in the UK probably edged down from 2.1% in July to 1.9% in August, and is likely to remain close to the 2% target for the rest of the year. If we are right, there should be little pressure for the MPC to adjust interest rates in either direction at its meeting on Thursday. *(Melanie Debono & Ruth Gregory)*

**Other Developed Markets**

In *Canada*, *manufacturing sales* fell by 1.3% m/m in July, which implies that output in the sector declined for the second month running. Otherwise, we think that headline *inflation* dropped to 1.8% in August, while an average of the Bank of Canada’s three core inflation measures was unchanged.

We think that *GDP* growth in *New Zealand* slumped to just 0.3% q/q in Q2.

We have pencilled in a 10.8% y/y fall in *Japan’s export values* in August. This would be the largest drop since 2016. What’s more, export *volumes* are likely to have fallen more sharply than imports, so *net trade* probably dragged on GDP growth in August. *(Stephen Brown, Marcel Thieliant & Tom Learmouth)*

**Other Emerging Markets**

In Emerging Europe, we think that *retail sales* growth in *Russia* remained sluggish in August, at just 1.0% y/y.

In Latin America, with inflation soft and the economy still weak, *Brazil’s* central bank is likely cut the *Selic rate* by 50bp once again at its meeting on Wednesday. This would take the rate to a historic low of 5.50%.

In Sub-Saharan Africa, the decline in *Nigeria’s inflation* in August strengthens our view that the central bank will cut interest rates in November. Meanwhile, we think that *inflation* in *South Africa* picked up in August. However, given the weak state of the economy, we suspect that the *South African Reserve Bank* will cut its repo rate by 25bp, to 6.25%, on Thursday. *(Liam Peach, Nikhil Sanghani & Virág Fórizs)*

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