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Resurfacing U.S. Slowdown Fears and Impacts on Crude Oil Prices

Ken Koyama, PhD
Director
Strategy and Industry Research Unit
Institute of Energy Economics, Japan

In response to uncertainties over the future course of the world economy, crude oil prices have continued falling. On August 12, the West Texas Intermediate futures price on the New York Mercantile Exchange closed lower at $75.74/barrel, falling for the third straight day. After rising to $82.55/barrel on August 3 following an upward trend that had continued on robust U.S. and European corporate earnings reports since the second half of July, the benchmark crude oil futures price fell back below $76/barrel level in some 10 days. It slipped below the level for the first time since July 8. Particularly, the decline from August 10 was large. What factors were behind the big change?

The factors are resurfacing economic slowdown fears mainly in the United State and Europe, and growing uncertainties about the future world economy. U.S. economic indicators, though including the above-cited robust corporate earnings as a bright sign, have been mixed. Recently, however, markets have gradually grown conscious of negative signs including a possible downward revision to the April-June GDP growth rate and a stall in improvement of employment. On August 10, the Federal Reserve Board released a statement downgrading its economic assessment and decided on an effective additional monetary easing measure to purchase Treasury securities with proceeds from redemptions of mortgage-backed securities that the Fed bought to ease credit in response to the financial crisis following the Lehman Shock. On August 11, U.S. trade data for June came out and indicated that the trade deficit posted a sharp expansion of 19% from the previous month to $49.9 billion on an export slump.

As risk avoidance moves spread on growing fears of a U.S. economic slowdown, New York Stock Exchange prices declined substantially. The Dow Jones Industrial Average on August 11 lost a substantial 265 points from the previous day to 10,389. On August 12, the average extended its losing streak to three days and closed at a three-week low of 10,320. Behind growing fears of a U.S. economic slowdown, market participants and policymakers reportedly have growing fears that the United States would plunge into a Japanese-type deflation. This factor is viewed as having prompted the Fed to take the additional credit easing measure.

While market players tend to focus on the U.S. situation now, the European market still has matters of concern. Although the recent stress test of European banks indicated that they were less undercapitalized than expected, test standards were criticized as too low. In this sense, the future banking system stabilization is still pending as a key challenge. Therefore, currency market players have recently sold euros for dollars, with debt default guarantee fees rising fast in the euro area. Some economists view European economic and financial problems as deeper rooted than U.S. problems.

As risk avoidance moves have thus spread from the United States to Europe and major Asian markets including Japan amid growing fears of a global economic slowdown and rising uncertainties about the future course of the world economy, stock prices have declined. Crude oil prices, which have become a financial instrument, are inevitably susceptible to such trend. Although there have been oil inventory accumulations and other weak supply/demand factors, the recent crude oil price changes have been closely linked to the world economic and financial situations.

The Chinese economic trend has also contributed to growing fears of a slowdown in the world economy including the United States. In China that has various problems such as potential asset bubbles and the yuan issue while driving the world economy, economic indicators released on August 11 posted slower growth in industrial production and fixed asset investment, indicating a decelerating economic growth pace. A key point regarding the Chinese economy is now expected to shift from a fear of overheating to downside risks. As China has so far driven the world economy, any turbulence in the Chinese economy may inevitably spill over to the world economy. Indications are that Japan and the world economy depending on growth in China and other emerging countries are fragile.

Such instability in the world economic and financial situations has begun to exert direct, great impacts on Japan. The Nikkei stock average on the Tokyo Stock Exchange extended its losing streak to five days on August 12 (hitting a year-to-date low below 9,100 briefly), while the yen appreciated against all other major currencies. Some experts have predicted that differences between the stances of Japanese and U.S. monetary authorities, Japan-U.S. interest rate gaps and difficulties with Japan’s unilateral currency market intervention could allow the dollar to fall toward its record low below 80 yen as seen in April 1995. The yen’s rapid appreciation and the sharp stock market decline have put a damper on the Japanese economy that had been recovering on robust exports to such markets as Asia including China. Fears of another economic slowdown have surfaced. Calls may grow for the Bank of Japan and the government to take appropriate, quick policy actions.

Such world economic and financial situations are the most important factor for anticipating international energy markets in the immediate future. This is because crude oil prices have close links with the economic and financial situations over a short term and serve as one of the fundamental factors that exert great impacts on the energy supply/demand structure. As market conditions and perceptions regarding the future economic situation fluctuate sharply, we may see not only the above-cited negative factors but also positive ones causing growing expectations of an economic recovery again. For the immediate future, however, market participants will focus on future developments regarding factors behind fears of a slowdown in the world economy.

Contact: report@tky.ieej.or.jp