**MORNING BRIEFING**
**August 16, 2022**

## Why Are Oil Prices Falling?

*Check out the accompanying chart collection.*

**Executive Summary:** Wondering what brought the price of gasoline and other petroleum products back down toward earth in recent weeks? Our data show it's not Biden's release of crude oil reserves but the effects of previously soaring prices—which depressed demand and sparked production—combined with China's economic slowdown. … Speaking of which: Just when we thought the much-anticipated recession would be a no-show like Godot, he was spotted in China and maybe New York too. Might the US be in for a "rolling recession" à la the 1980s?

**Commodities: Crude Thoughts.** Is the price of petroleum products falling because the Biden administration has been releasing crude oil from the US Strategic Petroleum Reserve (SPR)? Or is the drop attributable to less demand in response to high prices? Consider the following:

(1) *SPR.* At the beginning of April, President Joe Biden announced a "historic" release from the SPR of 1 million barrels a day (mbd) for six months. An April 7 *press release* by the White House said it would be in coordination with other countries' release of an additional 60 million barrels onto the market: "Together with the United States' commitment, this will add a combined global amount of 240 million barrels. It is both the largest release from the United States and the largest release from other IEA [International Energy Agency] countries in history and will support American consumers and the global economy."

In the US, the SPR was 569 million barrels during the last week of March (*Fig. 1* and *Fig. 2*). It fell by 107 million barrels to 462 million barrels during the August 5 week. The press release implies that the White House intends to reduce the SPR by a total of 180 million barrels by the end of September.

(2) *Global demand.* On August 9, the IEA *estimated* that 98.8 mbd of petroleum and liquid fuels was consumed globally in July 2022, an increase of 0.9 mbd from July 2021. The IEA forecast that global consumption of petroleum and liquid fuels will average 99.4 mbd for all of 2022, which is a 2.1 mbd increase from 2021. In addition, the IEA forecast that global consumption of petroleum and liquid fuels will increase by another 2.1 mbd in 2023 to average 101.5 mbd.

In other words, at the consumption rate of 99 mbd worldwide, the release of 240 million barrels over the next six months amounts to a grand total of 2.4 days of extra fuel to run the global economy. Whoop-de-doo!

(3) *US inventories.* During the August 5 week, US inventories of crude oil & petroleum products totaled 1.19 billion barrels (*Fig. 3*). So the SPR is currently just 39% as large as US inventories excluding the SPR, which are currently 3.8% below the year-ago level.

(4) *US production.* High crude oil prices have stimulated more US oil field production, which rose to 12.3 mbd during the August 5 week, the highest pace since the end of March 2020 (*Fig. 4*). We derive a total imputed US production series by subtracting net imports from total petroleum products supplied (including crude oil), which is also used as a measure of total US demand (*Fig. 5*).

Our series shows that the US has been petroleum independent since late 2019, when net imports dropped to zero. During the August 5 week, our implied production series was at a recent near-record 21.1 mbd, while products supplied (usage) was 20.1 mbd. The US exported 1.0 mbd more than was imported that week.

(5) *US consumption.* The data on US petroleum products supplied show that during the August 5 week, it was 400,000 mbd below a year ago (*Fig. 6*). That was mostly attributable to weaker gasoline usage of 8.9 mbd, which was 500,000 below the year-ago usage. Americans have cut back on their consumption of gasoline in response to high prices.

(6) *Prices.* The price of a barrel of Brent crude oil peaked this year at $127.98 per barrel on March 8 (*Fig. 7*). It fell to $94.98 yesterday. The national average retail price of a gallon of gasoline peaked at $5.11 during the June 13 week. It was down to $4.15 during the August 8 week (*Fig. 8*).

(7) *Conclusion.* Our analysis of the data strongly suggests that the Biden administration's release of crude oil from the SPR amounts to a drop in the bucket and doesn't begin to explain why petroleum prices have been falling. Much more significant reasons are the drop in gasoline usage in the US and the ongoing recovery in US crude oil production. Both have occurred in reaction to high petroleum prices. Probably even more significant has been the drop in China's oil demand, as the country seems to be slipping into a recession, as we discuss below.

**Global Economy: Is Godot Hiding Overseas?** Debbie and I have often observed that if the US economy is sinking into a recession or soon will do so, it will be the most widely anticipated recession of all times. It might already have started during the first half of this year since real GDP fell 1.6% during Q1 and 0.9% during Q2. Then again, these declines could easily be revised upward to show that the Bureau of Economic Analysis got the magnitudes right but the signs wrong.

It's possible that we might all collectively talk ourselves into a recession. It's also possible that we are all hunkering down just enough that any recession will be mild since there won't be too many excesses to worsen it. The downturn could be what we called a "rolling recession" during the mid-1980s for the US.

Only yesterday morning, we suggested that waiting for the next recession was like waiting for Godot, who never showed up on stage in the play by Samuel Beckett. But also yesterday morning, we learned that Godot might be hiding in plain sight in China or New York. Before we go there, let's look at the OECD's recently released batch of leading economic indicators for July:

(1) *Total OECD.* The OECD leading indicator has been falling for the past 11 months through July (*Fig. 9*). It fell below 100.0 in April of this year and was down to 99.2 in July. So far, that's more of a soft landing than a hard one for the OECD countries. The major economies of Europe (98.9), Japan (100.5), and the US (99.0) are mostly in sync, though Japan does stand out with a reading above 100.0.

(2) *BICs.* The OECD also compiles leading indicators for Brazil (98.0), China (98.5), and India (100.0) (*Fig. 10*). Yesterday's batch of economic indicators for China suggests that the country's economy might be weakening more rapidly than shown by its OECD leading indicator, as we discuss in the next section.

**China Economy: Hitting The Skids?** A month ago, on July 14, China announced that its real GDP rose just 0.4% y/y during Q2. That was weaker than the 1.0% consensus forecast. It implied that real GDP plunged 11.0% q/q (saar) (*Fig. 11*). The bursting of China's property bubble and its zero Covid restrictions have hammered the economy. July data released yesterday suggest that Q3 could also be a very weak quarter for China's economy. Consider the following:

(1) *Retail sales.* Retail sales rose 2.7% y/y in July, and so did the CPI, so real retail sales were unchanged y/y (*Fig. 12*).

(2) *Industrial production.* Industrial production, meanwhile, rose only 3.8% y/y in July, marginally slower than June's 3.9%, while growth in fixed-asset investments slowed to 5.1% y/y.

(3) *Social financing.* On Friday, we also learned that total social financing, which includes bank loans and is the broadest measure of credit in the economy, was extremely weak in July (*Fig. 13* and *Fig. 14*).

(4) *Policy response.* The People's Bank of China cut its one-year rate by 10bps to 2.75% after the country's sales and production data for July both fell short of expectations. It also trimmed its seven-day reverse repo rate.

(5) *Blackouts.* Beijing is facing a major energy crisis after sweltering heat led to soaring electricity demand across the country as families fired up air conditioners.

Yesterday, all industrial users of electricity in China's Sichuan province—including factories producing metals, chemicals, and other industrial products—were told to shut down or curb their output in a bid to ration power consumption and prevent blackouts among residential populations. The entire province spans 485,000 square kilometers, which is nearly twice as big as the UK.

(6) *Dr. Copper.* The nearby futures price of copper is a very sensitive indicator of global economic activity, particularly in China. It plunged 35.0% from this year's high of $4.94 on March 4 to this year's low of $3.21 on June 14. It rose to $3.71 on August 11 but was back down to $3.61 on the disappointing news out of China.

**US Economy: New York State Of Mind.** Yesterday, we might have spotted Godot in New York. The Federal Reserve Bank of New York released its July regional business survey. It was shockingly weak, as we reviewed in yesterday's *QuickTakes*.

The headline general business conditions index plummeted 42.4 points to -31.3. New orders and shipments plunged, and unfilled orders declined. Delivery times held steady for the first time in nearly two years, and inventories edged higher. Labor market indicators pointed to a small increase in employment but a decline in the average workweek. The only good news was that the region's prices-paid and prices-received indexes declined sharply last month.

We concluded: "Let's see August's business survey for the Fed's Philly district on Thursday before jumping to any conclusions. If it is as bad as the NY one, recession fears could make a fast comeback, which would weigh on stock prices, commodity prices, bond yields, and the dollar." Let us know if you happen to see Godot anywhere else.

## Calendars

**US: Tues:** Headline & Manufacturing Industrial Production 0.3%/-0.1%; Capacity Utilization Rate 80.1%; Housing Starts & Building Permits 1.54mu/1.64mu; API Crude Oil Inventories. **Wed:** Retail Sales, Total, Core, and Control Group 0.1%/-0.1%/0.6%; Business Inventories 1.4%; MBA Mortgage Applications; Cushing Crude Oil Inventories; FOMC Minutes; Bowman. (Bloomberg estimates)

**Global: Tues:** ZEW Eurozone Economic Sentiment; Germany ZEW Economic Sentiment & Current Conditions -52.7/-48.0; UK Average Earnings Including & Excluding Bonus 4.5%/4.5%; UK Employment Change & Unemployment Rate 253k 3m/3m/3.8%; Canada CPI 0.1%m/m/76%y/y; Canada Housing Starts 265k; Japan Core Machinery Orders 1.3%m/m/7.5%y/y; Japan Trade Balance -¥1.405b; Australia Wage Price Index 0.8%q/q/2.7%y/y. **Wed:** Eurozone GDP 0.7%q/q/4.0%y/y; Eurozone Employment; UK Headline & Core CPI 0.4%m/m/9.8%y/y & 0.2%m/m/5.9%y/y; UK PPI Input & Output 1.4%m/m/23.9%y/y & 0.8%m/m/16.2%y;y; Australia Employment Change 25k; Australia Unemployment & Participation Rates 3.5%/66.8%. (Bloomberg estimates)

## Strategy Indicators

**S&P 500/400/600 Forward Earnings** (*link*): Last week, forward earnings fell w/w for SmallCap, but rose for LargeCap and MidCap. LargeCap's gain was its first in five weeks, and MidCap's was its second following three straight declines. For a seventh straight week, none of these three indexes had forward earnings at a record high. LargeCap's forward earnings is now 1.3% below its record high at the end of June. MidCap's has dropped in six of the past nine weeks and is 0.6% below its record high in early June. SmallCap's six declines in the past eight weeks puts it 1.6% below its record high in mid-June. In the latest week, the rate of change in LargeCap's forward earnings fell to a 16-month low of 11.4% y/y from 11.9%; that's down from a record-high 42.2% at the end of July 2021 and up from -19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in

MidCap's forward earnings dropped w/w to a 16-month low of 23.6% y/y from 24.2%. That's down from a record high of 78.8% at the end of May and compares to a record low of -32.7% in May 2020. SmallCap's rate fell to a 17-month low of 19.9% y/y from 21.8%. It's down from a record high of 124.2% in June 2021 and up from a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' consensus earnings forecasts for 2021 to 2023 to improve instead of decline as is typical, but their forecasts are likely to head lower now. Here are the latest consensus earnings growth rates for 2022 and 2023: LargeCap (8.4%, 8.0%), MidCap (15.6, 3.2), and SmallCap (12.8, 8.3).

**S&P 500/400/600 Valuation** (*link*): Valuations rose for all three of these indexes last week to their highest levels since late April. LargeCap's forward P/E rose 0.6pts to 18.1 from 17.5 a week earlier, which compares to a 26-month low of 15.3 in mid-June and a six-month high of 21.5 in early November. LargeCap's forward P/E also compares to an 11-year low of 11.1 during March 2020. MidCap's was up 0.5pts w/w to 13.2 from 12.7, which is up from a 27-month low of 11.1 in mid-June. That's down from a 13-week high of 17.1 in early November. It had been at a record high of 22.9 in June 2020 and an 11-year low of 10.7 in March 2020. SmallCap's was up 0.5pts w/w to 12.8 from 12.3, up from its mid-June reading of 10.7, which was the lowest since it bottomed at a record low of 10.2 in November 2009 during the Great Financial Crisis. That compares to a 13-week high of 16.1 in early November and its record high of 26.7 in early June 2020 when forward earnings was depressed. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017; MidCap's current 27% discount to LargeCap is near its biggest since September 2000. SmallCap's P/E was below LargeCap's for a 104th straight week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 29% reading is near its biggest discount since February 2001. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 61st straight week; the current 3% discount is up from a 9% discount in December but remains near its lows during 2000-01.

**S&P 500 Sectors Quarterly Earnings Outlook** (*link*): Since the Q3-2020 earnings season, analysts as a whole have been raising their consensus forecasts for future quarters instead of lowering them as is the norm through the earnings warnings seasons. That six-quarter streak of positive revisions throughout the quarter officially ended with Q1-2022, and the declines have accelerated for Q3-2022. In the latest week, the Q3-2022 S&P 500 earnings-per-share forecast fell 39 cents w/w to $56.66, and is now 4.8% below its $59.49 forecast at the start of the quarter. Analysts expect S&P 500 earnings growth to weaken to 5.1% y/y on a frozen actual basis and 5.8% on a pro forma basis. That's down from Q2-2022's blended actual/estimate of a 10.0% y/y gain on a frozen actual basis and 9.7% y/y on a pro forma basis. Double-digit percentage growth is expected for just four sectors in Q3-2022, and y/y declines are expected for six. That compares to Q2-2022's count of four sectors with double-digit growth, three with a single-digit gain, and four with a y/y decline. Here are the S&P 500 sectors' latest earnings growth rates for Q3-2022 versus their blended Q2-2022 growth rates: Energy (121.7% in Q3-2022 versus 296.8% in Q2-2022), Industrials (28.2, 32.0), Consumer Discretionary (19.9, -12.8), Real Estate (10.3, 13.0), Materials (7.0, 17.4), S&P 500 (5.8, 9.7), Information Technology (-2.0, 2.9), Consumer Staples (-2.4, 0.9), Health Care (-3.8, 8.9), Utilities (-6.1, -3.7), Financials (-9.2, -19.1), and Communication Services (-14.9, -11.9).

## US Economic Indicators

**Regional M-PMI** (*link*): The New York Fed has provided the first glimpse of manufacturing activity for August and showed growth contracted sharply after moving back into expansionary territory in July. Meanwhile, the outlook over the next six months shows firms were not optimistic. August's composite index tumbled 42.4 points to -31.3 after jumping the prior two months by 22.7 points—from -11.6 in May to 11.1 in July. Both the new orders (to -29.6 from 6.2) and shipments (-24.1 from 25.3) measures plummeted this month, and unfilled orders (-12.7 from -5.2) continued to decline. Meanwhile, delivery times (-0.9) held steady for the first time in nearly two years, and inventories (6.4 from 14.8) continued to expand, though at a slower pace. As for the labor indicators, employment (7.4 from 18.0) continued to expand, though at less than half July's pace, while the average workweek (-13.1 from 4.3) declined for the first time since summer 2020. Looking at prices, the prices-paid index eased further from April's record-high 86.4, falling to a 19-month low of 55.5 this month, while the prices-received measure (32.7) was little changed from July's 16-month low of 31.3, down from its record high of 56.1 in March. Looking ahead, the best that can be said about the index of future business conditions is that it returned to positive territory, though barely, climbing to 2.1 this month from -6.2 last month—which was the second weakest reading in the history of the series. Both orders and shipments improved but remained at low levels, while employment is expected to pick up and delivery times are predicted to decline over the next six months. Both the prices-paid (49.1 from 43.5) and prices-received (43.6 from 28.7) measures accelerated, though remained considerably below their record highs of 76.7 and 62.1 during January despite the latter's noticeable move up.

**NAHB Housing Market Index** (*link*): "Tighter monetary policy from the Federal Reserve and persistently elevated construction costs have brought on a housing recession," noted Robert Dietz, NAHB's chief economist. He expects single-family starts to fall this year—which would be the first decline since 2011. Homebuilder's confidence dropped for the eighth time this year, by 6 points in August and 35 points ytd, to 49—the lowest level since May 2020 during the height of the pandemic. All components continued their descents in August, with current sales (-7points) posting the biggest decline this month, followed by traffic of prospective buyers (-5) and future sales (-2). Year-to-date, traffic of prospective buyers (-39 points to 32) posted the largest decline, followed closely by future sales (-38 to 47) and current sales (-33 to 57), with all falling to their lowest levels since May 2020. They were all at record highs of 77, 89, and 96 respectively during November 2020.

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