Yardeni Research

MORNING BRIEFING
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Oil Markets & AI In HR

Check out the accompanying chart collection.

Executive Summary: Oil futures leapt this week after OPEC+ announced it would cut oil production. Jackie examines possible reasons for the organization's decision and likely ramifications for Saudi Arabia, the US, and US oil producers. … Also: Judging by the 8% surge in the S&P 500 Oil & Gas Exploration & Production price index over the past week, investors expect the production cuts will mean much better 2023 earnings prospects than the declines that analysts had been expecting. … And: What can't bots do? Our Disruptive Technologies segment focuses on the use of AI to interview job candidates.

Energy I: Third Time's the Charm? The oil production cuts by OPEC+ this week mark the third time since the fall that the organization or one of its members has reduced the amount of oil hitting the market—but it's the first time that the market sat up and paid attention.

Production cuts began in October, when OPEC+ reduced supply by 2.0 million barrels per day (mbd). Then in February, Russia announced that it would reduce production by 0.5 mbd in March, and when March arrived, Russia extended the cuts through the end of June. But the oil market shrugged off both production cuts because economic growth and demand for oil was expected to slow. Central bankers around the world were busy raising interest rates to fight inflation, and then the banking crisis arrived last month, sparking fears of a global recession. Despite the oil production cuts, the price of Brent crude oil futures fell from a November 4 high of $98.57 to a low of $72.97 on March 17 (*Fig. 1*).

It took a third production cut on Sunday to grab investors' attention. Saudi Arabia and other OPEC+ members announced plans to cut production by another 1.2 mbd from May through year-end. Together, the three cuts take roughly 3.7% of the world's oil off the market. And the oil market has responded: The price of Brent crude oil futures has jumped to $84.94 as of Tuesday's close, up $5.17 from before Sunday's cut and up $11.97 from its recent low on March 17.

In making its decision, OPEC+ may have been considering the oversupply of crude in the market as well as the softening US economy. Let's take a look at both factors:

(1) *A well supplied market.* Before Sunday's production cuts, the US Energy Information Administration (EIA) expected global oil inventory buildups this year and next because it thought production would continue to outpace consumption, according to the agency's March 7 *Short-Term Energy Outlook*. Specifically, the agency estimates global consumption of liquid fuels of 100.9 mbd this year, less than the 101.6 mbd it had expected to be produced, followed by consumption of 102.7 mbd and production of 103.2 mbd next year (versus 99.4 mbd and 100.0 mbd last year). Those production estimates obviously will need to be revised given OPEC's move on Sunday.

The 1.5 mbd y/y increase in expected 2023 consumption comes from China (0.7 mbd), India (0.2 mbd), and other non-OECD countries (0.5 mbd). Consumption by OECD countries is expected to remain largely unchanged "as the effects of inflation continue to limit GDP and oil demand growth." Next year, most of the consumption increase (1.6 mbd of the 1.8 mbd forecasted increase) also comes from non-OECD countries.

(2) *Prices were expected to fall.* As of March 7, the EIA had expected the spot price of Brent crude oil would drop from 2022's average of $100.94 per barrel to $82.95 this year and $77.57 in 2024. Those estimates will most likely be revised upwards, as OPEC+ has drawn a new line in the sand.

"Before previous production cuts announced in October, Saudi officials said they believed economic data indicated that the government budget required $90 to $100 a barrel for Brent crude, above the $75 to $80 range the kingdom was targeting," an April 3 *WSJ* *article* reported.

(3) *Anticipating a softening US economy.* It's possible that OPEC+ oil ministers expected the economic soft landing that appears to have arrived in the US. The regional manufacturing purchasing managers index came in decidedly negative last month, sinking to its lowest level in nearly three years. It was below the break-even point of 50.0 for the fifth successive month, and even the red-hot service sector slowed, with March's reading of 51.2 coming in below the previous reading of 55.1.

Jobs were still plentiful in February, though there were fewer job openings (9.9 million) than last March, when openings were at a record-high 12.0 million. And the 10-year Treasury yield fell to 3.35% on Tuesday, down from its recent peak of 4.08% on March 2 (*Fig. 2*).

Energy II: Politics Behind the Cuts. The tangled webs binding Saudi Arabia, China, Russia, and the US make oil prognosticating more involved than counting barrels of oil produced and consumed. Let's take a look at some of the actors in this drama and what Saudi Arabia's cuts on Sunday will mean to them:

(1) *Saudis and US at odds.* President Joe Biden got off on the wrong foot with Saudi Arabia's Crown Prince Mohammed bin Salman before landing in the White House. As a presidential candidate, Biden in a debate pledged to make Saudi Arabia a "pariah" because the Crown Prince was considered responsible for the killing of prominent dissident and Washington Post columnist Jamal Khashoggi. As president, Biden tried to sidestep the Crown Prince, who essentially runs the country, and work instead with his 85-year-old father King Salman. It's doubtful that Biden's attempt to repair the damage last year by visiting the country and fist-bumping the Crown Prince erased memories of the "pariah" comment.

The Saudi production cuts could push US gasoline prices to $4 a gallon, according to some analysts, and that could hurt the US in several ways, pressuring US inflation higher, slowing the US economy, and making the Federal Reserve's job tougher. Higher costs related to oil prices could weigh on US consumption as well as corporate margins and profits.

(2) *Saudis help Saudis.* Higher oil prices will help fund Saudi Arabia's ambitious domestic projects aimed at boosting economic growth and diversifying the country's economy beyond its dependency on black gold. Among its projects, Saudi Arabia is constructing a new, $500 billion city in the desert that's 33 times bigger than New York City and it's building a Red Sea resort the size of Belgium.

Saudi Arabia also appears to be trading its relationship with the US for one with China, the world's second largest consumer of oil. Last week, Saudi Arabia's cabinet approved a plan to join the Shanghai Cooperation Organization (SCO) as a dialogue partner, an April 4 *article* on Oilprice.com reported. SCO is one of the world's largest political, economic, and defense organizations. "It was formed in 2001 on the foundation of the 'Shanghai Five' that was set up in 1996 by China, Russia and three states of the former USSR (Kazakhstan, Kyrgyzstan, and Tajikistan)," the article explains. The organization believes we live in a multi-polar world that China expects to dominate by 2030.

(3) *Saudis help US producers.* If the OPEC+ cuts continue to keep oil prices high, it could raise the cash flows and earnings of US oil companies and shale drillers. Shale producers have been keeping their production relatively flat and returning excess cash to investors or repurchasing stock instead of using it to increase production.

"US production growth is less than half of what it was before 2020, with overall output yet to return to pre-pandemic levels. Major forecasters see growth of just 500,000 barrels a day or so this year from the Permian Basin, the country's fastest-growing shale field, less than half of the more than 1 million barrels a day of cuts announced by OPEC+ on Sunday," an April 4 Bloomberg *article* reported.

Higher oil prices may tempt shale producers to produce more, if they can access the equipment and materials necessary, the article noted. The US rig count at 592 is near a recent peak of 627 during the weeks of November 25 and December 2, but it's well below the 2014 peak of 1,609. US oil production has risen to 12.2mbd, well off its Covid lows but still 900,000 barrels off its pre-pandemic highs (*Fig. 3*).

(4) *Saudis help Russia.* Saudi Arabia's production cuts have increased the price of crude oil by roughly $5 a barrel, and that means more cash flowing into Russia's coffers to fund its war with Ukraine. It's exactly what the US and European countries were trying to prevent by placing caps on the price of oil that Russia sells.

"Every $1 increase in the price of crude oil boosts Russian export revenues by about $2.7 billion a year," reported an April 4 *article* in The Telegraph, which cites Benjamin Hilgenstock, author of a report on Russian sanctions for the Centre for Economic Policy Research, a think tank.

The OPEC move is also interpreted as the organization's embrace of Russia and China as it shuns the US and other Western nations. The shift makes sense considering that future demand for oil is expected to come from Asian nations and not from the West.

(5) *Saudis help EV producers.* Electric vehicle (EV) sales have been picking up nicely in the US and globally, but they're likely to receive a boost if gas prices rise due to the OPEC+ production cuts. There's nothing like paying $4 a gallon at the pump to convince car buyers to give EVs a shot.

GM sold 20,000 EVs in Q1, expects to sell another 30,000 EVs this quarter, and anticipates selling twice those amounts during the H2-2023 quarters, an April 3 CNBC *article* reported. It's a pittance compared to GM's total Q1 car deliveries of just over 600,000. But the Q1 growth occurred despite falling gas prices.

Jackie and three of her friends each have purchased EVs or plug-in hybrid vehicles over the past year or so. That has prompted us to keep tabs on a chart that shows the number of miles driven by all motor vehicles plateauing after rebounding from Covid lows, while gasoline usage has fallen 4.6% from its recent peak on March 25, 2022 (*Fig. 4*).

Use of mass transit is also slowly recovering from the pandemic, when everyone opted to stay home or drive places in their cars. New York City subway trips rose to 84.3 million in February, which was 65% of the pre-pandemic February 2019's ridership levels but up decently from the prior three Februarys' ridership counts relative to pre-pandemic levels: 37% in 2020, 48% in 2021, and 56% in 2022, according to a March 16 *report* from the NYC Comptroller. Weekend ridership has been closer to 2019 levels than weekday ridership, indicating that further improvement may require more people returning to the office full time.

Energy III: Shares Jump. Last week's cut in oil production has energized the S&P 500 Energy sector's price index. For the week ending Tuesday, Energy is the S&P 500's top performing sector, up 5.7% compared to the S&P 500's 3.3% gain over the same period. Certain industries within the sector had even better performance stats over the past week: Oil & Gas Exploration & Production (8.0%), Integrated Oil & Gas (6.7), and Oil & Gas Equipment & Services (6.0). The only major underperformer: Oil & Gas Refining & Marketing (-3.9).

Given the recent jump in Oil & Gas Exploration & Production shares, investors seem to be betting that analysts' current earnings and revenues estimates are likely to get upwardly revised. Current estimates suggest y/y declines in the industry's revenues and earnings this year after both leapt last year—revenues down 14.9% in 2023 after jumping 54.3% in 2022 and earnings down 16.5% this year after having risen 122.8% last year (*Fig. 5* and *Fig. 6*). These estimates imply a forward profit margin that slumps from a 12-year high of 34.4% last June to 26.5% over the next 12-months (*Fig. 7*). But if the production cuts mean what investors seem to think they do, the industry's outlook may not be so pessimistic.

Disruptive Technologies: The AI Job Interview. Human resources departments have long used computer algorithms to scroll through stacks of resumes to identify the best candidates for a job. More recently, hiring pros have begun using artificial intelligence (AI) programs to judge recorded job interviews. Between 35%-45% of companies are expected to use "AI-based talent acquisition software" to evaluate job candidates in the coming year, a January 12 *article* in *Computerworld* reported.

In an AI interview, job candidates sitting in front of a computer are asked to respond rapidly to questions from the company. Responses are recorded and evaluated by AI systems. The candidate may be judged on visual or verbal cues, like how often they smile, use certain words, or their tone. AI programs might use data on these cues collected from past hires to determine whether the interviewee will be a good hire, a February 7 *article* in the *Harvard Business Review* explained.

The automated process should save recruiters time and money. Fans believe AI programs will be unbiased, or at least they should have fewer biases than their human counterparts. But others caution that AI systems may reflect the biases of their programmers, and because the AI is in a black box, interviewees won't know what those biases are.

Colleges have been offering students training to prepare for this new method of interviewing. It's just one more hoop that job applicants need to jump through before seeing an actual HR professional.

Calendars

US: Thurs: Initial & Continuous Jobless Claims 200k/1.699m; Fed's Balance Sheet; Baker-Hughes Rig Count; Natural Gas Storage. **Fri:** Payroll Employment Total, Private, and Manufacturing 240k/215k/5k; Average Hourly Earnings 0.3%m/m/4.3%y/y; Average Weekly Hours 34.5; Unemployment Rate 3,6%; Consumer Credit $19.0b. (Bloomberg estimates)

Global: Thurs: Germany Industrial Production 0.1%; UK Halifax Price Index -0.3%; Canada Employment Change 12k & Unemployment Rate 5.1%; Japan Household Spending -0.4%m/m/4.3%y/y. **Fri:** France Trade Balance; Japan Leading & Coincident Indicators; Tenreyro. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* climbed for the second week to 1.94 this week—the highest reading since the January 4 week last year—after falling the prior two weeks from 1.83 to 1.38. *Bullish* sentiment increased for the second week, jumping to 48.6% this week, equaling the end-of-January peak, which was the most since the end of 2021. Bulls outnumbered bears for the 20th consecutive week. *Bearish* sentiment fell for the second week to 25.0% this week, after a two-week climb from 24.7% (the fewest bears since January 2022) to 28.8%. Recent readings are well below the 44.1% reading in early October of last year. The *correction count* dropped 6.0ppts this week—from 32.4% to 26.4%—remaining well below its late September 2022 peak of 40.3%. Turning to the AAII Sentiment Survey (as of March 30), bearish sentiment fell but remained above average for the sixth successive week, while both bullish and neutral sentiment moved higher. The *percentage expecting stock prices to rise* over the next six months mover higher for the second week to 22.5%, after dropping from the prior two weeks from 24.8% to 19.2%—which was the lowest since the September 22, 2022 week's 17.7% reading. Still, optimism was at an unusually low level for the sixth successive week and the 46th time in the past 65 weeks. It's below its historical average of 37.5% 69 of the last 71 weeks. The *percentage expecting stocks to fall* over the next six months sank 2.8ppts to 45.6%. Pessimism was at an unusually high level for the fifth straight week and for the 44th time in the past 65 weeks; it's been above its historical average of 31.0% for 66 of the past 71 weeks. The *percentage expecting stock prices will stay essentially unchanged* over the next six months ticked up to 31.9% after slipping the prior two weeks from 33.4% to 30.2%, putting neutral sentiment back above its historical average of 31.5%, after slipping below the prior week for the first time since December 29, 2022's 25.9%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin was unchanged w/w at a 24-month low of 12.3% during the March 30 week. That's down 1.1ppts from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.0pts above its seven-year low of 10.3% during April 2020. Forward revenues fell 0.3% w/w from its record high during the March 23 week. Forward earnings fell 0.1% w/w to 5.7% below its record high during the June 16, 2022 week. Both had been steadily making new highs from the beginning of March 2021 to mid-June; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth remained steady w/w at 2.6%, barely above its 33-month low of 2.3% during the February 23 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth of 4.1% was down 0.1pt w/w, but remains above its 31-month low of 3.5% in mid-February. That's down from its 23.9% reading at the end of April 2021, which was its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 1.6% in 2023 (down 0.1pt w/w) and 4.9% in 2024 (up 0.1pt w/w) compared to a revenues gain of 12.2% in 2022. They expect earnings decline of 0.1% in 2023 (down 0.3pts w/w) and a 12.1% rise in 2024 (up 0.1ppt w/w) compared to an earnings gain of 7.2% in 2022. Analysts expect the profit margin to drop 0.2ppt y/y to 12.0% in 2023 (unchanged w/w) compared to 12.2% in 2022 and to rise 0.8ppt y/y to 12.8% in 2024 (down 0.1ppt w/w). The S&P 500's weekly reading of its forward P/E rose 0.4pt w/w to 17.9, and is just 0.6pt below its 43-week high of 18.5 during the February 16 week. That's up from a 30-month low of 15.3 in mid-October. It also compares to 23.1 in early September 2020, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio rose 0.05pt w/w to 2.20 and is down from a 24-week high of 2.29 during the February 16 week. That's up from a 31-month low of 1.98 in mid-October and down from a four-month high of 2.38 in mid-August, and also compares to a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Looking at the 11 S&P 500 sectors, the March 30 week saw consensus forward revenues rise for seven sectors and fall for four. Forward earnings rose for just two sectors and fell for nine. Similarly, the forward profit margin rose w/w for two sectors and fell for nine. Two sectors have forward revenues at a record high this week: Consumer Staples and Utilities. Among the remaining nine sectors, only three have forward revenues more than 5.0% below their post-pandemic highs: Consumer Discretionary, Energy, and Financials. Consumer Staples is the only sector with forward earnings at a record high. Among the remaining 10 sectors, just two have forward earnings that remain relatively strong, down less than 5.0% from their post-pandemic highs: Industrials and Utilities. Since mid-August, all sectors have seen forward profit margins retreat from their record highs. Those of Industrials and Tech remain closest to their post-pandemic highs. Energy and Industrials were the only two sectors to have their profit margins improve y/y for full-year 2022, and these five sectors are expected to improve y/y in 2023: Communication Services, Consumer Discretionary, Financials, Industrials, and Utilities. Here's how they rank based on their current forward profit margin forecasts along with their record highs: Information Technology (23.3%, down from its 25.4% record high in June 2022), Financials (18.4, down from its 19.8 record high in August 2021), Real Estate (16.6, down from its 19.2 record high in 2016), Communication Services (14.5, down from its 17.0 record high in October 2021), Utilities (13.2, down from its 14.8 record high in April 2021), S&P 500 (12.3, down from its record high of 13.4 achieved intermittently in 2022 from March to June 2022), Energy (11.7, down from its 12.8 record high in November), Materials (11.0, down from its 13.6 record high in June), Industrials (10.3, down from its 10.5 record high in December 2019), Health Care (9.6, down from its 11.5 record high in March 2022), Consumer Discretionary (7.3, down from its 8.3 record high in 2018), and Consumer Staples (6.7, down from its 7.7 record high in June 2020).

US Economic Indicators

ADP Employment (*link*): "Our March payroll data is one of several signals that the economy is slowing," noted Nela Richardson, chief economist, ADP. "Employers are pulling back from a year of strong hiring and pay growth, after a three-month plateau, is inching down.” *Private payrolls* in March fell short of expectations, adding 145,000 (vs 200,000 expected), though February payroll gains were revised higher to 261,000 from 242,000 jobs. Total payrolls continued to reach new record highs in March, as employment in service-providing and goods-producing industries rose 75,000 and 70,000, respectively, both to new record highs, though the pace slowed from February gains of 151,000 and 110,000. Within *service-providing* industries, leisure & hospitality (+98,000) once again posted the largest gain, followed by trade, transportations & utilities (+56,000), education & health services (+17,000), and other services (+8,000). Financial activities’ jobs declined for the fourth consecutive month, by 51,000 during March and 84,000 over the period, while jobs in professional & business services were cut for the second month, by 46,000 last month and 106,000 over the period. It was the first declines in the latter since July 2020. *Goods-producing* industries saw a 53,000 increase in construction jobs in March, following a 50,000 gain in February, while jobs in natural resources & mining posted gains the first three months of this year, by 47,000 in March and 103,000 over the period. Meanwhile, manufacturing lost 30,000 jobs last month, after a three-month gain of 55,000, holding in record territory—within 69,000 of January 2019’s record high. Turning to ADP’s median *annual pay* measures, the yearly rate for *job-stayers* slowed to a 14-month low of 6.9% in March, down from last September’s 7.8% peak, while the rate for *job-changers* eased to 14.2%, 2.2ppts below last June’s 16.4% peak.

US Non-Manufacturing PMIs (*link*): Demand cooled in the US service sector in March, with the NM-PMI sinking to 51.2, down from 55.1 and 55.2 in February and January, respectively. It had dipped to 49.2 in December, which was the lowest since May 2020. It remained above the 49.9 level that ISM says over time indicates growth in the overall economy. Meanwhile, inflationary pressures eased to a three-year low. Of the four components of the NM-PMI, the forward-looking *new orders* gauge slowed to 52.2 in March after shooting up to a 15-month high of 62.6 in February. It had slipped below 50.0 in December (45.2) for the first time since the pandemic. The *business activity* measure slowed for the second month to 55.4 from 60.4 at the start of the year, though remained relatively strong. The service sector’s *employment* (51.3 from 54.0) gauge showed a slowing in job growth in March, though was above the 49.4 reading at the end of 2022. Meanwhile, the *supplier deliveries* component sank to 45.8—indicating the fastest delivery performance since April 2009! On the *inflation* front, the price index continued to ease, slowing to a 32-month low of 59.5 last month; it was at a record-high 84.5 at the end of 2021. The service sector’s report comes on the heels of the ISM’s manufacturing report, which showed growth in March contracted at the fastest pace in nearly three years, dropping to a 34-month low of 46.3, and was below the break-even point of 50.0 for the fifth successive month.

Merchandise Trade (*link*): The *real merchandise trade deficit* widened for the third month in February to $104.6 billion after narrowing from $112.4 billion last October to $96.1 billion in November. The deficit the first two months of this year averaged $103.2 billion, compared with an average monthly deficit of $102.2 billion during Q4-2022, suggesting that trade had little impact on real GDP during Q1; it contributed only 0.42ppt to Q4's 2.6% GDP's growth. *Real exports* in February fell 4.1% after a two-month gain of 5.1%, while real imports fell 1.5% in February after gains of 3.6% and 1.7% the prior two months. They had plunged 7.3% in November. Looking at real exports versus a year ago, they're up 5.7%, with exports of other goods (23.2%) posting the biggest gain, followed by exports of automotive vehicles, parts & engines (7.8%), industrial supplies & materials (7.2), nonfood consumer goods ex autos (4.4), and capital goods ex autos (2.9), with only exports of foods, feeds & beverages (-3.3) falling versus a year ago. As for *real imports*, they were basically flat versus a year ago, with automotive vehicle, parts & engines (16.0) posting a double-digit gain, by followed other goods (5.6) and capital goods ex autos (2.7), while imports of nonfood consumer goods ex autos (-11.8) dropped sharply, and imports of and foods, industrial supplies & materials (0.1) and food, feeds & beverages (-0.5) showed little change from a year ago.

Global Economic Indicators

Germany Factory Orders (*link*): Orders in February climbed for the third month since slumping to a 27-month low last November. *Manufacturing orders* jumped 4.8% during February and 7.3% over the three months through February to a seven-month high. *Foreign orders* rebounded 9.3% over the first two months of this year, after sliding four of the final five months of 2022 by 9.4%, to its lowest level since July 2020. *Foreign orders from outside* the Eurozone soared 11.5% the first two months of this year, to its highest level since last February, after sliding four of the final five months of 2022 by 9.4%. Meanwhile, *foreign orders from within* the Eurozone rebounded 8.9% in February after falling 2.6% and rising 7.9% the prior two week, to its best level since last July. *Domestic orders* remain volatile around recent lows, jumping 5.6% in January following a 5.4% loss and a 4.6% gain the previous two months. *Versus a year ago*, total orders are down 5.7%, with domestic and foreign orders down 4.0% and 6.8%, respectively. Within foreign orders, billings were up 1.0% y/y within the Eurozone, the first positive reading in seven months; orders from outside the Eurozone were 11.4% below a year ago. Here's a look at the movements in domestic orders, along with the breakdown from both inside and outside the Eurozone, for the main industry groupings, respectively, versus a year ago: capital goods (-0.6, 13.9, -14.1), intermediate goods (-6.4, -15.0, -5.0), consumer durable goods (-11,2, -4.0, -2.8), and consumer nondurable goods (-13.3%, -6.9%, -7.2%).

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102