GLOBAL
ECONOMY

10/18

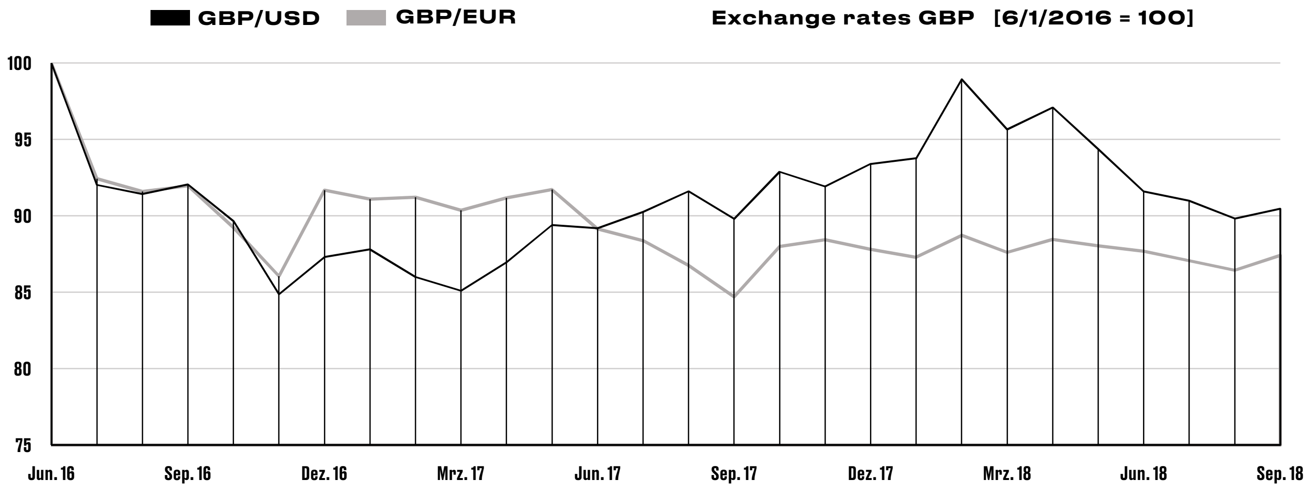
# US frackers faced with bottleneck fail to limit rising oil prices

# India brings in its own tariffs in effort to buttress rupee

J.S. Research

## Salzburg deals blow to Brexit deal while Ireland shortens the odds

When the affront came, it hit home with a thunder: On a summit at Salzburg, EU leaders told Theresa May bluntly that her Chequers plan, having been secured in her cabinet after much infighting and the loss of two Secretaries of State only, was inacceptable. But the harsh reaction by the EU27 didn't stop there: The UK was told, too, that if there wasn't a substantially improved offer on the table until the next summit on 18 October, there would not be any special summit in November to finalise and strike a Brexit deal. In other words: Deliver or it's no deal. Amidst the pounding of Theresa May, France administered particularly hard blows: After Emmanuel Macron had struck down the Chequers proposal in particularly forthright terms, his finance minister doubled down on the message, saying that agreeing to Chequers would be tantamount to the "end of Europe" - by creating a cherry-picking precedent for other EU rebels to follow. That was a devastating blow to the UK Prime Minister who had seemingly come to expect some sort of counter-proposal on the basis of Chequers alright, but not an outright rejection of the whole plan with no suggestion in its place. Visibly taken aback and, after some time had lapsed, increasingly furious, she opted for a counter-attack as the best defence, issuing the EU27 with an ultimatum on her own by demanding a detailed explanation as to the reasons why her Chequers proposal had been rejected, or else the UK would withdraw from the negotiations. The Brexit process, hence, has reached fever pitch, yet not in a constructive mood, but rather with both sides increasingly entrenched along their respective red lines. Point is: From here, it'll only become more difficult. That's because in Britain, party conference season is upon us, where all parties and thus both majors, too, hold their annual gatherings to discuss and declare their political platforms, should there be another general election in the months ahead. In a decidedly tactical, undogmatic approach, Labour left the door ajar to a second referendum on the UK's membership in the European Union, a possible u-turn on the exit decision included. Though the party's leadership has gotten its will that Labour strives for another general election rather than a second referendum, the latter remains on the table if no snap election is called – which is what the Prime Minister is professing. In any case, both a snap election and a second referendum



Data: comdirect

would need a majority in the Commons, so that in either case, Theresa May's government would have to collapse first, just as we have been anticipating for months. Far from giving up on her cherished Chequers plan, and in dogged defiance of her party detractors, the Prime Minister has sprung a major surprise when she declared that a no-deal Brexit would be preferable to a Canada-style agreement – the latter being the option of choice of the Brexiteers grouped around Jacob Rees-Mogg, David Davis and Boris Johnson. Then, in a surprising move just at the beginning of this month, Ireland signalled that it now supports Theresa May's all-UK solution for the so-called backstop included in the withdrawal agreement in case negotiations on future trade relations after March 2019 should fail: That backstop has been the last major snag on the road towards a deal agreed in Brussels, because the EU27 so far insisted on such a backstop solution with regard to customs affairs to encompass Northern Ireland only. Should the EU27 fall in line behind Ireland, a Brussels Brexit deal is at hand – yet only to fail in the Commons, as we continue to project after party conference season in Britain.

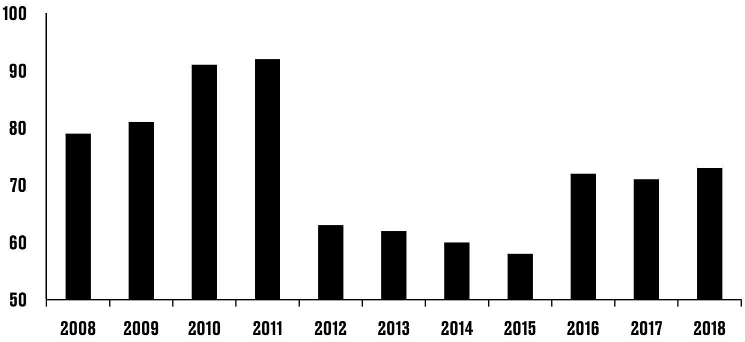
## US shale locked up in Texas leaves room for next round of inflation

Crude oil is a peculiar stuff. It comes in different sorts and proveniences, still dominates the supply of the world's hunger for energy, and is in the annoying habit of spiking in value just at the wrong time. Ever since so-called hydraulic fracturing or "fracking" changed the map of oil producers, the weal and woe of US frackers has become as important to the stuff's global market as that Vienna-based cartel, OPEC. The latter has seen successfully to its members cutting production levels so that prices recover from their multi-year troughs, creating the moment when most analysts would have expected US shale oil to flood onto the market to fill the gap. But not so. Insufficient pipeline capacity in West Texas, where one of the epicentres of the shale boom, the Permian Basin is located has led to a bottleneck damming up millions of barrels of oil in the Lone Star State and neighbouring Oklahoma. Output in West Texas has risen more than 50 per cent in the last two years alone, and has completely outstripped transport capacity to both refineries and export terminals. New pipelines, alas, will not come online until the end of 2019. All that, of course, has started to tweak prices of the different sorts of crude: The spread between the international benchmark Brent and the US yardstick West Texas Intermediate (WTI) has risen to multi-year highs. This leaves the shale business in a strange situation: After the dire sobering that followed the wild exuberance in the years until 2014, frackers have clamped down on production cost and efficiency, restraining capacity in the process. Now that they have been recuperating in a benign market, they cannot sell much of their production because they cannot reach their customers. Hence, expect that spread to widen, with US oil remaining relatively cheap, but locked up, while Brent keeps rising. Whether US President Donald Trump mis-judged that domestic development or not when he levelled new sanctions against a major oil producer, Iran at the same time when production elsewhere, for example in Venezuela came crashing down – it certainly helps to explain his frantic calls for Russia and OPEC to expand production to get down those "excruciating oil prices". As much as they would like, US shale producers won't be able to come to the rescue any time soon, while persistently high energy prices begin to trigger the next round of rising inflation. Dearer oil also puts much pressure on e-merging economies such as India (see related article in this issue) which struggle to balance increasing import prices by more exports in times of weakening global manufacturing trade. Higher oil prices thus serve to aggravate the choking effect of shrinking liquidity due to a wholesale change in monetary policy: The inflation nexus threatens to see particularly ill-timed capacity constraints in West Texas propelling so-called normalisation of monetary policy, where global central banks have started to raise rates back from historical rock bottom levels. That, in turn, will continue to push the US-dollar higher which again is not to the likening of the President, and all those emerging economies having issued loads of dollar-denominated debt. Macroeconomics can be a fiendish trap in a complex and interdependent world.

## India joins tariff fray in effort to prop up the rupee

After the United States and China, it's the turn of the largest democracy in the world: In an increasingly frantic effort to shield the rupee against further depreciation, the Indian government implemented another round of tariffs on 19 "non-necessary" items. Yet its definition of non-necessary more often than not begs scepticism: Gemstones might be considered a luxury item, even though the country's related industry is one of the biggest

**Terms of trade, India, pts.**




Data: trading economics

with a share of some seven per cent in its GDP. And home appliances might not yet be a mass product for a country with still huge swathes of impoverished rural people. But plastics as an all-important intermediary product for Indian manufacturing and jet fuel for its already ailing airlines may be considered irrelevant by a very far stretch of the imagination only. Still, the macroeconomic effect intended becomes discernible – for the time being. As a result of this and other tariff rounds before, India's terms of trade have improved to some 73 index points between 2016 and this year, up from the troughs of a mere 58 points back in 2015. The highs of 2010/11, however, when the index reached some 92 points demonstrate the deteriorated foreign trade position of India in the longer run (see chart). In other words: India's exports today buy considerably more of its imports than in 2015, but way less than eight years ago. India is chronically dependent on energy imports: A full 80 per cent of its energy demand needs to be supplied from overseas. That leaves the country very vulnerable to both steep rises in the US-Dollar or crude oil, or even both at the same time as in these days. Still, India is relatively better armoured by far than, say, Indonesia against too sudden a balance of payments crisis: Her foreign exchange reserves cover several months' worth of imports, and due to a history of trading restrictions and capital controls, the rupee is not as susceptible to the kind of speculative attacks as even Britain had to endure during its infamous ejection from the European Exchange Rate Mechanism in 1992. However, as much reassuring as India's relative resilience in the face of exchange rate turbulence might be, its readiness to implement trade barriers and other forms of state interventions at often extremely short or even no notice calls for an increased wariness in the months ahead, as global trade in general becomes embroiled in the escalating Sino-American economic stand-off. That has become all the more likely when just this week, the Reserve Bank of India left interest rates unchanged, signalling that it does not accept responsibility to prop up the rupee and passing the buck to the government. We therefore advise to better prepare for further trade impediments and tightened capital controls, if, in all likelihood, the current path of development continues. Exporters of all but any manufactured goods, whether finished or intermediary, and those using crude oil and its derivatives as inputs in particular should anticipate further obstructions to their business, at least until the federal elections are done and over with in May 2019: Economic interventionism has become of political value now that Prime Minister Narendra Modi has to be seen delivering on his election promises.

# Statistical Bulletin

### Consumer spending (Q2, y/y)

**Singapore: 3.3%** ↑ Consumers in the Lion City still are buoyant after all: After an outsized quarterly drop in Q1, consumer spending recuperated just as markedly, and well above the figure for Q2 in 2017. Yet the signs for the months ahead are not so good: Retail sales have been stalling in the recent past and stand to continue to do so.

**India: 8.9%** ↓ Don't be fooled by an isolated number: India's consumer spending growth appears to be just what you would expect from an emerging market – but not so. That's because the trend is negative, and has been that way all over the past three quarters. And a rupee in free fall does not aid to stop that.

### New orders

**France (Sep.): -5.3 pts.** ↓ New orders in manufacturing have been deteriorating all over the world of late, primarily due to the repercussions of an increasingly beleaguered global trade. Among the G10, France has been hit particularly hard.

**US (Aug., m/m, nom., seas. adj.): +2.3%** ↑ Not so in the US. Apparently immune to a drop in exports demand, American manufacturing booms on the back of a frothy domestic economy.

### Small business sentiment (pts.)

**Australia (Q2): 1.54** ↓ Australia increasingly threatens to become a collateral damage of the Sino-American trade war, with the primary market for its natural resources, China, tumbling even earlier than anticipated. Since the economy Down Under still is very much centred on the mining industry, SME feel the squeeze, too.

**UK (Q3): 6.0** ↑ The UK's SME, for the time being, corroborate the countenance of the British economy as a whole in the face of an ever growing likelihood of a no-deal Brexit. Indeed, not a few of them actually anticipate a beneficial effect of that scenario on their business.

### Unemployment rate (Sep.)

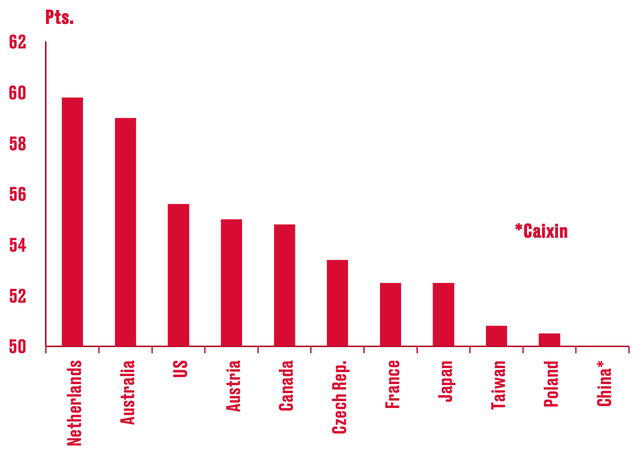
**Canada: 5.9%** → Canada's labour market is treading water for quite some time now; the recent accord struck in place of NAFTA will keep unemployment at its ten-year low.

**Austria: 6.9%** → For all its healthy economic growth, Austria's unemployment rate stays stubbornly high, at levels around double those of Germany. Inflation, however, is just as high as the big neighbour's, leaving the Alp's Republic in a tricky spot.

### Manufacturing PMI (Sep., pts.)

The Netherlands remain the sweet spot for manufacturing, with a PMI still close to 60 after several months well in excess of that exuberant level. Australia 's figure is at odds with its SME sentiment (see above), though manufacturing is not that dependent on the mining industry. Somewhat disconcerting, however, are the rear lanterns: Poland and China are just above the neutral level of 50 points.

Data: Trading Economics, bloomberg, comdirect, own calculations



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