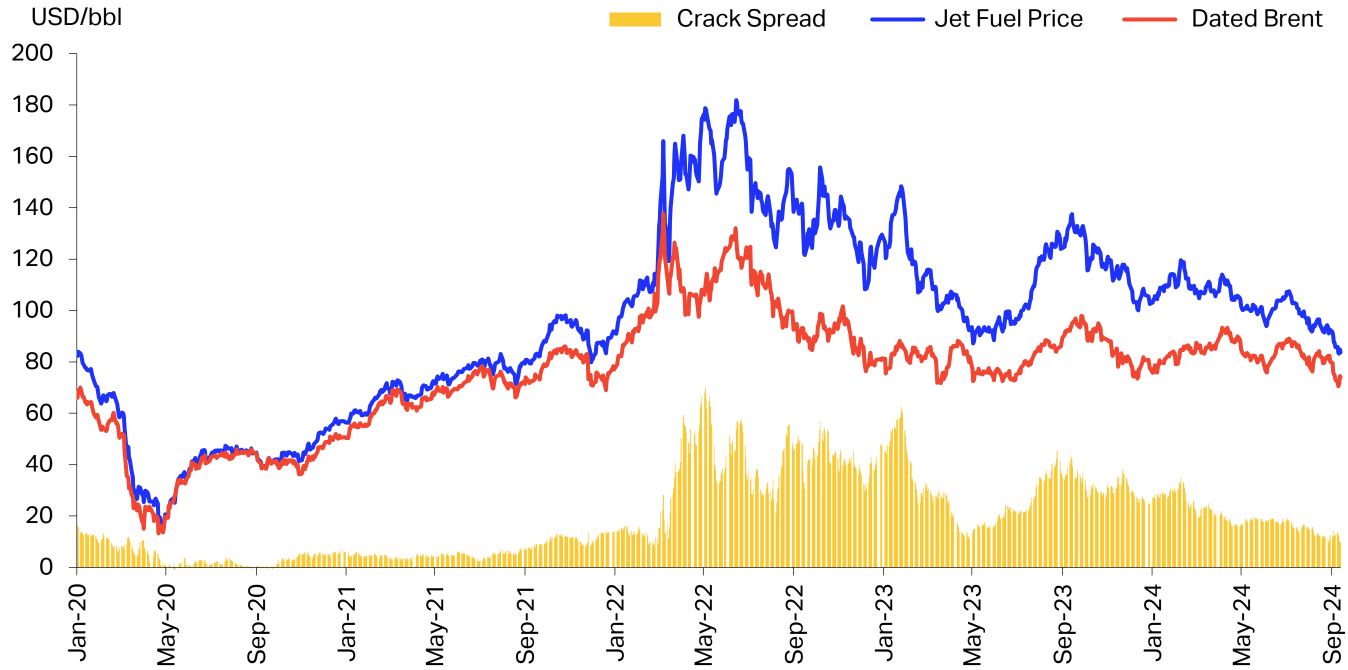
Chart of the Week

20 September 2024

A dramatic drop in oil prices is good for growth

Brent and jet fuel price, USD/barrel, and spread between the two (crack spread)



Source: S&P Global Commodity Insights

- The price of Brent crude oil is currently around USD 72/barrel, a 21% decline from the highs this year of USD 91/barrel and the lowest price since the end of 2021 (see chart). Many will be tempted to read this as a sign of impending recession, and indeed, growth in oil demand in China fell for four consecutive months as of July, pushing global demand growth to a low not seen since 2020. However, China's lack of demand growth can also be explained by a significant reorientation of demand in the energy sector. China is shifting from diesel to liquid natural gas (LNG) in road transportation, as evidenced by the 30% market share that such long-haul trucks have captured as of 2023. This has reduced the demand for diesel in China by 8%, according to Wood Mackenzie.
- On the supply side, the US, the world's No. 1 crude oil producer, will see record output this year, according to the US Energy Information Administration. This will drive global oil production, which the International Energy Agency thinks will post historic highs in 2024. As the oil market is uniquely sensitive to variations in supply and demand, these developments are the dominant factors behind the fall in oil prices that we are seeing at the current junction.
- Lower oil prices are good for growth. Lower prices will also help curtail inflation and arguably allow central banks to loosen monetary policy further. Such expectations are already contributing to weakening the US dollar to a 2024 low (USD index, DXY), which lends further support to growth in most of the global economy. Airlines will benefit on the demand side as GDP underpins air travel. Moreover, as fuel represents around 30% of airlines' costs, lower oil prices will shore up profits and might help expand the currently estimated slim 3% net profit margin for the industry in 2024.
- What the impact of the lower oil price will be on the relative appeal of investing in SAF production is hard to say. However, with the near 20% net margins in oil and gas production, chances are that SAF investments still need some essential policy support.

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