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Lower oil prices will be a net drag on the economy

Even a short-term reversal of the U.S. fracking revolution is likely to impact jobs and related industries. *By Brian Shapiro*

As U.S. consumers cheer the positive initial effects of falling energy prices, the future realization of the dilemma it creates for the U.S. economy is about to become apparent. At one point, before the fracking revolution came into being, the U.S. was dependent on foreign oil to complement domestic production capabilities in order to meet total U.S. energy needs. This foreign oil dependency led to some of the most important political mistakes the U.S. made in the 20th century, as placating members of the energy producing world was part of a foreign policy designed so that the U.S. could meet its vast energy needs. However, using the great intellect contained within the U.S., a technological revolution in the way oil and gas is produced along with vast untapped domestic natural resources has paved the way to U.S. energy independence in what is now known as the fracking energy revolution.

This revolution in sourcing domestic energy is an incredibly powerful force which may finally lead to U.S. energy independence and allow the U.S. to forego its policy of appeasing energy producing countries, which in the past has led to decisions that were less than stellar for long-term U.S. national interests. With new fracking technology, combined with conservation and opportunities in the alternative

energy world, U.S. energy is set to further expand the supply side of the equation and possibly make the U.S. an outright exporter of oil at some point in the near future. As it stands now, the U.S. can only export refined oil and in some cases a very light condensate crude as well as crude exports from Alaska (through an existing loophole). This leaves the U.S. with enough supply in the global balance to import less as well as have excesses in gas domestically.

Burgeoning supplies have caused declining prices because the boom of fracking/horizontal drilling has caused a seismic shift (pun intended) in supply capabilities as the world has drifted in the past 20 years to cheaper, cleaner and more plentiful natural gas. I remember being in the ancient city of Toledo, Spain several years ago overlooking the centuries-old ruins when I heard a bus rumble down a cobblestone street displaying a big sign proclaiming that it was powered by natural gas. Crude oil as a sole energy component had seen its best days.

So why is anything bad for America here? What could go wrong? On the positive side of the ledger, energy independence from foreign oil means America will have more authority politically and



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economically (and maybe even militarily) to exert suasion over such diplomatically complicated OPEC member states as Iran, Nigeria, Venezuela, and Saudi Arabia.

On the other side of the equation, the supply glut and falling crude prices could impact many large U.S. states (California, Texas, Pennsylvania, Louisiana, and Ohio), which have economies tied to the oil production boom in the U.S. Job growth could be thereby impacted, as recent gains have been partly driven by oil production and the industries that surround it, with employment in the energy sector up an astounding 50% since the last recession and 10% of all jobs in America are now energy related.

The current supply imbalance forced lower prices upon the market. Until either demand is ramped up to consume all the supply (unlikely in the short term) or supply falls because prices fall so low that the marginal producer can no longer be profitable, prices will fall.

The U.S. has become the higher cost marginal producer of crude oil. Offshore drilling, shipping, and costs of a democratized society make our energy industry vulnerable to lower prices from a supply side standpoint. As with many industrial innovative changes throughout history, an

economic boom can become a bust as many jobs are created to fill what was initially viewed as seemingly endless growth, which then turns into excess supply, forcing the burgeoning industry to retrench. The problem with all of the good that lower energy prices brings to consumers is that job growth in the U.S. has been in part driven by the energy sector. That sector is not only set to expand less due to lower crude prices but could actually contract as suppliers are forced from the industry. This slowdown in increased production caused by market forces will in turn cause a slowdown in energy job growth, more deflationary pressures for the economy and could cause a slowdown in 2015 that more than offsets the gains reaped from consumer savings (and increased discretionary spending) resulting from lower oil prices.

The industry effects will be felt very widely as rail transports, energy services, as well as industries implicitly tied to the production of oil all can potentially be affected. Although the long term stimulative effect of the fracking revolution will leave the U.S. as the dominant world player for our lifetime, the short-term downside of hiccup in this boom will soon be upon us.

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