ClearBridge Investments

Trade War Hurts Crude More Than Tariffs

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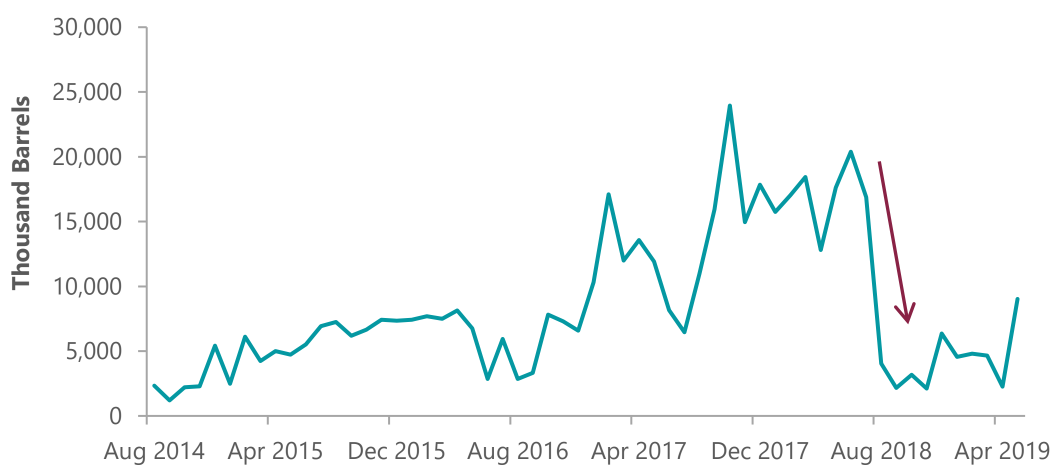
Key Takeaways

- A recently announced 5% Chinese tariff on U.S. oil imports is likely to have a limited impact on oil trading.
- The escalation of the trade war, on the other hand, is having a measurable effect on oil demand, which is putting downward pressure on oil prices.
- Unless the two sparring nations reverse course or the global economy strengthens, more downward revisions to oil demand estimates seem likely. In this environment, continued defensive, larger cap positioning remains warranted.

Crude Enters Tariff Tensions, but Demand Questions Still Dominate

A recent announcement that China will levy a 5% tariff on U.S. oil imports is likely to have a limited impact on oil trading considering exports to China have already been reduced due to trade tension fears (Exhibit 1). Only 2.5% of exported U.S. oil and petroleum product exports have gone to China year to date. In terms of the impact of oil tariffs on specific commodity grades, we could see lower prices for lighter grades from the Permian Delaware shale basin, to the extent that China's refining system, well-positioned to take lighter crude grades, would be removed as a buyer. We would see this manifested via wider West Texas Light spreads. One result is that this supports a preference for exposure to the more intermediate-grade Midland basin over the lighter-grade Delaware.

Exhibit 1: U.S. Oil and Petroleum Product Exports to China

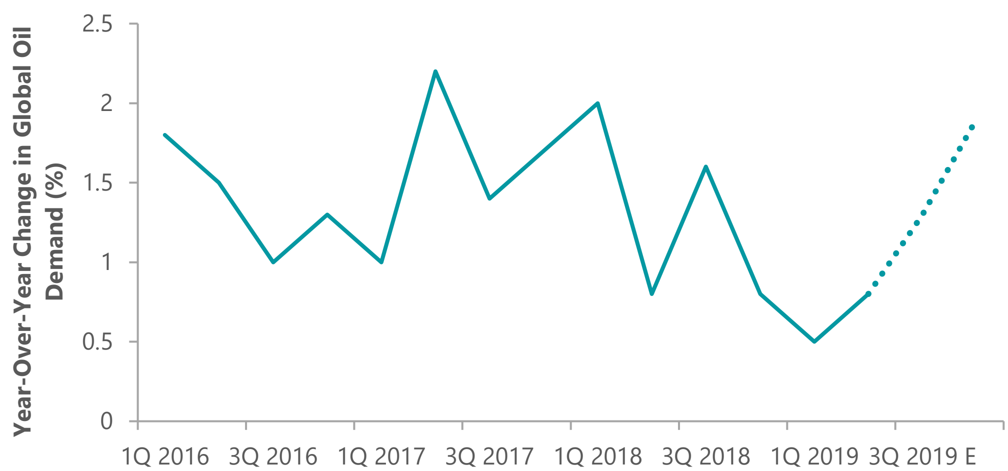


Source: U.S. Energy Information Administration. As of July 31, 2019.

The escalation of the trade war, on the other hand, is having a real impact on oil demand, which is putting downward pressure on oil prices. Crude prices react violently to trade war escalations. Unless the two sparring nations reverse course or the global economy strengthens, more downward revisions to oil demand estimates seem likely. In this environment, continued defensive, larger cap positioning remains warranted.

The larger question, however, is what impact the escalating trade war will have on the overall health of the global economy and resulting oil demand. Demand weakness has been the key reason for pressure on crude prices and why they have reacted violently to trade war escalations. In the first six months of 2019, global oil demand increased by only 600,000 barrels per day (bpd) — well below 1.3 million bpd in 2018 and 1.6 million bpd in 2017. The International Energy Agency's 2019 oil demand forecast of 1.1 million bpd includes a ramp up in demand to 1.6 million bpd year over year in the second half of 2019 from 0.6 million bpd in the first half of 2019, though this increasingly looks to be at risk of downward revision (Exhibit 2). The demand growth forecast for 2020 is 1.3 million bpd, but this does not take into account the possibility of a recession — one possible result of a trade war escalation.

Exhibit 2: Oil Demand Weakness Will Remain Key



Source: International Energy Agency. As of June 30, 2019.

About the Author

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- 14 years of investment industry experience
- Joined ClearBridge Investments in 2014
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