

# Macrocast

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## Independence Days

- We take our eyes off the “central bank fever” for a bit and look into the long-term effect of the US energy independence.
- New lessons from the “UK lab”?

COP7 was disappointing. No additional emission reduction ambition has come up. The agreement on providing financial help to developing nations towards their transition is big on principles but light of actual commitments and dependent on yet another future deal. This semi-failure in Sharm-el-Sheikh could reflect a generic “transition fatigue” while governments are dealing with the pressing issues of the inflation shock and energy security. The outcome of the US mid-term elections means that policy paralysis will likely define the remainder of Joe Biden’s mandate. His Inflation Reduction Act – in reality a Green Transition Act – could well be his last “big package”.

The re-emergence of a domestic oil and gas (O&G) industry has made the US energetically independent. This produces significant economic benefits and will play in the hands of those who resist the transition in the US. Yet, the US is in a comfortable position to push ahead on decarbonisation. The potential for renewables is massive in the US, and while the EU needs to fund its transition while dealing with the brutal deterioration in the terms of trade triggered by the rise in energy costs, the US is not facing the same external shock while it can leverage its large O&G income stream to fund investment towards renewables. Resources to deal with climate change are scarce everywhere, but they are less scarce in the US. Politics can get in the way, but maybe paradoxically we see the US energy independence as a potential asset for decarbonisation. The “will” may be debated, but the “way” is certainly there.

We also look at the UK’s backloaded fiscal plan. Although it can’t commit the government which will come out of the next general elections, it will still create a benchmark which will limit the capacity of Labour to stray far from fiscal rectitude. Yet, the British political configuration – returning to a classical confrontation between middle of the road centre-right and centre-left which can be conducive to policy continuity - is becoming a rarity in Europe where the push of populist parties is not over. This is a limit to any lesson we would want to draw from the “UK lab”.

## The ramifications of US energy independence

On 8 December, 2015, President Obama signed into law the repeal of the ban on United States (US) exports of crude oil implemented since 1975. The primary reason behind the 2015 decision was the degree of comfort the US had reached on the security of its own energy supply with the emergence of new local sources of crude, but beyond the strategic rationale, basic economic arguments could be made. By isolating US oil from the world market, the export ban resulted in a permanent price discount on locally extracted crude, thus hampering the further development of local supply. Opening world markets to US oil could, down the road, result in even more supply security at home by boosting production capacities. US oil production duly rose further in the years which followed the lifting of the ban (see Exhibit 1).

Exhibit 1 – The surge in US O&G output

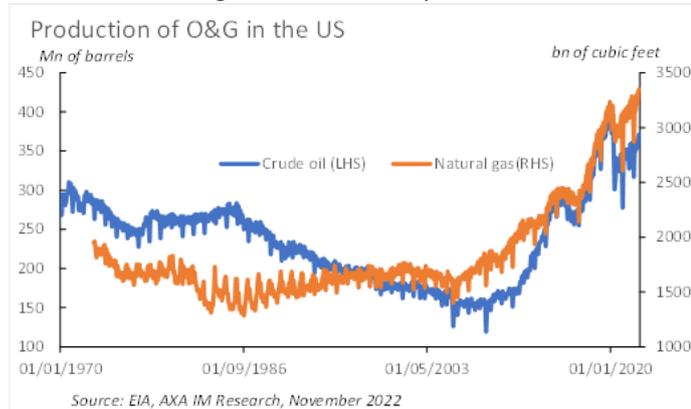
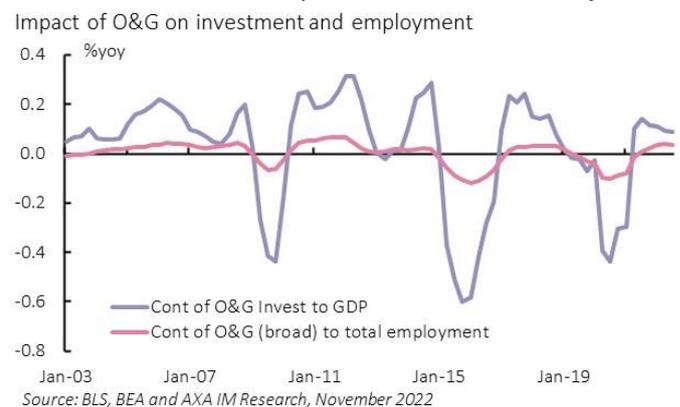


Exhibit 2 – Little direct impact on investment and jobs

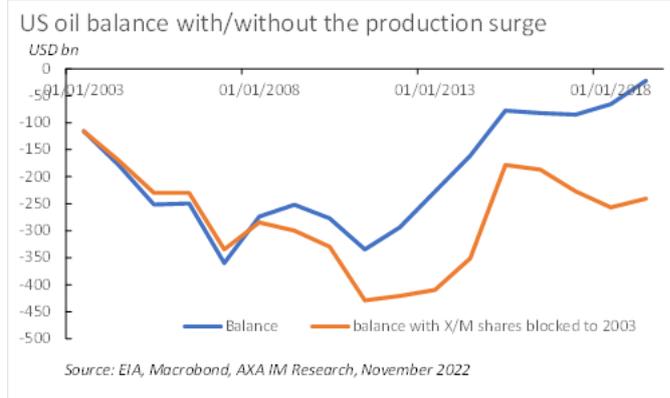
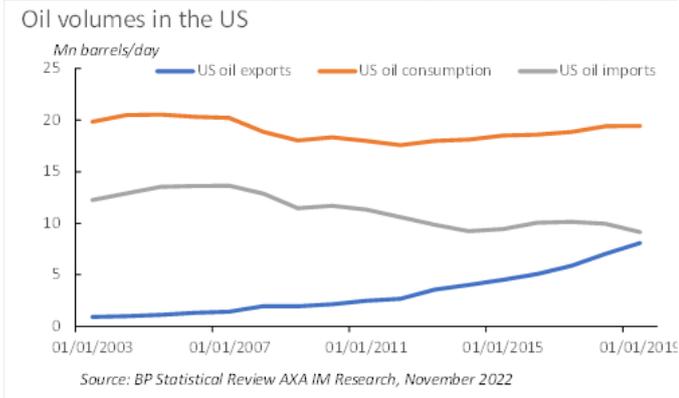


Despite this massive rise capacities, the oil and gas extraction industry only plays a marginal *direct* role in the US growth dynamics. The maximum positive contribution to GDP growth from investment in this industry has reached only 0.3% year-on-year over the last two decades and, as a massively cyclical sector, it also brought visible negative contributions, while its effect on employment never moved the dial (see Exhibit 2). **The most significant contribution the re-emergence of the oil and gas industry has brought to the US economy is via its effect on international payments.**

The US trade balance on oil products has reached near neutrality over the last 3 years, to which we need to add the surplus on gas, but this does not do full justice to the savings the US have accrued thanks to the re-emergence of their oil and gas industry in a general context of strong oil prices. Indeed, US *consumption* of oil has barely moved over the last 20 years (it fell by only 2.1%). The improvement in the US energy balance is thus not due to a decline in the overall recourse to fossil fuel, but to a complete reversal of the import/export pattern (see Exhibit 3). Imports fell from 60% to 45% of consumption. Had the share of imports in consumption stayed constant over the last two decades, the US would have paid to the rest of the world USD66bn more than it actually did in 2019 – the last “normal” year before the pandemic - for a barrel at 58 dollars at the time. Of course, beyond the reduced import bill, the US economy also benefits on the export side. If US exports of oil had stayed at their 2003 level in volume (i.e., as a number of barrels), export income would have been some USD150bn lower than what they have been in 2019. Exhibit 4 illustrates this phenomenon. **In other words, the rebirth of the US oil industry alone – i.e., without taking on board the benefits from gas – improved the US national income by 1%. Given the rise in prices in 2022, the benefit has probably reached 2%. Not bad.**

To be clear, **this does not mean that the US economy is insulated from movements in oil prices.** A rise in the price of crude triggers an elevation in inflation in the US, which is detrimental to consumers’ income, while the additional profits which accrue to US oil producers only partly find their way back to domestic spending given the high saving propensity of financial income. It is still in the interest of the United States to avoid a rise in oil prices – as illustrated by the recent efforts of the Biden administration to convince Organization of the Petroleum Exporting Countries (OPEC) to lift its production targets. Yet, for an economy which has been operating for decades with a current account deficit, the improvement of the energy balance is a welcome asset. Ultimately, this may raise the equilibrium exchange rate of the dollar.

Exhibit 3 – Oil consumption flat, imports down, exports up Exhibit 4 – It made a real difference on the trade balance



This helps understand the widespread reluctance in the US to fully engage in a decarbonization of their economy. Observers often focus on the political role played by “brown” states – e.g., Western Virginia or Texas – installing the US energy transition as local electorates are concerned about the disappearance of the O&G – and coal – industries, but numerically their weight in total employment would normally be too small to really “move the dial” on the national debate. Yet, the aggregate, macroeconomic saving these industries provide to the economy at large can be a powerful deterrent against more forceful action towards decarbonization, especially if it dovetails with concerns over “de-globalization”.

Indeed, the current backlash against deglobalization is triggering a new focus on the US as a production centre, and energy availability – and price – can be a key argument to foster the re-shoring of manufacturing activities. It is already a competitive asset for the US. The British Department for Business and Energy maintains series on the cost of electricity for industrial customers across the globe. The difference between the US and the European countries is staggering (see Exhibit 5). Yet, this advantage stems less from the “intrinsic” cost of power – before tax it is not that different in the US, France, and Germany – than from a clear choice on the taxation of energy (see Exhibit 6). Continuing to offer cheap energy can be a key plank in the US macro strategy of the coming decades, especially if its competitors in the developed world choose the opposite approach.

Exhibit 5 – Electricity is much cheaper in the US

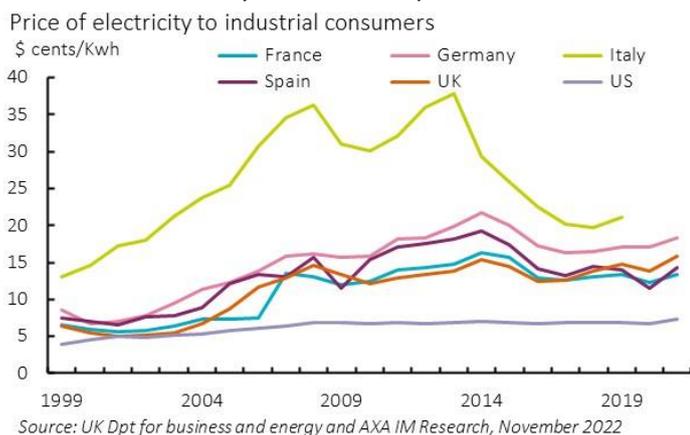
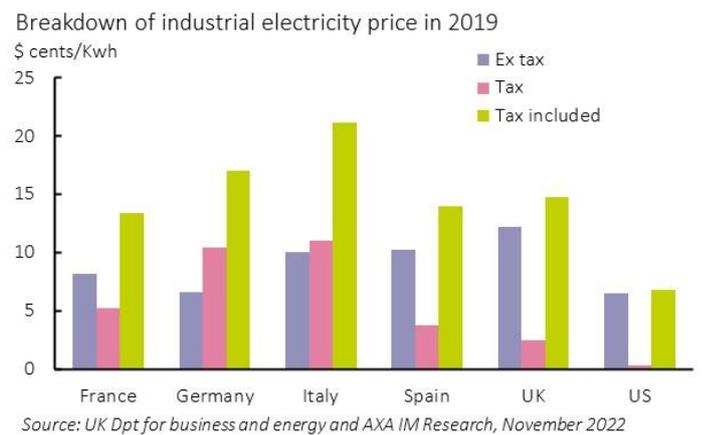


Exhibit 6 – Tax choices



Relying on O&G is not a sure strategy to maintain low power generation costs, but so far, this has been a key difference between the European Union (EU) and the US. Between 2007 and 2021, the US has reduced the share of coal in power generation by more than 50%, but 60% of this decline has been offset by gas-fired capacity, against only 40% by renewables such as wind and solar. Europe has also cut its reliance on coal by more than half, but most of the slack has been taken up by renewables, while the overall recourse to natural gas has been flat over the period. This has been a key source of the different performance in CO2 emissions across the Atlantic over the last 2 decades. The Biden administration is intent of narrowing this gap, and it materialised in this year’s Inflation Reduction Act – which despite its name is really a “Green Energy Act”. The US potential there is however quite promising, given an “efficiency advantage” relative to Europe.

Let’s start with onshore wind. Corrected for the relative size of its economy, the US existing capacity for this energy source is smaller than in Germany (roughly 100 Gwh against 60 for Germany), but it appears to be more efficient, when looking at the capacity factor (i.e., average production as a percentage of technical peak output), even if it has been rising in the two countries (see Exhibit 7). Moreover, the cost of installations – although declining in the two countries – is also lower by c.20% (see Exhibit 8). The further development of solar power looks also more promising, with a stated capacity factor of 24% in the US according to the Energy Information Administration, against a stated 11% in Germany according to the Federal Ministry for Economic Affairs (note however that contrary to wind we could not find a harmonized source for this so the calculation may differ).

Exhibit 7 – Wind power is efficient in the US...

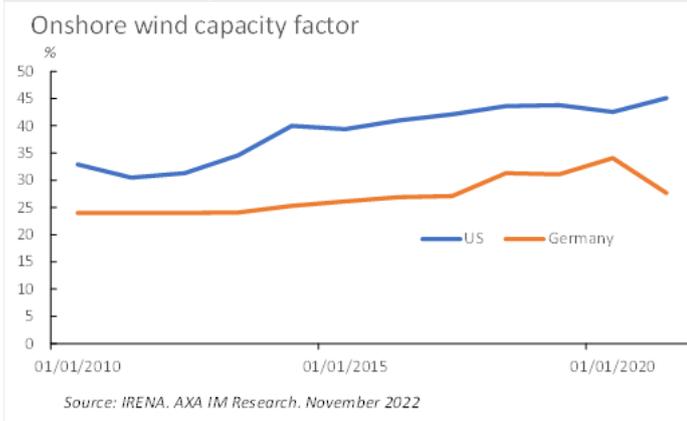
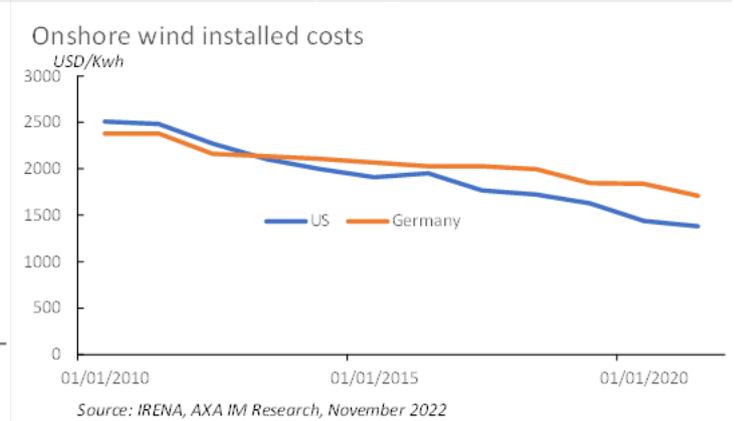


Exhibit 8 – ...and relatively cheap



Our main message here is that the US has more optionality when it comes to its energy policy in the years and decade ahead than Europe, and that irrespective of the choices it will make it will probably continue to benefit from – or even increase – a competitive advantage in this area. Indeed, if a “climate sceptical” administration returns to the White House in 2024, a further boost to domestic fossil fuel production is likely, making the US structural current account deficit even easier to manage and thus allowing for a wider policy space. By diverging from a net-zero compatible trajectory, the US would contribute to the exacerbation of the climate risks and will eventually pay an economic price for it, but we are in a “tragedy of the commons” landscape here. The US would suffer – as it has already experienced in 2022 – the cost of more extreme weather events as climate change would continue unmitigated (it would be difficult to convince emerging countries to speed up their own transition if the biggest economy in the world stalls), but so would the rest of the world. Your humble servant would see this configuration – which we would summarize as being “more competitive in a worse world” – as a pyrrhic victory for America, but this may not be how it would be seen in key segments of the US electorate.

Our concern is the emergence of a narrative in the US which does not bluntly reject man-made climate change but focuses on adaptation rather than mitigation. The idea there is that scarce resources should not be diverted to fighting global warming, especially since the direct contribution of the US to the depletion of what remains of the “carbon budget” (the sum of CO2 which can still be emitted while avoiding a rise in global temperature by more than 1.5 degrees) will be dwarfed by emerging countries, with China, the US now arch-rival, in the top rank. Instead, this school of thought argues that resources should be spent on building defences against the consequences of global warming. Despite the kilometres of convergent academic research which demonstrates that even the most optimistic estimates of the macro impact of unmitigated climate change would make the cost of any successful adaptation prohibitive, public opinion may be swayed by the fact that limiting CO2 emissions usually comes with a visible cost today – e.g., carbon tax – with only counterfactual, future benefits (avoiding a change in climate tomorrow).

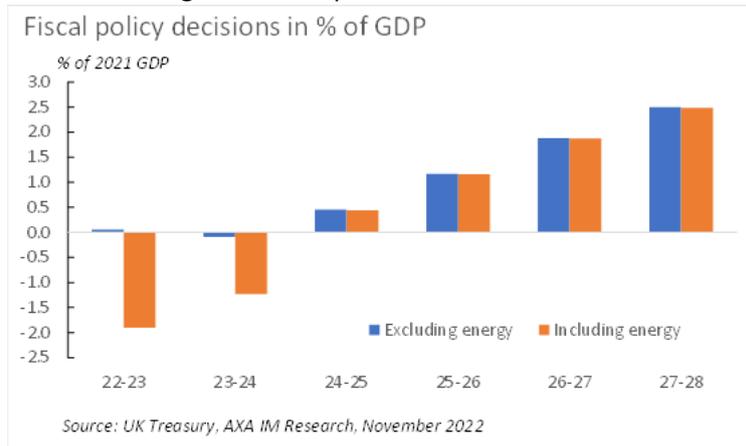
Yet, the latest mid-term elections and their tight results suggest there is still some space for the continuation of a “net zero” policy in the US, and the US finds itself in a much more comfortable position than Europe on this. While the EU needs to fund its own transition while dealing with the brutal deterioration in the terms of trade which the current rise in the cost of energy is triggering, the US is not facing the same immediate external shock while it can leverage what will

remain of the O&G income stream to fund investment towards renewables, on top of the state support provided by the Inflation Reduction Act. Resources to deal with climate change are scarce everywhere, but they are less scarce in the US.

## Backloading austerity: new lessons from the “UK lab”?

For all the noises around the United Kingdom (UK)’s sharp change of policy course, opting resolutely for fiscal rectitude after the ill-fated tax cut bonanza offered by the short-lived Truss administration, in reality most of the effort is pushed to the last years of the budget’s forecasting horizon, in other words after the next general elections which the Conservatives have – as of yet – a mountain to climb to win. Exhibit 9 illustrates how Jeremy Hunt, the new Chancellor of the Exchequer, has distributed the effort over the forecasting horizon of the budget programme. For the next two years, the discretionary component of the government expenditure and income will still be resolutely accommodative, to the tune of 2%, and then 1% of GDP, given the extension of the protection against the energy price shock. Restriction – evenly split between stealth tax increases (primarily by freezing the tax bracket thresholds despite mounting inflation) and spending restriction – will not reach 1% of GDP before the fiscal year 2025-2026, to culminate at 2% of GDP in 2027-2028.

Exhibit 9 – UK government passes the bill to successor



For now, the market seems satisfied with this backloaded approach to austerity. It’s probably enough of a relief for investors to hear that the UK is no longer planning to engage in permanent tax cuts which would alter for good the trajectory for public debt. We must be consistent there: we have been arguing for some time in Macrocast that European governments could get away with their current generosity with short-term stimulus only if they provide at the same time some visibility on a future effort to bring deficits under control. This is what the British government is doing, with the obvious limit that it can hardly commit a future government which, judging by the current dreadful polls for the Tories, is likely to come from the current Opposition. **This limit may not be that powerful though: with the Labour party busy restoring its economic credentials after its radical phase under its previous leader Jeremy Corbyn, we think it won’t have much latitude to ignore the need for fiscal consolidation after 2024.** It may choose a different tax/spending mix, but much as the Tories have spent the “Thatcherite” bullet for good with Truss’ attempt last month, the UK’s centre-left has spent its “tax and spend” bullet with its massive electoral defeat under Jeremy Corbyn in 2019. The fiscal programme set up by Jeremy Hunt last week is likely to remain for long the benchmark against which any government will be judged by the market after the next general elections.

Note however that the political configuration of the UK is becoming a rarity in Europe. Indeed, while both dominant parties have had their brush with radicalism, no overtly populist “third party” has emerged. The UK is moving back to a quite classical confrontation between centre-right and centre-left which allows for a modicum of policy continuity. The populist push is not over on the continent, and this will continue to create policy uncertainty.

Country/Region	What we focused on last week	What we will focus on in next weeks
	<ul style="list-style-type: none"> <li>• PPI inflation (Oct) 8.0%yoy, adding to disinflation hopes</li> <li>• Retail sales (Oct) +1.3% (+0.7% control) adds to hopes for firmer Q4, Atlanta Fed now tracker at 4.2% for quarter</li> <li>• Philly Fed survey (Nov) fell to -19.4 – lowest since pandemic</li> <li>• President’s Biden and Xi met at G20</li> <li>• Fed member Bullard advocates rates at least to 5.25%</li> </ul>	<ul style="list-style-type: none"> <li>• FOMC minutes (Nov) to gauge how many members join Powell in considering rates higher than signalled in Sept</li> <li>• Richmond Fed index (Nov), considered best indicator of broader IP, watched for following Philly Fed weakness</li> <li>• Thanksgiving holiday on Friday – watch for preliminary reports of holiday spending</li> </ul>
	<ul style="list-style-type: none"> <li>• EMU IP rose by 0.1%mom (0.9% including Ireland). Energy intensive industries continue to decline, auto sector is still recovering</li> <li>• Final EMU Oct HICP came at 10.6%yoy (-0.1pp vs prelim), boosted by strong rises in energy, food and good prices. Passthrough from high energy prices remain incomplete so inflation will remain elevated</li> </ul>	<ul style="list-style-type: none"> <li>• October Ge producer prices to decelerate but still elevated (cons:41.5%yoy from 45.8% in Sep)</li> <li>• Nov EMU Flash consumer confidence should be flat</li> <li>• Several business surveys with Flash PMIs in Ge, Fr and aggregated EMU; Fr business climate, Ifo</li> <li>• Ge Q3 GDP detailed to dig into the resiliency of the economy in Q3</li> </ul>
	<ul style="list-style-type: none"> <li>• Autumn statement ushers in fiscal consolidation, with £55bn in spending cuts and tax increases</li> <li>• In near term gov announced more support on HH energy, capping bills at £3000 w/ targeted support</li> <li>• CPI inflation surprised to upside at 11.1%, strength was broad based w/ energy and food</li> <li>• U/rate (Sep) rose unexpectedly to 3.6%</li> </ul>	<ul style="list-style-type: none"> <li>• Supreme court verdict on ‘indyref2’ expected (Weds)</li> <li>• BoE Watchers conference – Pill, Mann and Ramsden to speak</li> <li>• UK public finances data (Oct)</li> <li>• Flash PMIs (Nov) expected to rebound slightly from Oct lows</li> <li>• CBI Industrial trends survey</li> </ul>
	<ul style="list-style-type: none"> <li>• Q3 GDP unexpectedly fell by -0.3%qoq as imports rose sharply</li> <li>• Trade balance (Oct) driven further into deficit as weak yen pushed up imports</li> <li>• CPI inflation (Oct) rose to 3.7%yoy</li> </ul>	<ul style="list-style-type: none"> <li>• Flash PMIs (Nov)</li> <li>• Department store sales (Oct)</li> <li>• Service PPI (Oct)</li> <li>• Tokyo core CPI (Nov) expected to rise to 3.5%</li> </ul>
	<ul style="list-style-type: none"> <li>• October data surprises to the downside, with COVID flare-up making a visible dent on consumption and services activity, while manufacturing output and investment are hit by slowing exports</li> <li>• Tighter interbank liquidity, together with optimism on reopening, lead to a surge in interest rates, with the moves in yields exacerbated by WMP redemptions</li> </ul>	<ul style="list-style-type: none"> <li>• Markets will pay close attention to the COVID situation and how it affects the authorities’ implementation of containment policies after the “20 measures”</li> <li>• LPR to stay unchanged</li> <li>• PBoC may intervene further to ease liquidity stress and ensure no run-on wealth management products (WMP)</li> </ul>
	<ul style="list-style-type: none"> <li>• CB: Indonesia hiked +50bps to 5.25% &amp; Philippines +75bps to 5.0%</li> <li>• Q3 GDP (yoy) decelerated in Colombia (7.0%), Hungary (4.0%), Romania (4.0%) &amp; Poland (3.5%)</li> <li>• Annual inflation (Oct) fell in India (6.8%) &amp; remained stable in Poland (17.9%)</li> <li>• BRL down on increased concerns of fiscal slippage</li> </ul>	<ul style="list-style-type: none"> <li>• CB: Korea is expected to hike +25bp to 3.25% &amp; South Africa +75bps to 7.0%. Hungary to remain on hold at 13%. Turkey should cut 150bps to 9.0%</li> <li>• Annual inflation (Oct) data in Malaysia, South Africa &amp; Singapore</li> <li>• Q3 GDP figures in Chile, Thailand &amp; Peru</li> <li>• Industrial prod. (Oct) numbers in Taiwan &amp; Singapore</li> </ul>
<b>Upcoming events</b>	<p><b>US:</b> Wed: Durable goods orders (Oct), Weekly jobless claims (19 Nov), Manf &amp; Services PMI (Nov), Michigan consumer sentiment &amp; inflation expectations (Nov), New home sales (Oct), FOMC minutes (2 Nov)</p> <p><b>Euro Area:</b> Mon: Ge: PPI (Oct); Tue: Consumer conf. (Nov); Wed: EU19 Composite, Manf., Services PMI (Nov), Ge &amp; Fr Manf. and Services PMI (Nov); EU19 ECB account (27 Oct), Ge Ifo business climate indx (Nov), Fr Insee manf. confidence (Nov); Fri: Ge GDP (Q3), Fr Insee consumer confidence (Nov), It ISTAT business &amp; consumer confidence (Nov)</p> <p><b>UK:</b> Tue: PSNB (Oct); Wed: Composite, Manf, Services PMI (Nov), Supreme Court verdict on ‘Indyref2’; Thu: CBI Industrial Trends survey</p> <p><b>Japan:</b> Thu: Manf. PMI (Nov), Leading index</p> <p><b>China:</b> Mon: Loan Prime Rates; Fri: Industrial profits (Oct)</p>	

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