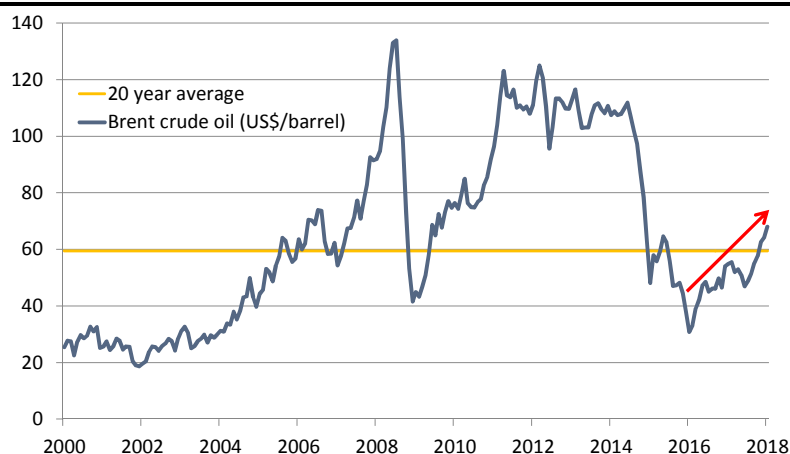


5 January 2018

The end of cheap oil: no big deal

Oil price – first sustained rise above the 20-year average in almost three years



Monthly data. Prices are nominal. January 2018 data taken as price on 5 January 2018.

Source: World Bank, Berenberg calculations

- Spring has sprung in the global economy:** Bad memories take time to fade. The wrenching 2008 global financial crisis, the subsequent euro crisis, and two oil price spikes badly sapped confidence across the advanced world. But after seven years of unusually restrained economic growth, the chill has eased. Economic reform in the US and Europe – think France’s Macron – nourished the already strengthening green shoots of confidence last year. As a product of the accelerating upswing, demand for energy and other inputs has grown. The rising oil price since early 2016 reflects both OPEC’s success at restraining its members’ production and improving global demand.
- Why the oil price matters:** No primary input matters more than crude oil. The components that are derived from the distillation process provide energy for, among other things, machines, plants, offices and cars. Oil is used as an ingredient in pharmaceuticals, plastics, road surfaces and an endless list of other consumer durables. The sharp fall in the oil price, and corresponding fall in global inflation, due to the growth in US shale from 2013/14 onwards was, therefore, a major boon for global consumption in the past few years. Think of it as a free tax cut. Since consumption makes up the biggest part of GDP – typically one-half to two-thirds – for advanced countries, the drop in the oil price helped jump-start demand and the synchronised upturn in global upturn we are enjoying now.
- Should we worry about the recent rise in oil price?** No, at least not yet. While a sudden rise in the oil price back towards, say, \$100 per barrel, would probably give the upswing an unwelcome jolt that would concern us, a rise towards c\$70 that adds, say, 0.2-0.3pt to headline inflation this year should not hurt very much.
- Where to next for the oil price?** As long as tensions between Saudi Arabia and Iran do not escalate far beyond their current proxy wars in Yemen and parts of Syria, and the Strait of Hormuz remains open, a further sustained spike in oil prices looks unlikely. Meanwhile, a continued gradual rise in the oil price owing to a further strengthening in global demand would more than likely prompt a significant rise in production in the US and elsewhere. While OPEC can still influence the price of a barrel of oil, its grip has been weakened by rising competition. Nowadays, global oil supplies are more price elastic than before. Prices may actually come down a bit in 2018 as production increases.
- Enjoy the good times for a while:** As we wrote in our annual outlook ‘[Global outlook 2018: coping with the boom](#)’, rarely has the outlook been as encouraging as it is today. We expect the synchronised global upswing to continue in 2018 at the above-trend pace reached in the last three quarters of 2017. When oil prices go up because of strong demand, we do not have to worry. Markets can continue to rise, profits can still go up, and economic agents will not see their confidence knocked. If somewhat higher oil prices encourage a few people to actually follow up on their new year resolutions to drive less and cycle a bit more, it might actually offer a little fringe benefit. Happy New Year!

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Contacts

www.berenberg.com



BERENBERG

PARTNERSHIP SINCE 1590

JOH. BERENBERG, GOSSLER & CO. KG

Internet www.berenberg.com

E-mail: firstname.lastname@berenberg.com

EQUITY RESEARCH

AEROSPACE & DEFENCE

Ryan Booker +44 20 3753 3074
Andrew Gollan +44 20 3207 7891
Charlotte Keyworth +44 20 3753 3013
Ross Law +44 20 3465 2692

AUTOMOTIVES

Cristian Dirpes +44 20 3465 2721
Alexander Haissl +44 20 3465 2781
Fei Teng +44 20 3753 3049

BANKS

Adam Barras +44 20 3207 7923
Stephanie Carter +44 20 3207 3106
Michael Christodoulou +44 20 3207 7920
Andrew Lowe +44 20 3465 2743
Andreas Markou +44 20 3753 3022
Alex Medhurst +44 20 3753 3047
Eoin Mullaney +44 20 3207 7854
Peter Richardson +44 20 3465 2681

BEVERAGES

Javier Gonzalez Lastra +44 20 3465 2719
Matt Reid +44 20 3753 3075

BUSINESS SERVICES, LEISURE & TRANSPORT

Roberta Ciaccia +44 20 3207 7805
Najet El Kassir +44 20 3207 7836
William Fitzalan Howard +44 20 3465 2640
Stuart Gordon +44 20 3207 7858
Annabel Hay-Jahans +44 20 3465 2720
Josh Puddle +44 20 3207 7881
Kate Somerville +44 20 3753 3081
Joel Spungin +44 20 3207 7867

CAPITAL GOODS

Nicholas Housden +44 20 3753 3050
Sebastian Kuenne +44 20 3207 7856
Philippe Lorrain +44 20 3207 7823
Rizk Madi +44 20 3207 7806
Jaroslaw Pominkiewicz +44 20 3753 3035
Simon Toennessen +44 20 3207 7819
Ethan Zhang +44 20 3465 2634

EQUITY SALES

SPECIALIST SALES

AEROSPACE & CAPITAL GOODS

Cara Luciano +44 20 3753 3146

AUTOS & TECHNOLOGY

Edward Wales +44 20 3207 7815

BANKS, DIVERSIFIED FINANCIALS & INSURANCE

Iro Papsodopolou +44 20 3207 7924
Calum Marris +44 20 3753 3040

BUSINESS SERVICES, LEISURE & TRANSPORT

Rebecca Langley +44 20 3207 7930

CONSTRUCTION, CHEMICALS, METALS & MINING

James Williamson +44 20 3207 7842

CONSUMER DISCRETIONARY

Victoria Maigrot +44 20 3753 3010

CONSUMER STAPLES

Molly Wylenzek +44 20 3753 3064

HEALTHCARE

David Hogg +44 20 3465 2628

MEDIA & TELECOMMUNICATIONS

Julia Thannheiser +44 20 3465 2676

THEMATICS

Chris Armstrong +44 20 3207 7809

SALES

BENELUX

Miel Bakker +44 20 3207 7808
Bram van Hijfte +44 20 3753 3000

FRANCE

Alexandre Chevassus +33 1 5844 9512
Dalila Farigoule +33 1 5844 9510
Manon Petit +33 1 5844 9507

SCANDINAVIA

Mikko Vanhala +44 20 3207 7818
Marco Weiss +49 40 350 60 719

CHEMICALS

Sebastian Bray +44 20 3753 3011
Anthony Manning +44 20 3753 3092
Rikin Patel +44 20 3753 3080

CONSTRUCTION

Saravana Bala +44 20 3753 3043
Zaim Beekawa +44 20 3207 7855
Lush Mahendrarajah +44 20 3207 7896
Robert Muir +44 20 3207 7860
Olivia Peters +44 20 3465 2646

DIVERSIFIED FINANCIALS

Chris Turner +44 20 3753 3019
Charles Bendit +44 20 3465 2729

FOOD MANUFACTURING AND H&PC

Rosie Edwards +44 20 3207 7880
Philip Patricia +44 20 3753 3039
Fintan Ryan +44 20 3465 2748
James Targett +44 20 3207 7873

FOOD RETAIL

Dusan Milosavljevic +44 20 3753 3123

GENERAL MID CAP - DACH

Martin Comtesse +44 20 3207 7878
Charlotte Friedrichs +44 20 3753 3077
Gustav Fröberg +44 20 3465 2655
Julia Kochendörfer +44 20 3753 3052
Alexander O'Donoghue +44 20 3207 7804
Gerhard Orgonas +44 20 3465 2635
Henrik Paganetty +44 20 3463 3140
Benjamin Pfannes-Varrow +44 20 3465 2620

GENERAL MID CAP - EU core

Christoph Gruelich +44 20 3753 3119
Anna Patrice +44 20 3207 7863
Trion Reid +44 20 3753 3113

GENERAL MID CAP - UK

Joseph Barron +44 20 3207 7828
Calum Battersby +44 20 3753 3118
Robert Chantry +44 20 3207 7861
Sam England +44 20 3465 2687
Ned Hammond +44 20 3753 3017

UK

Fabian De Smet +44 20 3207 7810
Marta De-Sousa Fialho +44 20 3753 3098
Jules Emmet +44 20 3753 3260
Robert Floyd +44 20 3753 3018
David Franklin +44 20 3465 2747
Karl Hancock +44 20 3207 7803
Sean Heath +44 20 3465 2742
James Hunt +44 20 3753 3007
Gursumeet Jhaj +44 20 3753 3041
James McRae +44 20 3753 3036
David Mortlock +44 20 3207 7850
Eleni Papoula +44 20 3465 2741
Bhavin Patel +44 20 3207 7926
Kushal Patel +44 20 3753 3028
Richard Payman +44 20 3207 7835
Christopher Pyle +44 20 3753 3076
Adam Robertson +44 20 3753 3095
Joanna Sanders +44 20 3207 7925
Mark Sheridan +44 20 3207 7802
George Smibert +44 20 3207 7911
Alexander Wace +44 20 3465 2670
Paul Walker +44 20 3465 2632

GERMANY

Michael Brauburger +49 69 91 30 90 741
Nina Buechs +49 69 91 30 90 735
André Grosskurth +49 69 91 30 90 734
Florian Peter +49 69 91 30 90 740
Joerg Wenzel +49 69 91 30 90 743

SWITZERLAND, AUSTRIA & ITALY

Andrea Ferrari +41 44 283 2020
Gianni Lavigna +41 44 283 2038
Jamie Nettleton +41 44 283 2026
Yeannie Rath +41 44 283 2029

GENERAL MID CAP - UK (cont'd)

Omar Ismail +44 20 3753 3102
Ian Osburn +44 20 3207 7814
Antony Plom +44 20 3207 7908
Edward James +44 20 3207 7811
Benjamin May +44 20 3465 2667
Owen Shirley +44 20 3465 2731
Donald Tait +44 20 3753 3031

GENERAL RETAIL

Conrad Bartos +44 20 3753 3053
Thomas Davies +44 20 3753 3104
Michelle Wilson +44 20 3465 2663

HEALTHCARE

Scott Bardo +44 20 3207 7869
Jakob Berry +44 20 3465 2724
Alistair Campbell +44 20 3207 7876
Klara Fernandes +44 20 3465 2718
Tom Jones +44 20 3207 7877
Joseph Lockey +44 20 3465 2730
Samantha Osborne +44 20 3207 7882
Michael Ruzic-Gauthier +44 20 3753 3128
Laura Sutcliffe +44 20 3465 2669
Charles Weston +44 20 3465 2746

INSURANCE

Trevor Moss +44 20 3207 7893
Emanuele Musio +44 20 3207 7916
Iain Pearce +44 20 3465 2665

LUXURY GOODS

Mariana Horn +44 20 3753 3044
Lauren Molyneux +44 20 3207 7892
Zuzanna Pusz +44 20 3207 7812

MEDIA

Robert Berg +44 20 3465 2680
Laura Janssens +44 20 3465 2639
Alastair Reid +44 20 3207 7841
Sarah Simon +44 20 3207 7830

REAL ESTATE

Kai Klose +44 20 3207 7888
Tina Munda +44 20 3465 2716

CRM

Laura Cooper +44 20 3753 3065
Jessica Jarmyn +44 20 3465 2696
Madeleine Lockwood +44 20 3753 3110
Rita Pilar +44 20 3753 3066

COO Office

Greg Swallow +44 20 3207 7833
Fenella Neill +44 20 3207 7868

CORPORATE ACCESS

Lindsay Arnold +44 20 3207 7821
Robyn Gowers +44 20 3753 3109
Jennie Jirincy +44 20 3207 7886
Ross Mackay +44 20 3207 7866
Stella Siggins +44 20 3465 2630
Lucy Stevens +44 20 3753 3068
Abbie Stewart +44 20 3753 3054

EVENTS

Charlotte David +44 20 3207 7832
Suzy Khan +44 20 3207 7915
Natalie Meech +44 20 3207 7831
Eleanor Metcalfe +44 20 3207 7834
Rebecca Mikowski +44 20 3207 7822
Ellen Parker +44 20 3465 2684
Sarah Weyman +44 20 3207 7801

SALES TRADING

PARIS

Vincent Klein +33 1 58 44 95 09
Antonio Scutto +33 1 58 44 95 03

LONDON

Assia Adanouj +44 20 3753 3087
Charles Beddow +44 20 3465 2691

METALS & MINING

Charlie Clark +44 20 3207 3133
Fawzi Hanano +44 20 3207 7910
Michael Stoner +44 20 3465 2643
Yuriy Vlasov +44 20 3465 2674

TECHNOLOGY

Josep Bori +44 20 3753 3058
Georgios Kertsos +44 20 3465 2715
Tej Shankiya +44 20 3753 3099
Gordon Tveito-Duncan +44 20 3753 3100
Tammy Olu +44 20 3465 2673

TELECOMMUNICATIONS

David Burns +44 20 3753 3059
Ondrej Cabešek +44 20 3753 3071
Nicolas Didio +44 20 3753 3091
Usman Ghazi +44 20 3207 7824
Laura Janssens +44 20 3465 2639

THEMATIC RESEARCH

Nick Anderson +44 20 3207 7838
Oyvind Bjerke +44 20 3753 3082
Steven Bowen +44 20 3753 3057
Asad Farid +44 20 3207 7932
Robert Lamb +44 20 3465 2623
Paul Marsch +44 20 3207 7857
Saliha Shariff +44 20 3753 3097
James Sherborne +44 20 3753 3073

TOBACCO

Jonathan Leinster +44 20 3465 2645

UTILITIES

Oliver Brown +44 20 3207 7922
Andrew Fisher +44 20 3207 7937
Neha Saxena +44 20 3753 3048
Lawson Steele +44 20 3207 7887

ECONOMICS

Florian Hense +44 20 3207 7859
Carsten Hesse +44 20 3753 3001
Kallum Pickering +44 20 3465 2672
Holger Schmieding +44 20 3207 7889

LONDON (cont'd)

Mike Berry +44 20 3465 2755
Joseph Chappell +44 20 3207 7885
Stewart Cook +44 20 3465 2752
Mark Edwards +44 20 3753 3004
Tom Floyd +44 20 3753 3136
Tristan Hedley +44 20 3753 3006
Peter King +44 20 3753 3139
Simon Messman +44 20 3465 2754
A.J. Pulley +44 20 3465 2756
Matthew Regan +44 20 3465 2750
Michael Schumacher +44 20 3753 3006
Paul Somers +44 20 3465 2753

EQUITY TRADING

HAMBURG

David Hohn +49 40 350 60 761
Gregor Labahn +49 40 350 60 571
Lennart Pleus +49 40 350 60 596
Marvin Schweden +49 40 350 60 576
Omar Sharif +49 40 350 60 563
Phillip Wiechmann +49 40 350 60 346
Christoffer Winter +49 40 350 60 559

LONDON

Edward Burlison-Rush +44 20 3753 3005
Richard Kenny +44 20 3753 3083
Chris McKeand +44 20 3207 7938
Ross Tobias +44 20 3753 3137

ELECTRONIC TRADING

Jonas Doehler +44 40 350 60 391
Matthias Führer +49 40 350 60 597
Sven Kramer +49 40 350 60 347
Matthias Schuster +44 40 350 60 463

BERENBERG CAPITAL MARKETS LLC

Member FINRA & SIPC

EQUITY RESEARCH

Andrew Fung +1 646 445 5577
Adam Mizrahi +1 646 445 4878
Gal Munda +1 646 445 4846

EVENTS

Laura Hawes +1 646 445 4849

CORPORATE ACCESS

Olivia Lee +1 646 445 7212
Tiffany Smith +1 646 445 4874

EQUITY SALES

SALES

Enrico DeMatt +1 646 445 4845
Kelleigh Faldi +1 617 292 8288
Ted Franchetti +1 646 445 4864
Shawna Giust +1 646 445 7216
Rich Harb +1 617 292 8228
Zubin Hubner +1 646 445 5572
Michael Lesser +1 646 445 5575
Jessica London +1 646 445 7218
Anthony Masucci +1 617 292 8282

SALES (cont'd)

Ryan McDonnell +1 646 445 7214
Emily Mourret +1 415 802 2525
Peter Nichols +1 646 445 7204
Kieran O'Sullivan +1 617 292 8292
Rodrigo Ortigao +1 646 445 7202
Rannique Sroa +1 415 802 2523
Matt Waddell +1 646 445 5562

CRM

LaJada Gonzales +1 646 445 7206
Monika Kwok +1 646 445 4863

SALES TRADING

Ronald Cestra +1 646 445 4839
Michael Haughey +1 646 445 4821
Christopher Kanian +1 646 445 5576
Lars Schwartz +1 646 445 5571
Brett Smith +1 646 445 4873
Bob Spillane +1 646 445 5574
Jordan White +1 646 445 4858

ECONOMICS

Mickey Levy +1 646 445 4842
Roiana Reid +1 646 445 4865

E-mail: firstname.lastname@berenberg-us.com