

Re-examining the Impact of Low Crude Oil Price

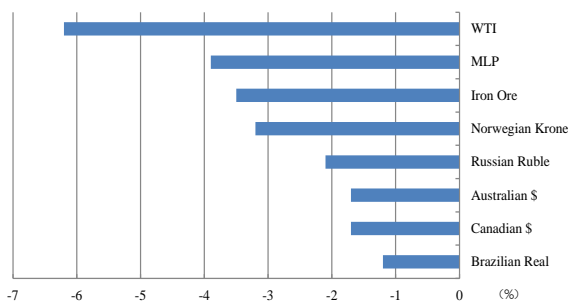
- Crude oil price continued to drop as production cut and production target setting were shelved at OPEC Meeting and commodity market softened as a whole.
- Low crude oil price does not mean that it negatively affects global economy, as it has benefits to oil importing countries.
- We expect crude oil price to remain low and stable for the time being, which is not bad to the Japanese economy and stocks.

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WTI Crude Oil Futures (WTI) listed on the New York Mercantile Exchange, a representative index of crude oil, touched USD36.64 / barrel during trading hours on 8th December, renewing its year low. Background of the recent sharp fall of crude oil price seems to be the rapidly growing concern over deteriorating supply and demand as both production cut and production target setting were shelved at the OPEC Meeting on 4th December.

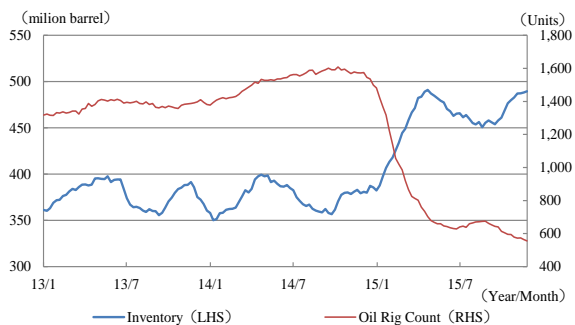
Reuters/Jefferies CRB Index, a representative index tracking price movement of international commodities such as energy, agricultural products and precious metals and the price of iron ore (62% Fe, CFR Tianjin) renewed their year lows on 8th December as well as WTI. LME index, comprised of 6 types of industrial metals traded on the London Metal Exchange (LME), is also trading in the lower band since the beginning of year 2015. It seems that the perception of a slowing emerging economy (e.g. China), leading to a cut back in commodity demand, is affecting these markets.

"Chart 1: Rate of Change of Commodity Price and Related Assets"



(Note) Data is from 4 December, 2015 to 8 December, 2015. MLP (Alerian MLP Index), Iron Ore (62% Fe, CFR Tianjin), WTI is price return basis. Currencies are measured against US\$.
(Source) SMAM, based on Bloomberg L. P. data.

"Chart 2: US Crude Oil Inventory and Oil Rig Count"



(Note) 1. Data is from 4 January, 2013 to 27 November, 2015.
2. Oil Rig Count means number of oil rigs in operation.
(Source) SMAM, based on Bloomberg L. P. data.

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After observing OPEC's decision to shelve production cut, currencies of oil producing countries such as Canadian Dollar, Norwegian Krone, Russian Ruble and those of iron ore producing countries such as Australian Dollar, Brazilian Real have weakened against the US Dollar in the currency market. Moreover, prices of US High Yield bonds, mainly issued by energy related companies, and MLPs (Master Limited Partnership), mainly engaged in natural resources related businesses, have also dropped (Chart 1). There is a concern that these assets will be further impacted negatively if commodity prices continue to fall.

Meanwhile, WTI fell almost 66% from the high of USD107.73 / barrel, touched during trading hours of 20th June, 2014, to the low marked on 8th December, 2015. Crude oil price falling down sharply to this extent does give a big blow to the economy of oil producing countries. In fact, International Monetary Fund (IMF) made a warning on Saudi Arabia's financial conditions. On the other hand, low crude oil price does not mean that it is negatively affecting the global economy, as it brings benefits to oil importing countries by providing more room for a rate cut due to weak inflation and by falling petroleum prices.

We expect crude oil price to remain low and stable for the time being, which is not bad to the Japanese economy and stocks.

In addition to US crude oil inventory stacking up, we expect further deterioration of demand and supply balance going forward, as Iranian crude oil will be supplied into the market if economic sanctions against Iran (for their nuclear program) were to be lifted. Meanwhile, the number of oil rigs (drilling equipment) operating in the US has sharply declined (Chart 2). This will eventually contribute to cuts in crude oil supply, though we expect WTI to remain low for the time being.

As Japan is an oil importing country, low crude oil price is expected to push down petroleum prices and electricity charges. For the Japanese economy, low crude oil price is not that bad as import prices will decrease and improve the trade balance. However, the impact of low crude oil price will differ from industry to industry. For companies classified under Mining and Oil & Coal Products, it will be a factor to squeeze margins. Meanwhile, those under Electric & Gas, Chemical, Land Transportation and Air Transportation, it will be a factor to expand margins as fuel and raw material costs will decrease. I think the negative impact of low crude oil price is not that significant for the Japanese equity market as a whole, as Nikkei 225 index rose 11.7% for year 2015 until 8th December

despite falling crude oil prices.

*** Please note that this report is a translation of Japanese report written on December 9th, 2015.**

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