



In Focus

August 9, 2011

Peter Buchanan (416) 594-7354

US GDP Growth: The “Tax Cut” From Cheaper Oil

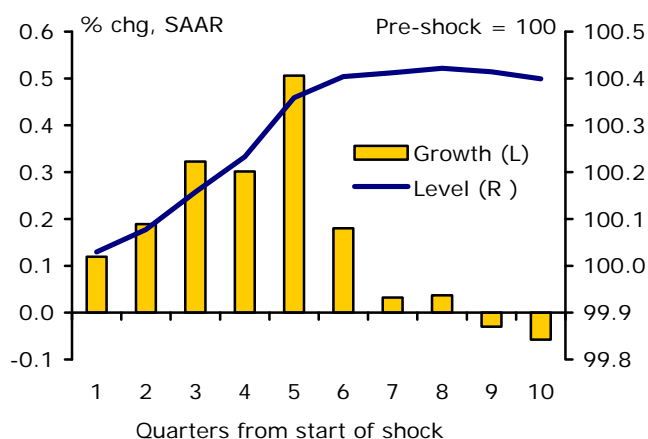
Mixed in with the unnerving headlines, beleaguered US consumers have received at least one piece of good news in recent days, as gasoline prices have followed plunging benchmark crude prices lower. Early 2011’s run-up in national average gasoline prices to a three-year high of nearly \$4/gallon represented a de facto tax of about \$200 billion on job-challenged consumers, contributing centrally to “headwinds” that undermined first half US GDP growth. The shock from triple digit oil appears in retrospect to have offset much of the lift from last December’s vaunted Obama-Republican tax cut deal. Besides dinging the consumer, rising oil prices have also hampered businesses like transport and travel, non-energy resources, and autos, adding in the latter case to dislocations due to March’s Japanese earthquake.

After a week of gut-wrenching volatility exacerbated by Friday’s US downgrade, there is uncustomary uncertainty over where crude prices will eventually settle. Observers were paring their GDP forecasts for Europe, China and the US even before last week’s fiscally restrictive US debt deal. Europe’s debt problems remain as troublesome as ever. A less-resilient global growth environment suggest oil prices will remain well below their recent highs through 2012 in the absence of new supply side shocks akin to the war in Libya, which sent prices through the roof earlier this year.

Refiner’s acquisition costs represent 70-80% of the retail pump price of gasoline in the US. A dollar decline in well head prices typically shaves 3-4 cents per gallon from pump prices. Average prices at just over \$3.60 per gallon are still about 10 cents above late June’s lows. That and longer term relationships suggest prices could fall by a further 40-50 cents per gallon if West Texas prices remain near today’s level of around \$80/barrel.

We recently developed a model (See Oil Prices and the North American Economy, Economic Insight, p. 7-9) to simulate the impact of oil prices on the US economy, drawing on the evidence of the last thirty years. Estimates from our VAR model—a statistical approach designed to capture historical data relationships—suggest that a \$20/bbl drop in crude oil prices would ordinarily add about half a point to the level of GDP over the course of the subsequent 4-6 quarters (see chart), allowing for the positive impact on auto sales, consumer spending and various types of business activity. Quarterly GDP growth on average in that period would be about 0.2–0.3%-pts stronger than in the base case.

Chart
Impact of \$20/Barrel Oil Price Decline in US GDP



Source: CIBC oil shock model

Given that sort of impact, the lift from cheaper gasoline isn't likely to be the magic bullet that single-handedly puts a sub-par recovery back on the rails. But it does form part of our view that the US economy will see disappointing growth rather than a return to outright recession in the next few quarters.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2011 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.