

Economic Insights: Amid the wave of worry, a price war

Update for the week of March 9 to March 13, 2020

Commentary by **Skyler Schneekloth**, economic analyst

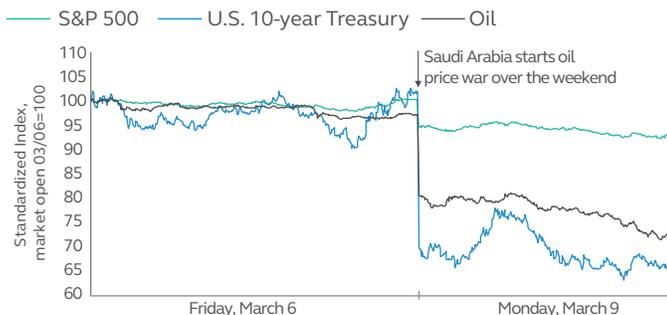
Saudi Arabia opened the floodgates on oil, causing a massive market sell-off last Monday. United States equities took a plunge alongside oil futures. Meanwhile, the 10-year Treasury collapsed to 54 basis points (bps), its lowest to date. As volatility was reaching its highest level since the Great Recession, President Donald Trump banned travel from Europe for 30 days and declared a state of emergency amid COVID-19 (coronavirus) pandemic concerns. Today's focus is oil as we assess the economic ramifications of an enduring price war.

What is a price war?

In this case, it's American, Russian, and Saudi Arabian oil producers undercutting each other to gain a competitive edge. But no one wins. In a price war, suppliers are forced to accept lower prices for a scarce commodity, hurting bottom lines.

Advantages

Market reaction to oil price war



Source: Bloomberg Terminal

Lower oil prices give U.S. consumers a break at the pump. With no inflation pressure to offset, oversupply could realistically send retail gas below \$2 per gallon. Another consideration is your energy bill, which fluctuates with the market for crude. A 10% decrease in the price of energy should lift consumer confidence by five index points. So households may continue pushing the expansion forward.

Disadvantages

But consumer advantages come at the expense of domestic oil companies, which have become far more important for growth over the past decade.

According to the [American Petroleum Institute](#), America's oil and natural gas industry now supports 6% of domestic jobs, accounts for 16% capital expenditures, and contributes 8% to gross domestic product. Oil production has become a significant component of the U.S. economy.

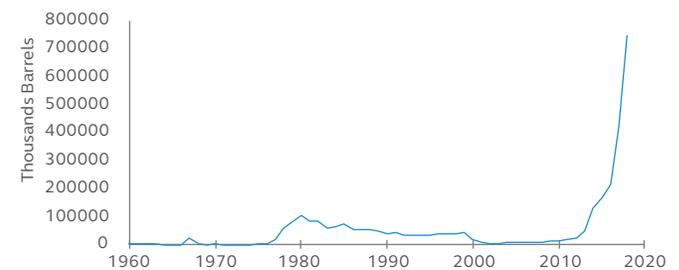
Week in review

London: The Bank of England slashed its policy rate, on the heels of the Fed's emergency 50-point cut. Officials expect economic activity to materially weaken over the coming months.

Ahead of the budget, the cut is the first part of a coordinated effort to combat coronavirus in the United Kingdom. Support is mainly targeted at small businesses, those most vulnerable to economic risks posed by the virus.

Europe: The euro may strengthen as a result of the European Central Bank holding rates unchanged. Chair Christine Lagarde's press conference inspired an immediate 0.5% rise in Italian bond yields and stocks became volatile, and she came under fire for not responding more aggressively to coronavirus. Meanwhile, Germany and Switzerland pledge billions in fiscal stimulus to protect the private sector. Any bit helps.

U.S. exports of crude oil



Source: U.S. Energy Information Administration

Now a major oil producer, the U.S. stands exposed. People could lose jobs; private investment could suffocate.

Investment implications

Needless to say, oil prices and credit spreads are on our radar. We're also watching weekly retail gas prices and initial jobless claims.

A bear market has surfaced. Yet investor fear may push equities down even further in the coming weeks. As investors move to risk-off, focusing on technicals may be appropriate.

Watch out for credit spreads. Corporate spreads would have to widen merely 20bps to begin signaling recession on our proprietary dashboard for the U.S. And energy is a big chunk of high yield.

Collaborative monetary and fiscal stimulus may calm the market. Over the weekend, the Federal Reserve cut a full percentage point and committed \$700 billion to its asset purchase program, but partisanship may get in the way of meaningful fiscal action.

Unless otherwise noted, the information in this document has been derived from sources believed to be accurate as of March 2020. Information derived from sources other than Principal Global Investors or its affiliates is believed to be reliable; however, we do not independently verify or guarantee its accuracy or validity. This material contains general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, recommendation or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that Principal Global Investors or its affiliates has recommended a specific security for any client account.

Subject to any contrary provisions of applicable law, Principal Global Investors and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in this document or in the information or data provided in this document.

Past performance is no guarantee of future results and should not be relied upon to make an investment decision. All figures shown in this document are in U.S. dollars unless otherwise noted. Investing involves risk, including possible loss of principal.

This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

This document is issued in:

- The United States by Principal Global Investors, LLC, which is regulated by the U.S. Securities and Exchange Commission.
- Germany, Austria and the Netherlands by Principal Global Investors (EU) Limited, Sobo Works, Windmill Lane, Dublin D02 K156, Ireland. Principal Global Investors (EU) Limited is regulated by the Central Bank of Ireland. For all other European countries, this document is issued by Principal Global Investors (Europe) Limited, Level 1, 1 Wood Street, London, EC2V 7 JB, registered in England, No. 03819986, which is authorised and regulated by the Financial Conduct Authority ("FCA"). In Europe, this document is directed exclusively at Professional Clients and Eligible Counterparties and should not be relied upon by Retail Clients (all as defined by the MiFID). The contents of the document have been approved by the relevant entity. Clients that do not directly contact with Principal Global Investors (Europe) Limited ("PGIE") or Principal Global Investors (EU) Limited ("PGI EU") will not benefit from the protections offered by the rules and regulations of the Financial Conduct Authority or the Central Bank of Ireland, including those enacted under MiFID II. Further, where clients do contract with PGIE or PGI EU, PGIE or PGI EU may delegate management authority to affiliates that are not authorised and regulated within Europe and in any such case, the client may not benefit from all protections offered by the rules and regulations of the Financial Conduct Authority, or the Central Bank of Ireland.
- Switzerland by Principal Global Investors (Switzerland) GmbH.
- Singapore by Principal Global Investors (Singapore) Limited (ACRA Reg. No. 199603735H), which is regulated by the Monetary Authority of Singapore and is directed exclusively at institutional investors as defined by the Securities and Futures Act (Chapter 289). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore.
- Hong Kong SAR (China) by Principal Global Investors (Hong Kong) Limited, which is regulated by the Securities and Futures Commission and is directed exclusively at professional investors as defined by the Securities and Futures Ordinance.
- Australia by Principal Global Investors (Australia) Limited (ABN 45 102 488 068, AFS License No. 225385), which is regulated by the Australian Securities and Investments Commission. This document is intended for sophisticated institutional investors only.
- This document is issued by Principal Global Investors LLC, a branch registered in the Dubai International Financial Centre and authorized by the Dubai Financial Services Authority as a representative office and is delivered on an individual basis to the recipient and should not be passed on or otherwise distributed by the recipient to any other person or organization. This document is intended for sophisticated institutional and professional investors only.
- India by Principal Asset Management Private Limited (PAMC). PAMC offers only the units of the schemes of Principal Mutual Fund, a mutual fund registered with SEBI.

This material is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

Insurance products and plan administrative services provided through Principal Life Insurance Co. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities offered through Principal Securities, Inc., 800-547-7754, [Member SIPC](#) and/or independent broker/dealers. Principal Life, Principal Funds Distributor, Inc. and Principal Securities are members of the Principal Financial Group®, Des Moines, IA 50392.

© 2020 Principal Financial Services, Inc. Principal, Principal and the symbol design and Principal Financial Group are trademarks and service marks of Principal Financial Services, Inc., a member of the Principal Financial Group. Principal Global Investors is the asset management arm of the Principal Financial Group.