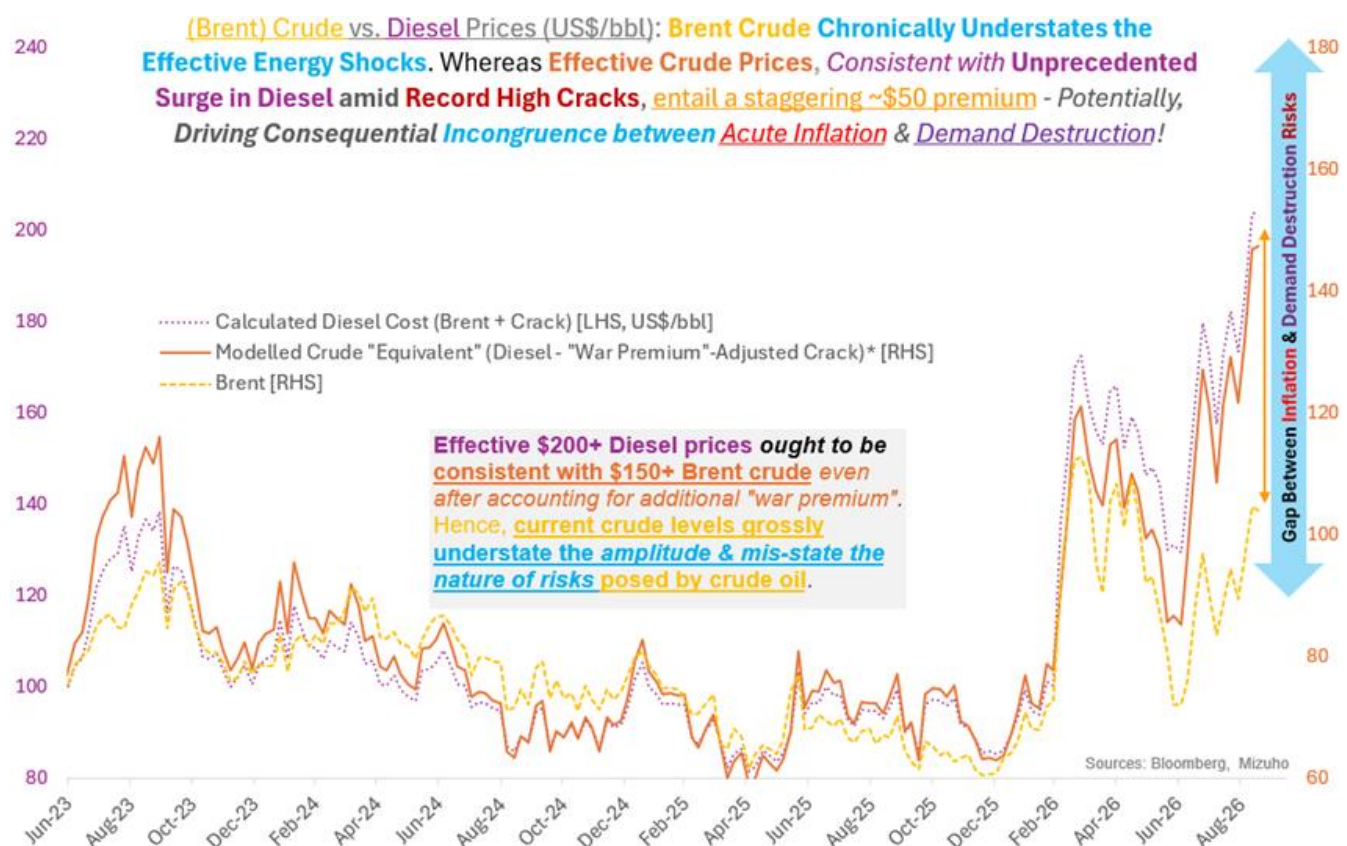


Second-Order Oil-Crack Risks

"Your eyes can deceive you. Do not trust them." Obi-Wan Kenobi, Star Wars

In a Nutshell: The **unprecedented surge in cracks** disproportionately driving diesel (and other end-use fuel) prices sharply higher simultaneously; i) understates adverse impact from energy shocks and; ii) unevenly re-distributes wider growth-stability threats, further exacerbated by asymmetric AI dynamics, to the disadvantage of EM Asia economies. The **first order problem** is that the **prevailing \$100 crude**, typically associated with \$120-125 diesel, understates the "oil shock" risks as it is conservatively consistent with \$150+ crude; even after accounting for additional "war premium". Crucially, as Major central banks fixate on inflation risks from \$100 crude, **demand destruction threat of \$200+ diesel** (effectively \$150+ crude) **may overwhelm EM Asia central banks**. Consequently, **unwelcome headwinds** from rising global rates/yields threaten to exacerbate **adverse industrial, fiscal, consumption growth dampeners** for EM Asia. In turn, **sharpening growth-stability trade-offs** to the detriment of "twin deficit" AXJ (and AXJ-denominated assets).



- The **unrelenting surge in cracks** has arguably **unleashed far greater-order**, and **under-the-radar**, risks than commonly tracked crude price alone might otherwise suggest.
- The obvious **first-order problem** is that the **amplitude of energy shock** is **chronically and misleadingly understated by Brent crude**.

- And especially problematic for past comparisons is the *highly uneven shifts in the known correlations” between crude and end-use energy*.
- Fact is, **diesel now at >\$200 per barrel** (as *diesel cracks soar to match crude at ~\$100*), **is dramatically above what \$100 Brent has been typically associated with**.
- In fact, **\$200+ diesel** may be suggesting economic stress/price shocks as high as ~\$180 crude (*based on simplistically backing out \$20-25 pre-Iran war, diesel crack*).
- And **even after accounting for “additional war premium”**, the record diesel is **at the very least, consistent with \$150+ Brent** (and *not the \$100 crude* quote).
- Crucially, it is **not just that the amplitude of adverse impact, but the asymmetric nature of shock transmission**, that is **grossly under-estimated**.
- More acutely as the **delayed and dampened shock transmission** from *inventory buffer* is **further obfuscated by the cover of** (more than?) offsetting **AI-related demand**.
- Which **leads into the second order risk of policy incongruence** (and resulting policy tensions) **between Majors and EM – especially for EM Asia**.
- **Major economies**, led by a hawkish Fed, are now **responding to inflation risks associated with \$100-120 crude**.
- Especially given the **growth cover**, and **attendant inflation risks, of disproportionate AI-related gains** (both in profits and capital).
- *Whereas demand destruction risks overwhelm* for **EM Asia**, which suffers **adverse economic dynamics from the effective impact of effectively \$150+ crude).**
- Especially *given how disproportionately reliant EM Asia is on refined products for industrial energy, downstream production, and fiscal-social sustainability*.
- **And ascendant global rates/yields from Fed-led hikes** by Major central banks inevitably accentuate pain from adverse fiscal-risk re-pricing-inflation feedback loops.
- All said, this **unprecedented tear-away in (diesel) cracks disproportionately subjects EM Asia to adverse growth multiplier dampeners** via *industrial, fiscal, consumption and risk channels*.
- Consequently, EM Asia’s **growth-stability policy trade-offs sharpen acutely amid Fed hikes – accentuating FX and bond/asset market vulnerabilities**.

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