



(UBS)

Energy: Not just a dollar story

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The strong US dollar (USD) over recent years has weighed on energy and commodity prices. This should not be surprising considering that commodities are quoted in USD but mostly consumed and produced in non-USD based economies.

Another factor connecting commodities and the USD are shifts in market sentiment. The USD tends to benefit (i.e., gets stronger) from risk-off environments and soften (i.e., gets weaker) when risk aversion falls. Most commodities, on the other hand, do well during periods of global growth and suffer during risk-off environments. So let's look at the correlation of energy commodities and the dollar over the last 30 years. Within the energy sector, on average, all three commodities—crude oil (Brent), US natural gas, and thermal coal (Newcastle coal, Pacific seaborne market benchmark)—are negatively correlated to changes in the USD's value. But the correlation patterns vary from commodity to commodity and are far from stable, fluctuating from very low correlation (around 0) to highly negative and even temporary periods of positive correlation. So let's dig into the individual commodities.

US natural gas prices are largely uncorrelated to the USD (average correlation over 30 years is -0.04). The US has been historically self-sufficient in terms of natural gas, so prices are mainly a domestic story. Despite rising US exports of natural gas by pipeline to Mexico and lately via liquefied natural gas (LNG) export terminals to the rest of the world, the correlation has remained close to zero.

One reason might be that exports via pipeline to Mexico and imports via pipeline from Canada are of similar magnitude. For the longer term, another factor to consider is a rising share of exports versus domestic consumption. If exports rise and domestic consumption remains the same, then other factors (like economic activity outside the US) could affect prices and the correlation. Another driver to monitor is rising natural gas demand to power artificial intelligence data centers, the demand for which could steer prices in the future as well.

Thermal coal prices (Newcastle coal, price data available since 2009) and the USD are negatively correlated, though the relationship is also close to zero (-0.06). China is the largest coal consumer and producer and mostly self-sufficient, with small quantities of coal imported with an impact on the Pacific seaborne market. So, while US natural gas is a US story, thermal coal is a Chinese story. The main reason for the high consumption despite the negative impact on the environment. It is abundant in China and cheaper than natural gas and crude, reducing the import dependency.

Crude oil has the most negative linkage with the USD. Even here though, it "only" stands at -0.2 over the last 30 years. Moreover, the relationship has been far from stable. Economic crises such as the global financial crisis in 2007-08, the European debt crisis of 2010, and the COVID pandemic in 2020 resulted in a high negative correlation. In contrast, spikes into positive correlation territory resulted from large production disruptions in Iraq and Libya in September 2013. The same applies to the start of the war in Ukraine in 2022, on anticipation of large Russian crude supply disruptions which did not materialize. But supply disruptions per se do not trigger a positive correlation—that's more a coincidence. In mid-2016, record production outages—driven by wildfires in Canada, attacks on oil infrastructure in Nigeria, power outages in Iraq, and halted exports in Libya—pushed oil up as the USD strengthened slightly, resulting in a negative correlation between oil and the USD.

We don't deny that a weaker USD can support sector prices over a short time period. But the linkage is insufficient to make the greenback a key factor when guiding for higher or lower prices. The far more volatile nature of commodities (swings of from 10-70%) versus currencies (5-15%) underpins our thinking here. We expect the US dollar to stay strong in the short term but to weaken over the coming 12 months. While this might be moderately positive for crude prices, we continue to believe that supply and demand factors are the stronger driver of commodities. We therefore still hold a moderately constructive outlook for crude and US natural gas and a cautious outlook for thermal coal.

Original report: [Not just a USD story, 5 February 2025.](#)

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