



# PERSPECTIVES

## The Bridge to Everywhere: Crude Oil and the U.S. Economy

3 June 2009

One of the storylines that held the public's attention for several months during the 2008 U.S. political season was Alaska's "Bridge to Nowhere."<sup>1</sup> Given that history, Alaska's position as one of the leading producers of crude oil in the United States,<sup>2</sup> and the contribution oil makes to our quality of life, it seemed fitting to entitle this article on the role of crude oil in our modeling of the U.S. economy – and the various wood fiber sectors in particular – as "The Bridge to Everywhere."

Some have questioned why we use the price of crude oil as a factor in our modeling and forecasting system instead of the price of diesel. After all, its use in most aspects of transportation – and to a lesser extent, power generation – makes diesel's price of more immediate interest to forest products manufacturers and consumers.

Our answer to that question is three-fold:

- Products made from crude oil are used in virtually every aspect of today's society; hence, crude's price reflects the interaction of supply and demand across the entire economy rather than the narrower segment affected only by diesel fuel.
- It's common in economic analysis to divide time into various epochs – before and after World War II, for example. The Energy Crisis that erupted in 1973 is another logical division; as one can see in Figure 1, price levels and volatility, and market responses began to behave differently around the time of that event – and have continued to do so since then.

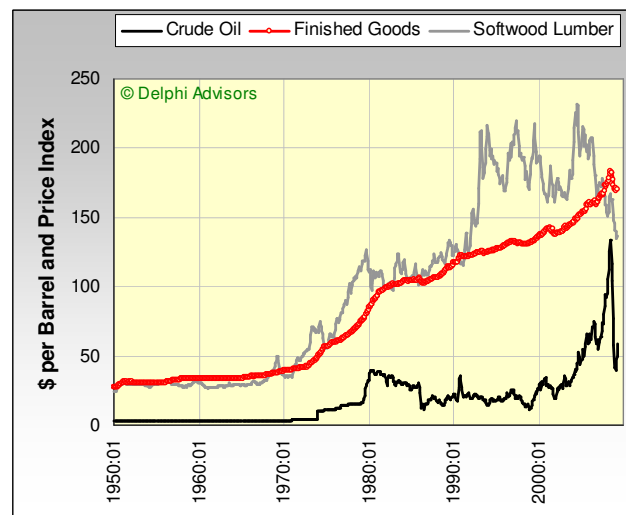


Figure 1. Comparison of West Texas Intermediate crude oil spot price and producer price indices of finished goods and softwood lumber. Sources: Dow Jones & Co. and Bureau of Labor Statistics

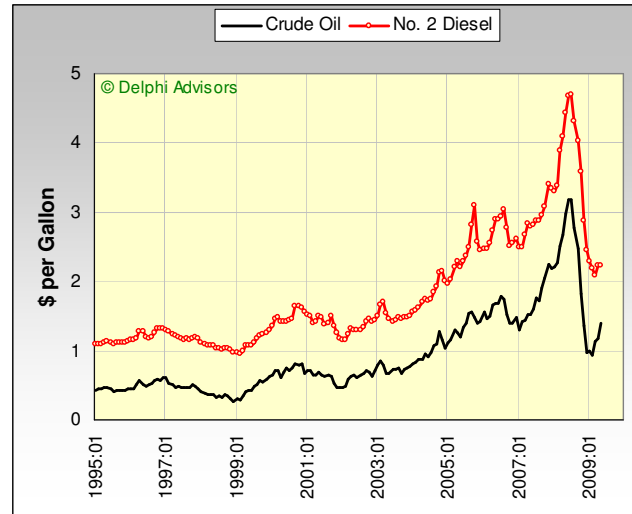
<sup>1</sup> [http://en.wikipedia.org/wiki/Gravina\\_Island\\_Bridge](http://en.wikipedia.org/wiki/Gravina_Island_Bridge)

<sup>2</sup> [http://tonto.eia.doe.gov/dnav/pet/pet\\_crd\\_crpdn\\_adc\\_mbbldpd\\_a.htm](http://tonto.eia.doe.gov/dnav/pet/pet_crd_crpdn_adc_mbbldpd_a.htm)

- With a correlation of almost 0.99, the crude oil and diesel price data series move nearly in lockstep (Figure 2).

While the third point is useful when modeling the connections between transportation economics and wood fiber markets, the first two points really drive our decision to focus on the price of crude oil instead of diesel. The cost of a barrel of oil is the common denominator that not only bridges temporal divides, but also profoundly influences every sector of today's economy. Crude oil truly is the Bridge to Everywhere.

In essence, then, using crude oil price in our modeling and forecasting work allows us to simultaneously capture its effects on the nation's economy and local timber sellers and buyers. So, when forecasting what factors may turn economies and markets in one direction or another, Delphi Advisors believes the outlook for crude oil prices ranks near the top of the list.



**Figure 2. Comparison of the spot price for West Texas Intermediate crude oil at Cushing, OK and the national average spot price of No. 2 diesel. Source: Energy Information Administration**