

TRENDMACRO LIVE!

On the Paris Terror Attacks

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Donald Luskin

Animal spirits in the aftermath offset the "terror tax." If only it had driven oil prices higher.

The world first learned of the Islamic State less than 18 months ago, in June 2014, when its forces invaded western Iraq. Prior to that, [President Obama referred](#) to ISIS as "a jayvee team." At the same time he went on to say, "I think there is a distinction between the capacity and reach of a bin Laden and a network that is actively planning major terrorist plots...versus jihadists who are engaged in various local power struggles." [Obama repeated](#) the same outlook as recently as Friday, saying, "from the start our goal has been first to contain, and we have contained them."

The attacks Friday night in Paris prove that ISIS is not "contained," and indeed could pose an ongoing and fundamentally uncontrollable threat to the daily life and business of the developed world. It should have been obvious all along that terrorists do not need to make grand gestures like the September 11, 2001 attacks to be effective. Attacks like the one in Paris have been experienced [in Israel for decades](#). For that matter, terrorists don't even need machine-guns or bombs. It is quite sufficient to drive a car up onto a crowded sidewalk, such as the [October 2013 attack](#) by Uighur separatists in Beijing's Tiananmen Square.

- There is little governments can do to prevent such events, but they inevitably *do something* -- [surveillance](#), [restrictions](#) on travel and immigration and cross-border payments, and [military ventures](#). It all may or may not be effective, but either way it adds up to a "terror tax" -- levied on top of the drag on economic activity already imposed by the threat of terror itself.
- On the positive side, events like the Paris attacks can stimulate a sense of shared pride and purpose, which can translate into the ["animal spirits"](#) that support economic activity. Remember, 9/11 didn't trigger a recession in the US -- [it ended one](#).

At the moment, though, we are especially interested in the effects of the Paris attacks on the price of oil -- the dramatic collapse of which over the last 18 months has, we believe, triggered some form of a global recession (see, among many, ["Is This the Oil Shock Tipping Point?"](#) August 20, 2015).

- The oil crash began precisely when ISIS moved on western Iraq, when in anticipation of potential regional instability, it had rallied to

Update to strategic view

EUROPE MACRO, OIL, US MACRO, ASIA MACRO: Friday's attacks in Paris demonstrate that ISIS or other terrorists can reach into the developed world without grand gestures like 9/11. Unless the attacks prove to be a wavefront of widespread similar events, the animal spirits of unity and pride unleashed can offset any "terror tax" of surveillance and restriction of movements. If, as a consequence of the attacks, regional instabilities in the Middle East lead to higher oil prices, that (all else equal, and to a point) would be a positive. In the meantime, we are still slipping into the first-ever recession caused by too-low oil prices. China and Japan are already there -- soon it will be obvious elsewhere, and hopefully the Fed will see it in time.

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almost \$116.

- We anticipated the crash exactly then, arguing that ISIS would be unable to significantly impede production or transportation of oil -- and at the same time, that a technology-driven revolution in US production was opening up a new age of abundance (see "[The Stench of CrISIS](#)" June 25, 2014).
- Now, less than 18 months later, ISIS is on the front page of every newspaper in the world again, and the oil price is about 62% lower.
- As of this writing, the Paris attacks do not seem to have had an important effect on oil prices -- or any other markets, for that matter.
- *Given our view that the world is entering the first-ever recession caused by low oil prices, we think it actually would have been a positive development if the Paris attacks had led to higher oil prices -- all else equal and only to a certain point We think oil prices are at their bottom anyway -- for reasons we have already outlined, and will be updated shortly in a forthcoming report* (see "[Oil's Hard Road Forward](#)" October 5, 2015).

Our task here, despite the tragic loss of life in Paris, is to cold-bloodedly assess the economic impact of Friday's attacks. Our base case is that the impact will be negligible, unless and until it is demonstrated that the attacks are indeed more than one-off, and represent a new persistent pattern of activity. For the moment, "animal spirits" will dominate -- and with luck, that will offset any new "terror tax" that will be levied.

And again, the branch on the event-tree that leads to regional instabilities in the Middle East, driving oil prices higher, would -- again, all else equal and only to a certain point -- be a positive. But unless that happens, nothing here changes our view that we are already in some kind of recession. China's there. Japan's there. We're just waiting for it be obvious elsewhere (and for the Fed to see it, hopefully in time).

Bottom line

Friday's attacks in Paris demonstrate that ISIS or other terrorists can reach into the developed world without grand gestures like 9/11. Unless the attacks prove to be a wavefront of widespread similar events, the animal spirits of unity and pride unleashed can offset any "terror tax" of surveillance and restriction of movements. If, as a consequence of the attacks, regional instabilities in the Middle East lead to higher oil prices, that (all else equal, and to a point) would be a positive. In the meantime, we are still slipping into the first-ever recession caused by too-low oil prices. China and Japan are already there -- soon it will be obvious elsewhere, and hopefully the Fed will see it in time. ▶

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