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THE OIL PRICE TSUNAMI

The drop in oil price provides the 'Perfect Storm' opportunity for policy reforms.

PLUNGING OIL PRICES HAVE been giving sleepless nights to many a trader, finance minister and central bank governor.

Oil exporters are under pressure from the sharp nose dive in oil prices: Lower oil revenues means growing fiscal burdens and external accounts pressure.

In June 2014, the price of a barrel of oil, then almost $115, began to slide; it sank to a six-year low of around $45 (as of January 13) but has since partially recovered to $60. Normally, falling oil prices would boost global growth.

A $10-a-barrel fall in the oil price transfers around 0.5 per cent of world GDP from oil exporters to oil importers who have a higher marginal propensity to spend.

However, this time round, weak global demand was one of the culprits, alongside increasing oil production. Prior to the sharp decline in oil prices, the market was overflowing from non-OPEC members with the US energy technology breakthrough raising shale-oil output and leading it to prospective energy self-sufficiency.

US SHALE, RUSSIA, VENEZUELA, NIGERIA ARE BLEEDING

The OPEC meeting on November 27, 2014 in Vienna was a turning point with the collective supply quota maintained at 30 million barrels a day, while oil demand was faltering due to slower growth in China and lackluster global growth prospects.

The decision not to cut production levels amid lower demand from Asia and Europe is a tsunami shock for oil producers like Russia, Nigeria, Iran and Venezuela.

The pressure is severe, as the oil price shock has also led to rapidly depreciating exchange rates and inflation as well as sharp falls in asset prices and stock markets.

The Ruble tumbled, forcing the Russian authorities to spend some $83 billion defending the currency in market interventions during 2014. Fitch downgraded Russia's foreign currency bonds to BBB-, one notch above junk bond grade, while CDS rates for Russian and Venezuelan debt skyrocketed.

Nigeria has been forced to raise interest rates and devalue the Naira. The government also had to recalculate its budget twice in recent months, first down to $78 a barrel and later to $65 a barrel.

Venezuela, which was running deficits of close to 15 to 20 per cent of GDP during peak oil boom years, is facing inflation levels jumping to 100 per cent this year and looks ever closer to defaulting on its debt, sending its president on a fruitless overseas financing/aid raising trip.

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But market prices do not discriminate. US shale producers are also bleeding. US shale producers had drilled some 20,000 new wells since 2010, more than ten times Saudi Arabia's tally, boosting America's oil production by a third, to nearly nine million barrels a day. Many will not survive.

Already, the total US rig count is down 30 per cent since October 2014. More US shale capacity will be cut.

Big oil companies are being hit hard: BP is halving its exploration activity and slashing capital expenditure by 20 per cent. Shell said it would reduce costs by $15 billion over the next three years, continue with a major divestment programme and freeze its dividend; and various others have announced significant layoffs.

S&P has downgraded 19 high-yield oil and gas companies since October — the largest set of ratings downgrades for a single sector since 2009, near the peak of the financial crisis.

To add salt to its wounds, many an oil company had borrowed heavily during the period of peak oil prices and low interest rates, only to find that given the strengthening of the dollar since then, not only do they have to repay larger amounts, but they also need to continue pumping oil to meet debt service.

LOWER OIL PRICES AND AN APPRECIATING IS A DOUBLE-WHAMMY FOR THE GCC

GCC countries have announced 2015 budgets that already reflect lower oil prices with some countries announcing budget deficits. The oil