Fall of oil prices

The price of a crude oil barrel has, so far, fallen by around 40% since mid-June 2014, when the price of the crude oil barrel peaked at 115$. The price has so far settled below 59$ a barrel. Oil being an international strategic commodity, fluctuation in the global oil prices has direct effects on some of the major world powers and their economies in addition to global economy. Such a situation would result in clear cut winners and losers among main international players such as the US, the EU, Russia, Iran, KSA in addition to other oil producing countries as well as oil consuming countries. (Refer to the section pertaining to the consequences)

It is thus very interesting to understand what actually happened, what caused this change and what are the possible and most probable geopolitical ramifications of such a change which is expected to last at least until the end 2015.

Causes

Three main reasons caused the fall in oil prices; these reasons would be explained by the simple economic theory of supply and demand.

1. North American supply on shale is booming: Even as OPEC kept production steady, it has been growing elsewhere. The United States, most of all, has seen a major growth in oil production, thanks to the shale oil revolution, in which new technologies like horizontal drilling have allowed access to hydrocarbons deep beneath the Earth's surface.[1] Iraq is expecting an increase of its production. Several hundred thousand more barrels of oil per day are expected from Iraq this year. Following the 80% decrease of oil production in Libya, a resolution is leading to double the previous production from 237000 to 500000 barrels a day. The International Energy Agency indicates that high energy production in the U.S. will continue in 2015 although lower oil prices may slow energy technology development. The greater production will continue to hold down gas prices[2].
2. As far as demand is concerned, the International Energy Agency (IEA), which coordinates the energy policies of industrialized countries, has cut its demand forecast for 2015 by

---

[1] http://www.washingtonpost.com/blogs/wonkblog/wp/2014/11/28/a-simple-guide-to-the-sudden-collapse-in-oil-prices/
[2] http://www.inquisitr.com/1679386/why-are-gas-prices-going-down/

800,000 barrels, while it says U.S. oil output will grow next year by 1.3 million barrels a day. U.S demand for imported oil decreased also because of the 40% increase in shale gas production since 2007. The aforementioned agency amended its projection to suggest that the demand for oil would grow at a slower rate in 2015 than anticipated. The significant increase in North American production on one hand and the decline in demand in Europe and China on the other hand led to a bigger difference between supply and demand. In Europe, for instance, while total petroleum consumption averaged over 15.3 million barrels per day in 2009, it was under 14.3 million in 2013, and has dropped further since[3]. China**,** the world's second-largest net importer of oil, has slightly decreased its demand due to the on-going slow-down[4]. (Based on 2013 figures, every $1 drop in the oil price saves it an annual $2.1 billion. The fall of the prices will lower its import bill by $60 billion (3%).)

3. The world's eyes turned to the Organization of Petroleum Exporting Countries (OPEC)'s semi-annual meeting on November 27, 2014 to see if, as the trend suggests, the organization would take a decision to cut back on its production in an attempt to contain the situation and consequently re-balance the prices. Historically, OPEC's interference usually meant that the organization would cut back on its oil production in order for the demand to outrun supply which pushes crude oil prices upward and ends up benefitting oil producing countries in general and especially OPEC's member countries. So the organization was expected to intervene, cut back on its production in order to rebalance the supply with the demand and stabilize the global oil prices. However, OPEC chose not to intervene and instead the organization decided to "sit out" falling crude oil prices and watch how the market would react. OPEC said that it expects demand for its crude to fall to 28.9 million barrels per day next year, 400,000 barrels per day less than in 2014. The cartel's official production target is 30 million barrels a day, which would mean far more oil on the world market than is being consumed. This being said, while OPEC is a key stakeholder, as far as the recent developments with regard to the falling oil prices are concerned, it has decided to watch and its decision , in turn, contributed to an additional decrease in crude oil prices which settled below 59$ per barrel as of December 12, 2014. It might be that OPEC is perhaps losing its power to push up markets to its own advantage. In order to understand OPEC's decision, it is

[3] http://www.washingtonpost.com/blogs/wonkblog/wp/2014/11/28/a-simple-guide-to-the-sudden-collapse-in-oil-prices/
[4] http://www.juancole.com/2014/11/targets-shale-russia.html

very important to examine the role of Saudi Arabia OPEC's, and the world's biggest oil producing country.

Saudi Arabia, alone, produces a third of OPEC's oil output. KSA hopes that, by deciding not to cut back on OPEC's oil production, the prices would actually fall to below the level at which Shale oil production is economical[5]. Experts believe that this level is around 60$/ barrel. If this indeed happens, this would most probably mean increased dependency on the Gulf region's energy resources as opposed to the alternative of the supply of energy resources from the North-America. So far, the crude oil barrel price is at 57.81$ and it seems that the Shale oil production is still profitable. So would OPEC reconsider its decision and attempt to re-regulate the prices?

Consequences:

As a first wave of repercussions from the drop in oil prices, it is evident that the oil producing countries; such as KSA, Russia, Iran and Venezuela, would suffer the most from the falling oil prices; simply because this means less revenue from oil exports and because the governments of these countries have been using the high prices over the past years to "underpin" their national budgets.

Also, this means that the major oil consuming countries would benefit the most since they would pay less for more.

Moreover, the 50% slide in oil prices, since their peak last summer, could boost consumer spending and business investments in many economies around the world as fuel bills fall.

But this drop in oil prices would also, indirectly, affect sectors beyond the "gas pump" such as energy, water, food supplies and trade routes.

- Russia:

  It is estimated that Russia needs the price of oil to hover around $100 a barrel to pay its bills[6]. Russia's economy has been hurt by two main events: the falling price of oil and the US led economic sanctions. The oil and gas industry generates about half of Russia's revenue. A

[5] http://www.economist.com/blogs/economist-explains/2014/12/economist-explains-4

[6] http://america.aljazeera.com/watch/shows/inside-story/articles/2014/12/15/what-do-falling-oilpricesindicateabouttheglobaleconomy.html

combination of the shale boom in the U.S. and weaker demand worldwide pushed the price from $110 per barrel earlier this year to below $60, Russia got hammered[7]. The sanctions imposed by Europe and the US, designed to punish Russia's companies for President Vladimir Putin's actions in Ukraine, have also had their toll on the Russian economy in general and the Ruble in particular. Over the last six months, the ruble (the Russian currency) has lost more than half its value. It fell to 80 rubles to the dollar and 100 to the euro.[8]

- Iran:

  The Iranian government's budget had been based on an average crude export price of $100 per barrel and a daily export of 1 million barrels of crude oil. That translates into $36 billion crude export revenue of for the budget year ending in March 20, 2015. Before the recent fall of the international oil price, Tehran was selling its crude at an average price of $105-$110. There is already talking about next year's budget plan being based on a crude price of $75 per barrel. If export quantities don't change, this would mean a 25% decline in hard currency revenues. However, the government is hoping to make up for the loss caused by the lower price through increased production. In fact, if Iran and the five permanent UN Security Council members and Germany (P5+1) sign a comprehensive nuclear deal, Iran could increase its crude exports to a level that would compensate for the price fall[9].Iran was already struggling with the impact of western sanctions imposed over its nuclear program before oil began to fall. The government of Hassan Rouhani is seeking to rebalance the economy to reduce its dependence on oil in next year's $93.6bn budget from around 50 per cent to closer to one-third — which would be the lowest in decades. With no prospect of oil prices going up in the near future there is added pressure to strike a nuclear deal before the June deadline. US banking sanctions have cost Iran half its oil revenues. But an agreement could potentially allow Iran, which holds the world's fourth largest oil reserves, to sell more crude and have access to about $100bn of foreign exchange reserves which it has been barred from accessing. Failure could lead to shrinking the economy and to social unrest.[10]

---

[7] http://www.businessweek.com/articles/2014-12-16/no-caviar-is-not-getting-cheaper-everything-you-need-to-know-about-the-russian-ruble-collapse

[8] http://www.huffingtonpost.com/2014/12/16/russia-ruble-collapse_n_6333546.html

[9] http://www.al-monitor.com/pulse/originals/2014/11/iran-oil-economy-falling-prices-crude-exports-market-reacts.html

[10] http://www.ft.com/intl/cms/s/2/3f5e4914-8490-11e4-ba4f-00144feabdc0.html?segid=0100320#axzz3M3rPw9Mf

Adding to that, Syrian businessmen and trade officials are worried the economic lifeline provided by Iran is under strain from plunging oil prices. Syrian President Bashar al-Assad has relied on oil-producing Iran to help him fight insurgents in a nearly four-year-old civil war and also prop up a currency under pressure.[11]

- Venezuela:

  Venezuela needs 120$ per barrel, for every dollars of the price the government loses as much as 700 million per year. Oil accounts for 95 percent of Venezuela's export earnings, and combined with gas, it's 25 percent of the country's gross domestic product. As the price of oil hits a four-year low at $70 per barrel, the OPEC nation's oil-dependent economy is set to implode, experts say, bringing deeper political instability and chaos to the world's 10th-largest oil exporter.[12]

- Oman:

  Oman, Britain’s closest political ally in the Middle East, faces a potential economic catastrophe from the collapse in crude oil prices. Its state budget is based on the price remaining at levels above $85 per barrel. Many of Oman’s oil fields are in decline and require expensive enhanced oil recovery (EOR) technologies to maintain its current output rate. Oman is not only a major trading partner for the UK, the Daily Telegraph says, but it has also played a “pivotal role” in helping to build relations between the US, the Gulf Co-operation Council (GCC) and Iran.[13]

- KSA:

  With oil at $115 a barrel, Saudi Arabia earns $360 billion in net exports a year; at $85, $270 billion. Saudi Arabia’s long-term interest may in fact be served by a period of cheaper oil. It can afford one, unlike most other exporters. Net foreign assets were 2.8 trillion riyals ($737 billion) in August—over three years’ current spending. It could finance decades of deficits by borrowing from itself even if oil were cheaper than it is now. Over the past year production by non-OPEC countries, such as Russia and North America has risen from 55m b/d to 57m b/d. The Saudis might conclude that the main beneficiaries of oil have been non-OPEC members. Some of the new output is high-cost, unlike the Saudis’. A period of cheaper oil

---

[11] http://www.reuters.com/article/2014/12/20/us-mideast-crisis-syria-iran-idUSKBN0JX21420141220

[12] http://www.nbcnews.com/business/economy/venezuelas-future-barbarity-looting-oil-drops-n259116

[13] http://www.theweek.co.uk/business/oil-price/60838/oil-price-north-sea-oil-fields-close-to-collapse#ixzz3KgekJrXW

could drive some high-cost operators to the wall, discourage investment in others and let the Saudis regain market share. And Saudi Arabia can survive low prices because, when oil was $100 a barrel, it saved more of the windfall than it spent. Moreover Saudi Arabia can tolerate lower oil prices quite easily. It has $900 billion in reserves. Its own oil costs very little (around $5-6 per barrel) to get out of the ground.

- ISIS and Iraq:

  Experts say that ISIS is making $3 million a day by selling crude oil captured from Iraq and Syria in black markets. It was believed that ISIS is selling crude oil at prices ranging from $25 per barrel to $60 per barrel, which amounts to almost half of the international crude oil price.[14] In these months it is estimated that the average price is less than 40$ a barrel[15]. With the current oil price (around 55$), the International price is no competition to the one sold by ISIS in black markets. Therefore ISIS till now is the least to lose in this battle. In Iraq, the falling oil prices and the cost of fighting ISIS have created a cash crisis that could affect its ability to make its last war reparations payment of $4.6 billion to Kuwait.[16]

Lebanon

With oil prices falling more than 50% since their peak in 2014, how would the Lebanese government budget be affected?

According to the Bassel Fuleihan financial institute, the main sector to be affected is the energy sector. In fact, 70% of the expenditures made by the Electricité du Liban (EDL) are made to purchase the necessary gas used to produce electricity. It is estimated that the 50% drops in the prices of oil will save the public company around 450 million dollars (if we consider that the annual cost of gasoline is 1.5 billion dollars). These savings would contribute to the reduction of the budget deficit (which is slightly over 6 billion dollars per year or 6% of the GDP as at the end of December 2013)[17]…

A hidden cost?

---

[14] http://english.alarabiya.net/en/perspective/analysis/2014/08/28/Experts-ISIS-makes-up-to-3-million-daily-in-oil-sales.html

[15] http://www.foxnews.com/world/2014/12/15/will-falling-oil-prices-impact-isis-terror-operations/

[16] http://www.csmonitor.com/World/Security-Watch/terrorism-security/2014/1212/Falling-oil-prices-shake-economies-of-Iraq-Russia-video

[17] http://www.institutdesfinances.gov.lb/admin/img.ashx?pageid=3572&phName=File1

In an interview with a local TV station (MTV) in early December, Mr. Riad Salame, governor of the Lebanese central bank, expressed his fears because of the falling oil prices. Since the Lebanese economy depends greatly on the cash transfers it receives from the Lebanese workforce active in the gulf countries, most of which are oil producers who will be greatly affected by the dropping oil prices, where it is estimated that almost 60% of the total remittances received are from the gulf region. If the economies of the gulf countries are to be affected badly by the lower oil prices, this will be reflected on the Lebanese diaspora economic activity in these countries[18]

Mr. Salameh assured that the central bank will issue a new incentive package of subsidized loans worth 1 billion dollars to benefit the private sector borrowers. It is estimated that such package would lead to an additional 2.5% growth of the Lebanese economy.

Consumers too will benefit from the fall of oil prices. Actually it is forecasted that prices in commodities in Lebanon will fall by 20 to 30% the first three month of 2015. In fact, this decrease will be gradual due to the stock of oil product with the traders. According to Arselan Sino, both agriculture (Corn, cereals…) and industrial products will be affected by this decrease.[19]

How does KSA benefit from this decrease and why is it willing to lose?

Some believe that Saudi Arabia was refusing to cut down oil supply because it wanted to force American producers out of the market. (Fracking oil or gas from mile-deep shale is expensive, US shale firms need the price of oil barrel to be around 60$ to make money.[20]).

Some seem skeptical about KSA motivation in keeping oil prices low. In fact, the political agenda that KSA have against Iran made her take the decision. KSA is looking to

[18] http://www.dailystar.com.lb/Entity/People/3892839329/Riad-Salameh.ashx

[19] http://newspaper.annahar.com/article/199223-%D8%A3%D8%B3%D8%B9%D8%A7%D8%B1-%D8%A7%D9%84%D9%85%D9%88%D8%A7%D8%AF-%D8%A7%D9%84%D8%BA%D8%B0%D8%A7%D8%A6%D9%8A%D8%A9-%D8%AA%D8%AA%D8%B1%D8%A7%D8%AC%D8%B9-%D9%85%D8%AA%D8%A3%D8%AB%D8%B1%D8%A9-%D8%A8%D8%A7%D9%86%D8%AE%D8%AE%D9%81%D8%A7%D8%B6-%D8%A3%D8%B3%D8%B9%D8%A7%D8%B1-%D8%A7%D9%84%D9%86%D9%81%D8%B7-%D8%AA%D8%B1%D8%A7%D8%AC%D8%B9-%D8%AA%D8%AF%D8%B1%D9%8A%D8%AC%D9%8A-%D9%8A%D8%B5%D9%84-%D8%A5%D9%84%D9%89-20

[20] http://news.nationalgeographic.com/news/2014/12/141219-fracking-oil-supply-price-reserves-profits-environment/

undermine Iran and Russia for their support of Syria and their role in the political game in the Middle East. The oil market will follow a political shock not an economic one since an increase in the prices will only happen after the "end" of this political battle.

The Saudi strategy could backfire if Iran and Russia decided to cut down their production (together they have more than 17 % of oil production in the world[21]). With a decline of production in these two countries prices cut slightly increase. Additionally, oil prices cannot stay low. When prices are that low, demand will increase to reach a certain level where prices will increase once again.

The question is how much will these prices keep on increasing, and will Russia and Iran survive till the demand increase again?

[21] http://www.whichcountry.co/top-10-largest-oil-producing-countries-in-the-world/