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Recession in Russia, revolt in Venezuela? The knock-on effects of tumbling oil prices

Sudden slump in price of crude - now at its lowest for four years - sends tremors through capitals of the world's great oil powers. A look at the economic and geopolitical implications of $80 oil

Alberto Nardelli, Larry Elliott, Alec Luhn in Moscow, Saeed Kamali Dehghan, Ian Black and Virginia Lopez in Caracas

Thursday 16 October 2014 07.29 BST

The sudden slump in oil prices, which have fallen 15% in the past three months, has sent tremors through the capitals of the world's great oil powers, many of whom could face testing budget crunches if the tendency persists.

Higher output coupled with weaker demand from China and Europe has driven the price of crude down to $85 - its lowest for four years. The US also now produces 65% more oil than it did five years ago following the boom in shale production. The rise has contributed to the global glut of crude and allowed the US to import 3.1 million fewer barrels of oil a day compared with its peak in 2005. Prices are now well below the level on which many oil exporters have based their budgets.

If prices remain weak - and many forecasters suggest they will - then from Moscow to Caracas and from Lagos to Tehran governments will start to feel the impact on macroeconomic policy.

Brent has averaged $103 since 2010 - trading mostly between $100 and $120 - so a continued period of $80 oil, or less, would have an impact across the world, and from multiple angles.

The lower price isn't bad news for everyone. For example, India would not suffer much - commodities account for 52% of India's imports but only 9% of its exports (paywall), and unlike Brazil, Russia or South Africa, India would reap immediate advantages from a fall in commodity prices.

Russia

Western sanctions against Russia over the Ukraine crisis have yet to cause significant changes in Moscow's economic or foreign policy. But plummeting oil prices will strike a significant blow to Russia's economy and could send it into a recession, analysts said.

Growing economic troubles could test the Russian business elite's support for Putin and potentially weaken his popularity, which began skyrocketing after his annexation of Ukraine's Crimea peninsula and reached an all-time high of 87% in August.

Russia obtains more than half its budget revenue from oil and gas, and its economy is highly sensitive to oil price changes.

Bank of America predicts Russia's economy will shrink 1.5% in 2015.

The falling oil price has dragged down Russia's currency. The Russian Central Bank has spent almost $7bn this month propping up the rouble, which nonetheless reached a record low on

Wednesday, hitting 41 roubles to the dollar for the first time.

In response, the finance ministry announced it will sell off foreign currency reserves to the tune of several billion dollars over the next month in an attempt to soften the shock to the economy. Russian oil companies' share prices also sank on Wednesday, with state oil champion Rosneft dropping by 1.2% after Bank of America cut its rating to neutral from buy. The Moscow stock exchange fell by 0.9%.

Timur Nigmatullin, a macroeconomic analyst at Investcafe, argued that relatively high oil prices in the first half of the year, when prices were above $100 a barrel, would compensate for the lower prices now. "The Russian economy is pretty large, even all these shocks and the fall in oil prices can't cause a drastic, immediate negative effect," Nigmatullin said. "They lead to effects half a year later, like spending cuts. Plus the government will soften the blow using its reserve fund. I don't think it will be as bad a crisis as in 2008."

He predicted the government would seek to mitigate the country's worsening economic situation by borrowing, reducing expenditures and spending money from the reserve fund built up when oil prices were higher. But all these have negative effects, notably rising debt servicing costs and reduced popularity for the government, he said.

The 2014 federal budget was calculated with $93-a-barrel oil prices in mind, while 2015 counted on about $95 a barrel.

Strong energy prices have been the rock on which the long record of economic stability of Vladimir Putin (below) has been predicated. But plunging oil prices were responsible at least partly for unseating his two predecessors in the Kremlin, Mikhail Gorbachev and Boris Yeltsin.

Konstantin Sonin, a professor at the Higher School of Economics in Moscow, said shrinking oil prices would cause problems for Russia's budget and lead to spending cuts that could serve as a "signal" to the government that "we can't live as we have been".

The political elite is now realising what the true cost of Putin's aggressive Ukraine policy will be, he said.

"The main correction is to understand that economic policy should be the main one, it is more important than any geopolitical concerns," he said. "I think that fall of oil price will force the elite and population to more soberly evaluate Putin's successes and mistakes."

But Nigmatullin doubted that Putin's popularity would suffer significantly.

"Unemployment has the greatest effect on political ratings, and in Russia, unemployment is going down because the working part of the population is shrinking, so by this theory I don't think Putin's rating will drop." **Alec Luhn in Moscow**

Iran

Iran's economy, which depends on oil for most of its exports revenue, has faced huge economic problems in recent years due to international sanctions imposed over Tehran's nuclear programme.

A EU and US oil embargo, strict banking restrictions and trade bans have among the major measures designed to punish Tehran for its failure to comply with international demands over its nuclear activities. Falling oil prices will just add to economic woes in a country with the world's fourth largest oil reserves.

Amir Handjani, of the Dubai-based RAK Petroleum, said that since the west struck an interim nuclear agreement with Iran last November Tehran has increased its sales of crude, especially to fund access to essential commodities and goods.

In 2010, he said, Iran was the fourth largest producer in Opec, whereas today it stands in eighth place.

Handjani added: "Iran has been very lucky that in the past eight years oil prices were so high. But now oil prices are coming down and given the fact that Tehran is already under sanctions, the issue of falling oil prices is going to be very sensitive."

He said it was difficult to predict what would happen if prices continued to drop but said it will certainly have an impact on the country's economy.

"No one can predict the future but if you go back to 1998 when the price of oil was 10 dollars per barrel then yes, falling prices today can be catastrophic."

Marie-Claire Aoun, the director of the centre for energy at French Institute of International Relations (IFRI) said the capacity of Opec would determine how the current declining trend will continue.

"Whether there's going to be a catastrophe or not wholly depends on how Opec is going to deal with it," she told the Guardian.

Authorities in Iran have been urged to press for an emergency Opec meeting.

Iranian officials have pointed the finger at Saudi Arabia, saying it has deliberately kept prices low by manipulating Opec sales.

Iran's oil minister, Bijan Zanganeh, has explicitly blamed Riyadh for the situation. "Some of the biggest producers at Opec should reduce their sales," he said, in what was widely viewed as a criticism of Saudi Arabia.

Other Iranian officials have been more candid with their views about Saudis.

Masoud Mirkazemi, a former Iranian oil minister but now an MP said: "We should have an emergency Opec meeting so that countries like Saudi Arabia that pursue policies against producers' interests would reduce their sale," the ex-minister said, according to the conservative Tasnim news agency.

"Saudi Arabia, which intends to manage the Opec, serves the interests of the G20 group. We should not let Saudi Arabia to do this and our oil ministry should change its passive response to the issue," he said.

Saeed Kamali Dehghan

Saudi Arabia

Falling oil prices have forced Saudi Arabia to act to preserve its position in world markets - but unlike other big producers it can use its huge cash reserves as a cushion against a temporary fall in revenues.

Saudi officials have been signalling that they are prepared to see prices sink to as low as $80 per barrel at least for a year or two - well below the IMF estimate of the country needing a price of $91 to balance its budget.

Analysts suggest one motive of Opec's largest producer may be to make US shale oil unprofitable and force a US production cut at a time when the world market seems to be facing years of oversupply.

The Saudis are masters of opacity so their motives are unclear but the conclusion of most experts is that they are taking a long-term view designed to retain their market share in years to come.

The conservative kingdom, the largest economy in the Arab world, currently pumps around a third of Opec's oil, or about 9.7m barrels a day. It has reserves of 266bn barrels of crude.

The short-term downside of lower prices is that with expensive infrastructure projects under way a growing budget deficit will require dipping into foreign currency reserves - though at an estimated $750bn that could be sustained for a while. The Saudis also have the benefit of low production costs.

"Riyadh's oil output is its most strategic resource, and one that the government is quick to use to its advantage," the Stratfor consultancy commented recently.

"With summer temperatures beginning to cool and regional consumption starting to taper off, Riyadh can free up larger volumes to export, even at lower prices.

"The Saudis are also looking to leverage their short-term economic stability over rivals such as Russia, especially as they square off with Iran over the future of the Syrian government."

Other Gulf producers are less exposed, with the UAE needing an oil price of about $73 to balance its budgets and Kuwait $53. Reduced revenues have drawn attention to the perennial problem of the kingdom's dependence on oil - suppling 90% of state revenues. On Tuesday, the billionaire Prince al-Waleed bin Talal published an open letter to the country's oil minister, Ali Al Naimi, warning that "our country faces the danger of continuing to depend almost entirely on oil."

Ian Black

Venezuela

Even at $100 a barrel, Venezuela was eating into its currency reserves. Experts believe that $80 oil will deepen a fiscal crisis that is already threatening social unrest.

Venezuela relies on oil revenues to pay for imports, everything from car parts to basic foodstuffs, and this supply might be compromised if cash runs dry. Anti-government protests across the country left more than 40 people dead in February.

"If prices remain at current levels Venezuela will see its cash flows reduced by $16bn in the next 12 months," said Alejandro Grisanti, head of Barclays Latin America economic research team.

"For a government that is reluctant to adjust and has the worst set of economic policies, this decline in (foreign exchange) income will bring higher inflation, more scarcity and lower purchasing power to the Venezuelans."

Francisco Monaldi, of the Belfer Center, said if prices remained depressed for more than a year Venezuela would suffer more than other Opec countries.

"The economic adjustment required will involve giving up a lot of the gains in poverty reduction that the country had in the previous decade. Politically the government will get into a very difficult level of popular support."

Virginia Lopez in Caracas

Analysis: winners, losers and political uncertainty

There have been four major recessions in the West since the mid-1970s and each has followed a spike in the oil price. All downturns have their own peculiarities, but one common thread links the stagflation of the seventies to the mega-crash of 2009: dearer crude. The opposite also applies. A low oil price was a vital ingredient in the post-war Golden Age, and a falling oil price lubricated the strong and sustained growth of the 1990s. Logically, therefore, the 25% decline in the cost of crude since June should mean higher levels of activity.

For that to happen, however, the oil price will have to fall a lot further, to somewhere around $50 a barrel. At $115 a barrel the price was consistent with rip-roaring levels of demand.

In the meantime there will be winners and losers. The winners are the large net importers of oil and those that have high inflation rates, such as Turkey and India. Business costs will fall and consumers' incomes will stretch further.

The losers are oil producers, which will see growth fall and budget deficits swell. Iran, subject to a crippling western embargo, needs an oil price of more than $140 a barrel to make its budget break even. Anything below $120 a barrel spells trouble for Venezuela and Nigeria. About $105 a barrel is Russia's cutoff point. At today's price even Saudi Arabia, the world's biggest producer, is starting to feel the pinch as it has used a high oil price to fund generous public spending. It needs $93 a barrel to balance the books.

The problems are magnified for many of these countries because high oil prices have stunted the development of other sectors of the economy. In Russia, oil and gas accounts for 70% of exports. The country's struggling manufacturing sector relies heavily on orders from energy companies.

Falling oil prices are the result of a glut of supply and an easing of demand from a slowing global economy. Saudi Arabia could try to arrest the decline by cutting production, although a similar ploy was notably unsuccessful in the mid-1980s. Despite having youth unemployment of above 30%, Riyadh would probably live with $80 barrel oil prices if it thought it would discourage Vladimir Putin from turning off the taps to the west.

This is where the economics of oil mesh with geopolitics. One theory is that lower oil prices will force Russia to adopt a softer line over Ukraine, and Iran to come to terms over its nuclear programme. But a sharp dose of economic pain in countries that are highly volatile could have the opposite effect.

Larry Elliot

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