

Why oil prices keep falling -- and throwing the world into turmoil
The year has opened with turbulence on world financial markets, reflecting the interaction between deepening slump, heightened geo-political tensions and growing political instability in virtually every country.

While consumers and the government are cheering the over 50% fall in global oil prices resulting in cheaper petrol and diesel, oil-producing nations are in a quandary. BankersAdda helps you understand the dynamics of this free fall.

1

The mounting problems in the global financial system are expressed most directly on Wall Street, its apex. US equity markets are on course to have their worst start to the year since 2008. That year culminated in the global financial crisis set off by the collapse of Lehman Brothers in September.

Yesterday, the Dow was down by 130 points--a decline of 0.8 percent--following a 331-point decline on Monday.

The most immediate factor behind the fall on Wall Street was a further decline in the price of oil, with West Texas intermediate falling below \$50 per barrel and Brent, the global benchmark, approaching that level. Since June, the price of oil has declined by more than 50 percent.

What has been the trend in oil prices?

Since 2010, global oil prices have stayed above \$100 a barrel level.

Among the reasons attributed to this trend was the higher consumption patterns by importing nations like China and India. Also, the geopolitical tensions in nations like Iraq and Libya too kept the prices high. As oil producing nations could not keep up with the demand, prices soared and hence the spike was attributed to this gap. Till June 2014, the global oil prices were hovering at \$115 a barrel in contrast to the present levels of \$52-53 a barrel.

What has been the impact of the sudden fall in global oil prices?

While the trend has cheered most oil guzzling and importing nations like India, China and Japan, the unexpected fall has also caused havoc for oil producing nations, including the top Gulf producers and also other countries like Russia and Venezuela.

Why a sudden fall in oil prices?

By 2014, the world oil supply was on track and in line with the demand. However, over the past few years, countries like the United States and Canada in order to reduce their over dependence on imported oil started exploring other alternatives such as shale gas. Shale usage in US and Canada coupled with the weakening of economies in Asia and Europe led to a sudden fall in oil demand. So while producers, including the major oil producing Gulf nations, resorted to higher production, a weaker demand led to the fall in oil prices. From September onwards, crude oil prices have been plummeting and have

fallen to more than 50%.

Did OPEC play any role in combatting the fall in oil prices?

As oil prices continued to slip onwards of September 2014, experts and analysts hoped that OPEC - group of major oil supplying countries including Saudi Arabia and Iran - at its crucial meeting in November 2014 would intervene and arrest the falling trend. However, much to everyone's surprise OPEC did nothing and rather decided against cutting back production. This came as a big trigger and oil prices went into free-fall.

What are the ramifications of this unexpected fall on the global economy?

The free fall in global oil prices has an impact on every country in the world. While for the economies of large consuming nations like China, India, Japan and the US, the fall in oil prices is an excellent news. However, suppliers of oil, including large economies like that of Russia and Venezuela, are facing a potential threat. Most of oil producing nations will face serious unrest if oil prices stay low and the fall continues.

How falling oil prices could affect Russia, Iran, and the US?

The plunge in oil prices is having significant economic consequences around the world. A few examples:

Russia: Russia's situation is getting the most attention these days.

The country's is hugely dependent on oil and gas production -- with oil revenues making up 45 percent of the government budget -- and the sharp fall on prices has been ruinous.

RUSSIA'S ECONOMY IS EXPECTED TO SHRINK 4.5% NEXT YEAR IF OIL STAYS AT \$60 PER BARREL

On December 15, the country suddenly hiked interest rates from 10.5 percent to 17 percent in an attempt to stop people from selling off rubles. But those rate hikes are likely to slow the country's economy down even further.

Iran: Iran's economy had recently started to rebound after years of recession. The International Monetary Fund had been projecting that the country was on track to grow 2.3 percent next year. But that was all before oil prices started to plunge -- a potentially precarious situation for the country.

One big problem for Iran is that it also needs oil prices well north of \$100 per barrel to balance its budget, especially since Western sanctions have made it much harder to export crude. If oil prices keep falling, the Iranian government may need to make up revenues elsewhere -- say, by paring back domestic fuel subsidies (always an unpopular move, at least in the short term).

Saudi Arabia: There's no question that Saudi Arabia, the world's second-largest crude producer (after Russia), will suffer financially from cheap oil. If oil stays at around \$60 per barrel next year, the government will run a deficit equal to 14 percent of GDP.

The United States: In the US, meanwhile, a fall in crude prices would have more varied impacts. For many people, it will offer a nice economic boost: cheaper oil means lower gasoline prices -- which have fallen to \$2.47 per gallon, the lowest since 2009.

How does the fall in oil prices affect India?

India imports nearly two-thirds of crude oil requirements. The sharp fall in global crude oil prices will cut down the country's import bill and enable oil marketing companies to reduce retail prices of petrol and diesel. Lower oil prices have also aided government's efforts to keep inflation low and stable besides curtailing fuel subsidies. A lower subsidy bill will help contain the country's fiscal deficit -- a measure of the amount the government borrows to fund its expenses -- at the budgeted level of 4.1% of GDP in 2014-15. Being the world's fourth-largest oil consumer, India imports around 190 million tonnes of crude oil a year - costing \$145 billion a year, or more than a third of its total import bill. With every dollar decrease in oil prices, the government's oil import bill comes down by Rs. 4,000 crore.

Dalal Street takes a hit - The BSE Sensex and Nifty slumped more than 3% on Tuesday, posting their biggest daily loss since the rupee crisis in 2013 as a continued slide in oil prices hit emerging markets, sending blue-chips such as State Bank of India sharply lower.
Foreign Exchange Market -

Here is a case in the context -

India has a huge demand of petrol and diesel in their economy, to buy fuels from Saudi Arabia India needs a currency that Arab accepts (same as you cannot buy milk by paying wheat anymore). Arab needs dollars to invest and purchase goods from different countries (dollar is the most accepted and sought of currency). So Indian oil companies will have to go to foreign exchange market to buy dollars with rupees.

How the rates are decided-

Now the Indian oil companies go to Forex market to buy dollars for paying fuel bills but the dollar rich institutes citing the opportunity will not release their funds this easily, as they don't need Rs anymore (due to the unsupportive govt, Inflation and scams in India), The case is same as you fetch a drastically low prices for the junk lying inactive at your home, So this will lead in to extended round of negotiations and the past rate of 55Rs (say) against a dollar will go up to 60Rs a dollar or even more. This will in turn be a reason for rise of transport of goods in India and the final goods that used to come for 10Rs in past will jump to 12 or more hence the price rise will strike in India leading to inflation.

Decoded: Shale gas

It is a natural gas found in shale formations - a type of rock in the earth's crust. It is being considered as the new source of natural gas as other sources are fast depleting. US is at the forefront of exploring and producing shale gas. It accounted for 39% of its natural gas production in 2012. India is expected to have around 6 trillion cubic metres (tcm) of recoverable shale gas (compared to 1.3 tcm of conventional natural gas). However, production costs in India will be

significantly high due to the advanced technological requirements and relatively unknown terrain.

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