

# A cheat sheet on lower oil prices

**Oil prices have plunged, helping consumers but worrying energy-reliant countries and companies. Here's a cheat sheet on what's happening and its implications.**

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**A little background:** over the past seven-plus months, the price of a barrel of oil dropped from \$107 to less than \$50. This took prices to 2009 levels and surprised just about everyone. Stock markets do not like surprises, and many global indexes have dropped, adding another wrinkle of worry to an already wobbly global economic recovery. Let's consider some of the implications.

## The good news

For US consumers, the drop in oil prices is excellent. A two-car family that drives 2,000 miles a month might have to buy 100 gallons of gas. With the average price per gallon now \$1.25 less than it was at its 2014 peak, that adds up, essentially, to a \$125-a-month raise. For American households, spending on gas is on track to be the lowest since 2003.

European and Japanese consumers, who drive much less and for whom taxes account for a much higher share of the price at the pump, will not benefit as much. Still, since both markets are importers, less expensive oil is a nice little economic boost. On the other hand, it also adds to the deflationary pressures that are hampering these markets' ability to retire debt. Still, on the whole, a net benefit.

Countries that subsidize the price of oil, such as India, will also benefit (though they really should seize the opportunity to cut such subsidies on the way to eliminating them altogether). Analysts reckon that every \$20-per-barrel fall in the price raises global GDP growth by 0.4 percent.

## The bad news

Obviously, crashing prices are bad for oil companies; the S&P energy index fell more than 19 percent in the second half of 2014, and high-cost producers may have to shut down some operations. The *Financial Times* has estimated that some \$1 trillion in planned production projects are in danger of cancellation.

But the really crushing, and frankly scary, situation has to do with state-owned producers. The simple fact is that many of the places that rely most heavily on fossil fuels are not

exactly easy. Plunging prices poke holes in state budgets and can have wider ripple effects. Consider:

- *Nigeria*. The currency, the naira, is at its lowest level against the dollar since at least 1999.
- *Russia*. The ruble is hemorrhaging, which is hardly surprising, since oil and gas account for about three-quarters of the country's exports. The weaker ruble will drive up the price of food; in addition, international banks hold a fortune in Russian debt. If that debt cannot be serviced, the still-fragile global financial system would get seriously hurt.
- *Venezuela*. This place is already in such a mess that it had shortages of toilet paper. Debt default is a real possibility.
- *Iraq, Iran, and Libya*. These countries rely almost entirely on oil for their export earnings and domestic budgets. In a region that is hardly short of turmoil, more of it isn't out of the question.
- *Norway*. Even Norway is warning of a "severe downturn."

## **Don't get used to it**

What's next? The thinking is all over the map on this one. Some analysts say prices will rebound in six months. Others think they will stay low for two years or more. Some believe prices will eventually come back to \$100 a barrel. Others say they will come back to a new equilibrium—perhaps \$80. I say that I don't know. I am not going to start predicting oil prices, which is an all but certain way to look foolish down the line.

I will say, however, that even \$60 a barrel is not sustainable. Already, energy companies are cutting upstream investment. Also, at less than \$60 a barrel, a lot of higher-cost production is no longer economical; that includes a good deal of US shale. Both factors will reduce the amount of oil that reaches the market and will eventually drive prices up. Probably.

After all, Saudi Arabia has indicated that its priority is to protect OPEC's market share; therefore, the cartel has agreed not to cut production, at least for now. If Saudi Arabia decides to get more aggressive and produce more, that would obviously depress prices. But OPEC suffers with very low oil prices. On the whole, then, the long-term pressures are in the other direction—that is, up. Advice: take that driving holiday sooner rather than later.

## **And speaking of driving...**

When gas prices are high, electric cars are a lot more appealing because they are more economically competitive in terms of the total cost of ownership (meaning how much it costs to run a vehicle, taking everything into consideration). Low oil prices reduce the enthusiasm to explore alternative ways of driving. At the moment, the nascent electric-car industry needs high oil prices the way it needs charging stations; it is hurting under the present circumstances. The share price of Tesla, for example, has slumped more than 20 percent since early September. Hybrid-car sales are also suffering.

## No more peak oil? Please?

Peak oil is one of those fashionable notions that simply cannot be killed, no matter how often reality contradicts it. It's the idea that oil production has maxed out and that decline is therefore inexorable and inevitable. In the original declaration of peak oil, the United States was supposed to run out of oil sometime in the 1960s, and the date keeps getting pushed back. This idea had a lot of advocates—even unlikely ones, such as Texas oil man T. Boone Pickens, who said in 2004 that “never again will we pump more than 82 million barrels” a day of liquid fuels (we've been at 90 million and up for several years). There was a peak and a decline, but in the past few years, thanks mostly to the exploitation of shale resources, there has also been a recovery. Under peak-oil theory, that cannot happen. But it has.

A better play than peak oil is to bet on the power of the market and the human ingenuity that propels it. High oil prices encouraged substitution on the demand side, in the form of greater efficiency and other measures. They also encouraged innovation: finding new sources of supply, such as oil sands in Canada and shale in the United States. Basically, when oil prices went up, so did the interest in alternatives and their economic viability. There is no reason on Earth—or under it—to expect that dynamic ever to change.

*This article was originally published on LinkedIn. For more of Scott Nyquist's columns, visit his [LinkedIn Influencer page](#).*

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Fuente:

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