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## **Oil price uncertainty**

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The oil price is rising.

Good days of price per barrel between US\$40 to US\$50 appear to be over.

In normal times, oil price is determined by its own supply and demand. Oil price rose more than 70 percent since early this year due to supply disruptions around the globe.

The June 23 British referendum on to stay in or exit European Union is the biggest of all uncertainties. A positive stay-in vote will boost economic prospects of Britain, EU, and the rest of the world.

An exit, negative vote would make all commodity assets riskier and the US dollar will go up. Price of oil as an asset will be down!

From a close US\$140 a barrel in 2008, oil price plunged to US\$48 a barrel in 2009, as the world recession began. It rallied in the next two years, when China began its role as the engine of world growth. Oil price reached US\$125 in early 2011 and then hovered around US\$100 for next three years. It fell to a close US\$50 a barrel in 2015, as China slowed down, plunging all commodity prices. Thereafter, there was a steady fall to the delight of all.

Early this year, it touched the bottom: US\$33.

Now, it is rising: above US\$50 early this month.

### **Oil Market Monthly Report**

International Energy Agency (IEA) says during 2014-2016, crude oil supply soared. It was due to big increase in USA, as the investments by fracking companies came to fruition. When the price was around US\$100, fracking operations began from the shale formations in Texas and North Dakota, doubling US crude production.

Saudi Arabia, the leader of OPEC wanted to get the shale producers in the US, out of the market. The only way was to forcibly pushdown the price level close to US\$50. OPEC did not reduce output but went on pumping.

In the meanwhile, Iran joined the world producers, as the sanctions by US and EU were lifted as part of the nuclear deal. Iran adds 700,000 barrels per day. In addition, Iraq's post war recovery led to resumption of oil production.

Once the price started falling in 2015, the shale boom in USA busted. The shale producers had to quit. That is the effect which we are going to face. There are also some unexpected disruptions in supply.

- huge forest fires in Alberta, Canada reducing daily supplies by 700, 000 per day
- destruction of oil wells and gas infrastructures by Nigerian militants
- violence in Libya
- political situation in oil-rest in Venezuela

These contributed to rise in oil price.

Although, the world has tucked away in storage some 3 billion barrels, developing countries add to demand, despite the Chinese slowdown.

The world demand of crude is expected to reach 1.6 million barrels per day, as against the earlier forecast of 1.2 million barrels. IEA says supply and demand will balance, when supply is around US\$ 1.6 million barrels.

### **The US Fed action**

The US Federal Reserve (the Fed) decided on Wednesday June 15 to maintain the benchmark rate in the range of 0.25 percent to 0.50 percent. It is likely to raise the rate only if inflation exceeds the targeted 2 percent. It would be bad for developing countries, if the Fed increases the benchmark rate, as it indicated it would raise rates twice in 2016. Rise in the US interest rate will strengthen US dollar. Other currencies will have to go down in value.

Since oil price is quoted in US dollars, developing economies have to pay more in their domestic currencies depleting their foreign reserves.

So, difficult times are ahead of countries fully dependent on oil imports.

The Reserve Bank of India fears rise in oil price and uncertain domestic agricultural production, as monsoon is delayed in the western states. Early this month, it decided against any reduction in its benchmark interest rate. A decrease in interest rate will see outflows of capital and depreciation of the rupee will render imports of oil expensive. It will feed inflation.

On June 7, Reserve Bank of Australia (RBA) decided against another cut this month in its cash rate of 1.75 percent. In fact, it left no room for any guess about the future unlike in the last month statement. RBA expects inflation returning to target over time.

The Reserve Bank of New Zealand (RBNZ) was also against cutting present interest rate (2.25 percent). Its immediate concern is to control booming property market. Property values rose at an annual pace of 12 percent in May. It expects inflation to strengthen due to accommodative monetary policy and increases in fuel and other commodity prices.

### **Fiji's case**

The accommodative monetary policy stance (benchmark rate at 0.5 percent) of May announced on April 28 continues for June. The Reserve Bank of Fiji (RBF) Board did not meet in May. The developments on the oil price front are yet to be duly recognized.

As *IMF Staff Report* of January 2016 notes oil imports of Fiji are around 20 percent of total imports. Although the pass-through of world oil prices to domestic consumer price index is gradual and 50 percent, the pass-through from global prices to transportation sector is almost 100 percent.

The impact on foreign reserves level will also be of some concern.

The *RBF Economic Review for May 2016* states foreign reserves declined in April by FJ\$29.9 million, although the reserve level at FJ\$2,005.1 million is still adequate to cover 5.6 months of imports.

It is budget time again.

Vigilance is called for containing recurrent expenditure. Any budget surplus would certainly contribute to keeping inflation at bay.