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DID YOU KNOW?

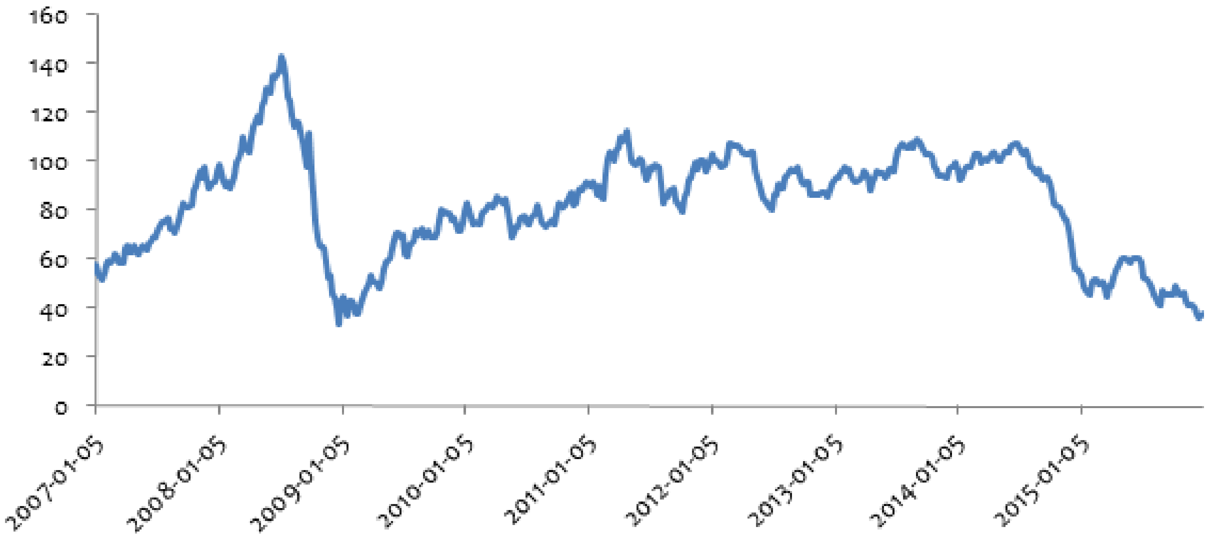
OIL PRICES

COLIBRILAW

Over the past year, oil prices have experienced the largest drop since the 2007-2009 recession. Throughout the mid-2000s oil prices fluctuated around the psychological benchmark of $100, whilst today it seems that $30 per barrel is the new reality. Indeed, according to market forecasts[1] for 2016, companies and investors are preparing for another year of strain.

duction level showed multi-decade highs. According to official data, on average since October 2015 the U.S. produced 9.3 million barrels each day. Canada, Russia, China and Norway all are expected to post annual production gains this year, according to the U.S. government's Energy Information Administration.

Figure 1. Weekly crude oil prices: WTI, US$ per barrel
Source: U.S. Energy Information Administration



There are several prominent reasons why further drops in oil prices can be expected in the near future. First, this price drop is very different from the demand-induced oil crisis of the recession.

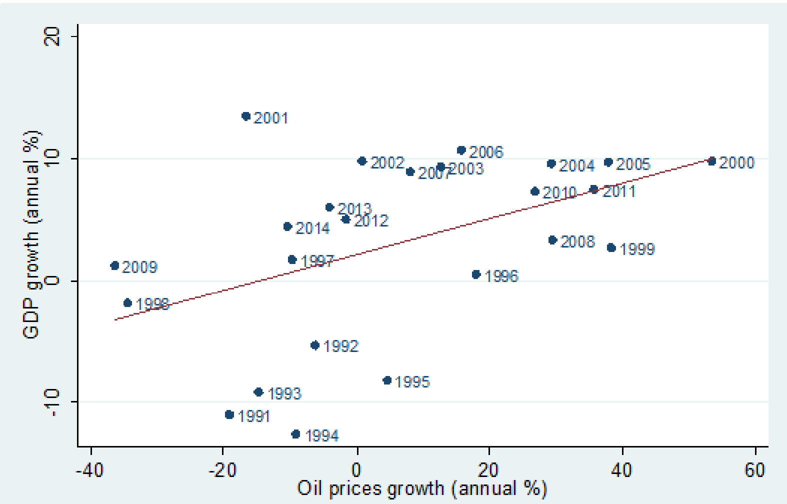
One of the unexpected triggers was caused by OPEC, which increased oil production at the beginning of the drop in oil prices, rather than decreasing it. Meanwhile, producers in the U.S. and Russia proved much more resilient than expected. For example, despite the reduction in U.S. oil production in spring 2015, its annual pro-

The second reason is the slowdown of Chinese economic growth, which continued to slow in the third quarter of 2015 and is nearing its slowest pace since the global financial crisis[2]. The recorded GDP growth rate in the third quarter of 2015 reached 6.9%, the first time since the recession that economic growth in China fell below 7%. This slowdown of Chinese economic growth triggers additional concerns about the world economic outlook.

Finally, the struggle for the market share between Iran and Saudi Arabia may add further impetus to the plummeting of oil prices. Iran is back on the international market following the recent lifting of western sanctions. Furthermore, recent evidence shows that Saudi Arabia has an excess production capacity of 2.5 million barrels per day, which is double the supply it released onto the oil market last year. This may signal Saudi Arabia's willingness to keep up with low prices and foreign reserve cuts to protect its share in the oil market. In addition, Saudi Arabian Oil Co., better known as Saudi Aramco, has recently announced that it is considering the possibility of going public by listing in capital markets. Aramco produces more than 10% of the world's oil supply every day and controls a large chain of refineries and petrochemical facilities. According to preliminary forecasts, its value may be in excess of $10 trillion. The IPO of Aramco may have a number of implications for the prospects of the oil market. For instance, U.S. producers may potentially lose the competition to this listed giant.

Overall, declining oil prices have several direct and indirect implications for the Central Asian economic outlook in the medium term. Firstly, with the falling oil prices, Russia is close to a recession with a contraction of 4.3% in the third quarter of 2015. As a result, the ruble has been very volatile, placing additional pressure on the basket of Central Asian currencies, especially the Kazakh tenge.

Secondly, with Kazakhstan's accession to the World Trade Organization this year, the economic prospects of the Eurasian Economic Union look very gloomy. Kazakhstan may consider shifting its attention to WTO member markets. In this vein, the slowdown of its neighbour and key partner, China, suggests that demand for raw materials from Kazakhstan will face a decline. The devaluation of the tenge did not yield the anticipated results for the private sector, as cheap labour costs and investments in the resource sector, for example the Kashagan oil field, faced the near-collapse of oil prices.



The table on the left shows that over the past two decades a 10% increase in average annual oil prices correlated with a 1.4% increase in the average GDP growth rate of Kazakhstan. Therefore, the alarming trends and forecasts of global oil prices may well drive the Kazakh economy into a deep recession.

[1] USEIA (2015)

[2] WSJ (2015)

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