

Cheaper oil

Both symptom and balm

The oil price is tumbling. Is that good or bad news for the world economy?



Print edition | Finance and economics

Oct 21st 2014

AFTER declining gradually for three months, oil prices suddenly tumbled almost \$4 on October 14th alone. It was the largest single-day fall in more than a year and brought the price of Brent crude, an international benchmark, to \$85 a barrel. At its peak in June, a barrel had cost \$115.

Normally, falling oil prices would boost global growth. A \$10-a-barrel fall in the oil price transfers around 0.5% of world GDP from oil exporters to oil importers. Consumers in importing countries are more likely to spend the money quickly

BRITAIN

Gene editing takes another step forward

SCIENCE AND TECHNOLOGY

Fears that Xi Jinping is bad for private enterprise are overblown

BUSINESS AND FINANCE

See all updates

been caused by a surge in the supply of crude. If weak demand is the culprit, that is worrying: it suggests the oil price is a symptom of weakening growth. If the source of weakness is financial (debt rans and so on), then cheaper oil may

Sign up or subscribe to read more

cheaper oil may even make matters worse by increasing the risk of deflation. On the other hand, if plentiful [Subscribe](#), that is potentially better news: cheaper oil should eventually boost spending in the world's biggest economies.

Sign up: 3 articles per week

The global economy is certainly weak. Japan's GDP fell in the second quarter. Germany's did too, and may be heading towards recession (recent figures for industrial production and exports were dreadful). America's growth has accelerated recently, but its recovery is weak by historical standards. Just before this week's oil-price slump, the International Monetary Fund cut its projection for global growth in 2014 for the third time this year to 3.3%. It is still expecting growth to pick up again in 2015, but only slightly.

Weaker growth translates into lower energy demand. This week, the International Energy Agency, an oil importers' club, said it expects global demand to rise by just 700,000 barrels a day (b/d) this year. That is 200,000 b/d below its forecast only last month. Demand has been weak for a while but the recent slowdown—notably in Germany—took markets by surprise, hence the sharp fall in the price.

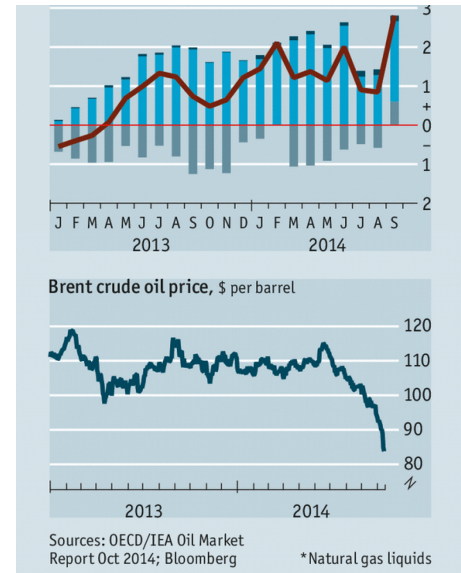
But feeble demand is not the only explanation. There has also been a big supply shock. Since April last year the world's total output of oil has been rising strongly. Most months' output has been 1m-2m b/d a day higher than the year before. In

Thanks partly to increases in shale-oil output, the United States pumped 8.8m b/d in September—13% more than in the year before, 56% above the level of 2011 and not far short of Saudi Arabia. Russian oil production is also inching up, suggesting sanctions have not yet begun to be felt in its oilfields. In September, its output rose to 10.6m b/d, within a whisker of the highest monthly figure since the collapse of the Soviet Union.

Non-OPEC production, though, has been rising for a while. The biggest recent change has come from within the cartel. In April, Libya's production—hit by civil war—crashed to just 200,000 b/d; by the end of September output was back up to 900,000 b/d and heading towards its pre-war level of 1.5m b/d. No less surprisingly, Iraq's output is rising, too. The upshot is that OPEC production started to grow again in September after almost two years of decline, compounding the impact of growing non-OPEC supplies.

With demand weak, much of the extra output has gone into rebuilding oil stocks in rich countries. But that cannot go on indefinitely. As the hoarding slows, prices are likely to weaken again—unless world demand picks up or oil production is cut.

Neither seems imminent. Antoine Halff, the IEA's chief oil analyst, points out that very little current production becomes uneconomic even at \$80 a barrel. The break-even point for most American shale-oil producers has been falling as they have refined their fracking techniques, and is now well below \$70 a barrel. So prices will have to fall further if they are to drive marginal producers out of business.



Saudi Arabia shocked the rest of OPEC by cutting forward prices for Asian delivery and by increasing oil output slightly in September (by 107,000 barrels), at a time when other exporters wanted it to cut back. The organisation is due to meet again in November. But as Kuwait's oil minister remarked recently, "I don't think there is a chance today that [OPEC] countries would reduce their production." How soon—and how much—lower prices will translate into an increase in global demand, though, is far less certain.

You've seen the news, now discover the story

Get incisive analysis on the issues that matter. Whether you read each issue cover to cover, listen to the audio edition, or scan the headlines on your phone, time with *The Economist* is always well spent.

Enjoy great savings

