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Will global oil price remain low?

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Low inflation is a comforting situation.

Low inflation maintains the purchasing power of daily wages or monthly salary earners steady. It also provides a justification to governments for embarking upon expansionary budgetary policies.

To the central banks all over the world, low inflation is a helpful indicator, enabling them continue their cheap money policies. That is one of the reasons for the US Federal Reserve behind its last week decision not to raise its seven year old, near zero interest rate policy.

The mandatory objectives of major central banks are similar : low inflation, not more than 2% in the US, UK and European Union, ensuring stable economic growth; and an acceptable level of unemployment, around 5% level as in the US.

RBF's dual mandate

The Reserve Bank (RBF) aims to keep inflation not more than 3 to 3.5 percent. With a fixed exchange rate regime, its policy objective has two components: domestic stability and external stability of the Fiji dollar. Domestic stability refers to inflation level and external stability to maintenance of the external value of Fiji dollar. The latter requires adequate level of international reserves to defend the Fiji dollar. The RBF aims at maintaining a level of international reserves equivalent to 4 to 5 months of imports.

Fiji's inflation rate for 2014 was just 0.1 %. The August press release on monetary policy stance projects the 2015 year-end inflation at 3 percent. The foreign reserves are at a record breaking level: $2.04 billion, adequate to cover more than 5 months of imports.

The major determinant of the happy position is the oil price. The latest RBF Quarterly Review for June 2015, recognizes that economic performance was helped by a favourable external environment of low commodity prices, especially low oil price below US$ 50 per barrel.

Global oil prices have fallen sharply over the past one year. Until June 2014, oil prices were stable at around $110 a barrel. By mid-2014, prices have more than halved.

Last Thursday, the light sweet crude was US$44.48 a barrel and Brent, the global benchmark was US$47.75 a barrel.

Reasons for low oil price

There are two reasons: weak world demand in many countries due to poor economic growth, which is now compounded by China's economic slowdown; and rise in US domestic supplies. The US stepped up investments in fracking technology, when the inflation adjusted oil price reached the highest: US$136 a barrel way back in 2008. Due to relentless efforts over two decades, the oil production by extracting from shale formations by hydraulic fracturing, was at the highest level in 2014 reducing imports. USA is one of the world's three largest oil producing countries, the other two being Saudi Arabia (SA) and Russia.

However, the oil cartel, known as Oil Producing and Exporting Countries (OPEC) led by SA is determined not to cut its production. It wants to keep the price low enough to make the production un-remunerative so that the US shale gas companies are priced out of the oil market. The breakeven price according to US producers is about US$100 a barrel.

Since early January 2015, many rigs in the US have been closed. However, the US shale oil producers who are now debt ridden are forced to produce shale oil to generate revenues to meet debt payments. It is expected they will soon close shop and US domestic supplies will fall and the world oil price will recover to the advantage of OPEC leader, SA.

US, not the only target.

Russia is the second target. If SA through keeping the price as low as US$40 can reduce domestic supply in the US, it can also bring Russia on to its knees. SA is not happy over Russia's support for Syria.

Sanctions against Russia over the Ukraine issue have made the Russian currency, the rouble to fall in value. Russia hiked its interest rate to 17% to stop capital outflows. Oil and gas exports account for 40% of export receipts. With fall in oil price, Russia is in crisis. Russia does not want to displease Syria although SA has held out the carrot of cuts in oil output in exchange for withdrawing support to Syria.

The third target of SA's strategy is to weaken the Islamic State of Iraq and ash-Sham (ISIS) , which by capturing oil wells is making money by exporting oil at black market price for financing its wars.

Small producers of oil, which are members of OPEC, including Libya, Iran, Iraq, Nigeria depend much on oil export revenues to support their budgets. Already Venezuela, facing a recession with inflation topping 60% is losing on exports. They want cuts in output and higher export prices

It is all politics.

Meanwhile, the beneficiaries are small island states with no oil resource!