http://www.wsws.org/en/articles/2014/12/02/pers-d02.html

Oil price slide rocks world economy

Nick Beams

2 December 2014

Shock waves from last Thursday's decision by the Saudi-led oil cartel, OPEC, not to cut production in the face of an oversupply on world markets have reverberated throughout the global economy, hitting energy and mining companies as well as financial markets, and threatening whole economies with bankruptcy.

The most immediate impact of the decision was seen in Russia on Monday, where the ruble hit a record low against the US dollar since the ruble's redenomination in 1998. That followed the Russian default, which occurred in the aftermath of the Asian financial crisis of 1997–98.

The Russian economy, which relies on oil for 60 percent of its export income and 50 percent of its budget revenues, has been hammered by the 40 percent slide in the price of oil since June. The impact of the decline in oil revenues has been exacerbated by the sanctions imposed by the US and the European Union, which have considerably restricted Russian access to global financial markets and led to the drying up of investment inflows.

Oil has now slumped in price from around $100 per barrel just five months ago to below $70, and is expected to fall further. On Monday, the deputy chairwoman of the Russian central bank, Ksenia Yudaeva, said the bank had been working on the assumption that the oil price could go to $60. But no one knows if the slide will stop there.

Among the other countries most immediately impacted are Venezuela, Iran and Nigeria, all of which are heavily dependent on oil revenues to fund government programs.

In another expression of the global consequences of the OPEC decision, more than $30 billion was wiped off of the Australian share market yesterday, as mining and energy stocks tumbled. The giant global mining company BHP Billiton recorded its lowest share price in five years.

While the trigger for the decline was provided by the Saudi decision, the plunge in the price of oil is indicative of deeper processes. The year 2014 has marked the exhaustion of the various stimulus measures—above all, the program of "quantitative easing" pursued by the US Fed and other major central banks—which have sent asset prices to record highs.

The tendency in the underlying real economy has been continuing economic stagnation and the emergence of outright recession. The movement of the financial markets as compared to the real economy is, to use an analogy once employed by Leon Trotsky, like the opening of the blades of a giant pair of scissors.

Some six years after the eruption of the global financial crisis in 2008, the euro zone economy has not even reached the level of economic output achieved in 2007, with investment levels down by as much as 25 percent, while the inflation rate continues to fall.

The Japanese economy, despite the massive financial stimulus provided by so-called Abenomics, has entered another recession, its fourth in the past six years, as concerns grow over the capacity of the government to repay the public debt, now estimated to be more than 250 percent of gross domestic product. On Monday, the rating agency Moody's downgraded its credit rating for the country, the world's third largest single economy, putting it below China and South Korea and on a par with Bermuda, Oman and Estonia.

Over the past six years, the global economy has been sustained to a significant extent by continuing Chinese growth, largely the result of the stimulus package initiated by the Chinese government and the massive expansion of credit, estimated to be equivalent in size to the entire American banking system. But throughout this year it has become increasingly apparent that the Chinese economy is in the grip of a deflationary vortex. So-called "producer prices," which record the value of commodities as they leave the factory gate, have been falling for the past three years. Property prices have fallen significantly, ending the real estate boom.

This week, a report by official government researchers put a figure on wasteful spending. It said some $6.8 trillion had been laid out since 2009 on "ineffective investment," including needless steel mills, ghost cites and empty stadiums, as well as other government efforts to insulate China from the impact of the global financial crisis.

While American financial markets appear thus far to have been only marginally affected by the OPEC decision, the falling oil price will have major long-term consequences. One of the motivating factors for the Saudi decision appears to have been its determination to squeeze relatively high-cost US shale oil producers out of the market by driving prices lower. This is a replication of the strategy in the iron ore market, which has experienced a price fall similar to that of oil this year. Major producers, in particular BHP Billiton and Rio, have responded by increasing, rather than cutting, production in an effort to send their higher-cost rivals to the wall.

A continued slide in the oil price will have major consequences for junk bond and leveraged loan markets in the US. With oil prices reaching around $100 per barrel in 2011, shale oil production became profitable, even at extraction costs of between $60 and $70 per barrel. As recently as the start of the year, it was expected that oil prices would remain at $100 per barrel and shale oil was increasingly held up as providing a new vista for American economic expansion.

Over the past five years, using ultra-cheap money provided by the Fed, banks and financial speculators poured money into companies involved in shale oil extraction, with the result that energy debt now accounts for 16 percent of the $1.3 trillion US junk bond market, compared to 4 percent a decade ago.

Unlike more traditional methods of oil production, where physical capital has a relatively long life, shale oil extraction requires the continuous acquisition of new capital equipment. This means the industry is highly dependent on the flow of funds from financial markets. If this begins to dry up, companies could go bankrupt, with major flow-on consequences for the financial system as a whole.

As the case of Russia so clearly demonstrates, the underlying recessionary tendencies have been exacerbated by the increase in geo-political tensions.

Now a negative feedback process could be set in motion as the deepening global slump heightens conflicts among the major powers. Korea and other countries in the Southeast Asian region, together with China, have already been adversely affected by Abenomics, which has led to a fall in the value of the yen, hitting their export markets.

This year has also seen the emergence of tensions between the US and Germany, with the political and foreign policy establishment emphasising the need for Germany to play a greater and more independent role on the global stage in the pursuit of its own interests. With the euro zone economy on the verge of another recession, not least because of a significant weakening of the Germany economy, and the prospect of further financial turbulence, those tensions are certain to deepen.

The oil price slide is another expression of the underlying driving forces of the world capitalist system—towards economic contraction, the rise of inter-imperialist conflicts and, ultimately, war.