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Is the fall in oil prices good for financial markets? Q&A's

Is the fall of oil good for financial markets?

Without a doubt, yes. Like everything in life, it is preferable to avoid abrupt movements that generate disruptions and negative effects in the short term. For example. The rise in oil crude prices seen in 2018 was very vertical and violent, and generated panic in emerging markets (which have had a pretty miserable life in the second half of the year). In this sense, it would have been preferable to see a gradual rise in oil price (less pressure for the Fed, less pain for EM, etc.). In the same way, it would have been preferable to see a gradual and constant reduction in the price of crude oil recently. That said, without a doubt, the effect of the fall in the price of oil is very positive for financial markets, and specially for EM (which usually have an external deficit, and recent falls in oil will help reduce their need for external financing).

Why is it positive?

Lower fuel prices act as a global tax cut, spurring margins, profits, consumption, sales, etc.

Can we expect oil prices to remain at these low levels?

There are some reasons that make us feel comfortable with the idea that oil prices should remain structurally low.

1. Saudi-Russian alliance facing its toughest test: Russian Energy Minister Novak has sounded less convinced about the need for production cuts (Russian producers haven't shown much enthusiasm for cutting output either). Novak also observed that the Russian government can cover its budget spending next year even if its Urals crude benchmark falls to $40, underlining that “the government may welcome lower inflationary pressures” as well. Meanwhile, Saudi Arabia would be pumping as much as 11.2M bpd, which would be the highest production level since the

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kingdom extracted its first oil eight decades ago. Production was running at already high levels (about 10.9M bpd) earlier in November as it responded to stronger-than-usual demand from clients preparing for a reduction in Iranian supplies. Increase of oil exports may be due to the Saudis keeping raising output or supplementing supply from inventories.

2. Global demand will probably moderate in 2019. Growth in a number of important economies (China and the Eurozone) appears to be deteriorating, which is never good news for the price of cyclical commodities. No doubt that one thing that could trigger further falls in the oil price would be a collapse in demand, and to get some insights about this probability we have to look towards China, which has just overtook the US as the world's largest oil importer (about 9 million bpd). While it seems unlikely that Chinese growth will implode over the coming year, there are two reasons that could lead Beijing to decide to constraint energy imports (causing a fall in global demand). 1) Beijing may want to keep US dollars (savings) to preserve its stimulus capacity if it feels that the US-China economic cold war could took a turn for the worse. 2) Beijing may simply want to ensure that China's current account balance remains in surplus, if only to keep its need for external financing at low levels in a global scenario of tight liquidity.

Best regards

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