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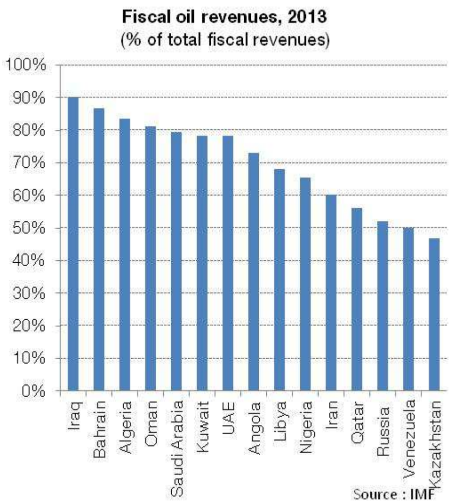
EMERGING OIL PRODUCING COUNTRIES: WHICH ARE THE MOST VULNERABLE TO THE DECLINE IN OIL PRICE?

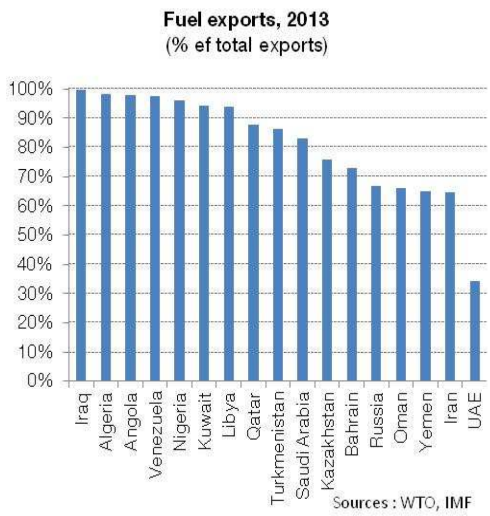
— The plunge in oil price and the downgrading of medium-term forecasts will adversely affect the fiscal and external accounts of all emerging oil producing countries. This note aims at distinguishing the countries according to their initial macroeconomic fragilities and their financial leeway to absorb this shock.

— Saudi Arabia, Kuwait, Qatar and the United Arab Emirates (UAE) have substantial financial resources to absorb this shock.

— The majority of the other oil producing countries (Algeria, Angola, Bahrain, Oman, Nigeria) are exposed to the decline in their foreign exchange reserves, the depreciation of their currencies and budgetary adjustment plans. That said, their levels of financial resources are likely to enable them to prevent a sharp macroeconomic adjustment. Russia should be able to contain the impact of lower oil price given its financial resources. However, the Russian economy is weakened by the combination of this negative shock with other specific factors (international sanctions, geopolitical risks).

— Some countries appear more vulnerable (Iraq, Libya, Venezuela, Yemen) due to their unfavorable initial macroeconomic situations and limited financial resources.





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DIVERSE INITIAL MACROECONOMIC SITUATIONS

All emerging hydrocarbon producers are expected to post a budget deficit in 2015 (with the exception of Kuwait, Qatar and Kazakhstan). The oil price level that would balance their budget accounts (fiscal breakeven oil price) is higher than the estimated average oil price in 2015.

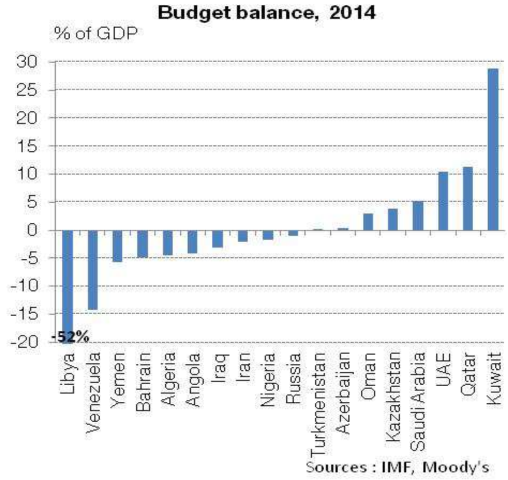
However, some countries appear relatively more vulnerable given their initial fiscal position. We can distinguish:

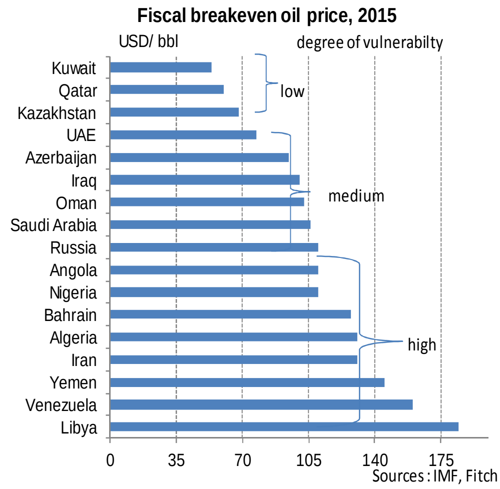
- Countries whose public accounts show a surplus but which are likely to go into deficit in 2015.

For these countries, the oil price level ensuring a balanced budget is situated between USD 75 and USD 105 per barrel. This situation concerns Saudi Arabia, Azerbaijan, Oman and the UAE.

- Countries whose public accounts already show a deficit and are expected to deteriorate even more in 2015.

For these countries, the oil price that ensures balanced public accounts is relatively high (on average in excess of USD 105 per barrel). Algeria, Angola, Bahrain, Iraq, Iran, Libya, Nigeria, Russia, Venezuela and Yemen are the countries concerned.





BOX 1 – WHAT IS THE FISCAL BREAKEVEN OIL PRICE?

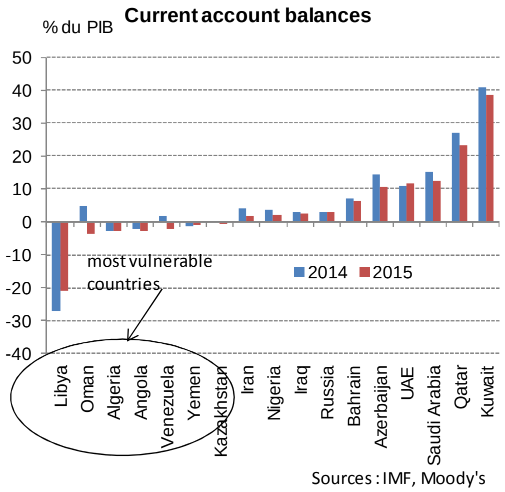
The fiscal breakeven oil price is an annual estimate for a given country of the oil price that would ensure the balance between the level of its tax revenues and the level of its public expenditure. The breakeven price does not take into account the past accumulation (or exhaustion) of a country's net financial assets and therefore cannot in itself be used as a comprehensive measure of solvency. That said, the breakeven price is a good risk indicator, especially for countries with limited financial resources and/or possibilities for accessing international financial markets.

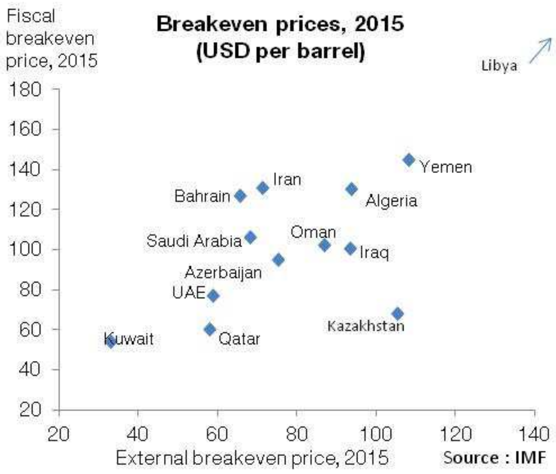
The main determinants of the level and trend in the breakeven price are:

— the fiscal revenue tax policy (the breakeven price declines when taxation increases),
— the level of inflation, (inflation has a positive impact on fiscal revenues),
— the trend in the exchange rate (all other things being equal, the trend in the exchange rate impacts the amount expressed in local currency of revenues drawn from oil income),
— the level of public expenditure (the breakeven price rises with the increase in expenditure).

Therefore, in order to re-balance their public finances, countries can combine a decline in public expenditure, an increase in taxation and a depreciation of the currency.

The decline in oil price is also likely to affect the current account balances of emerging hydrocarbon producers. The countries most exposed to the decline in oil price are those who already displays current account deficits (Algeria, Angola, Kazakhstan, Libya, Oman, Venezuela, and Yemen).

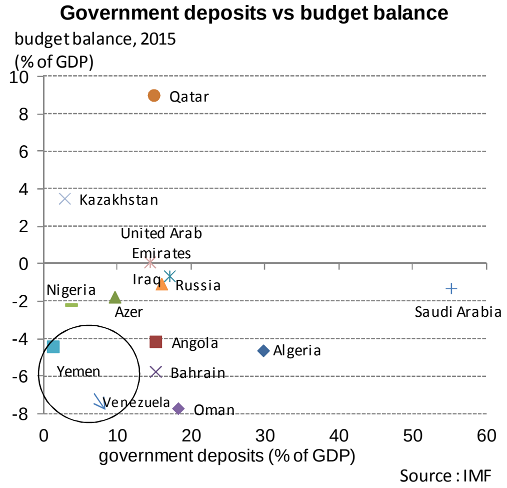


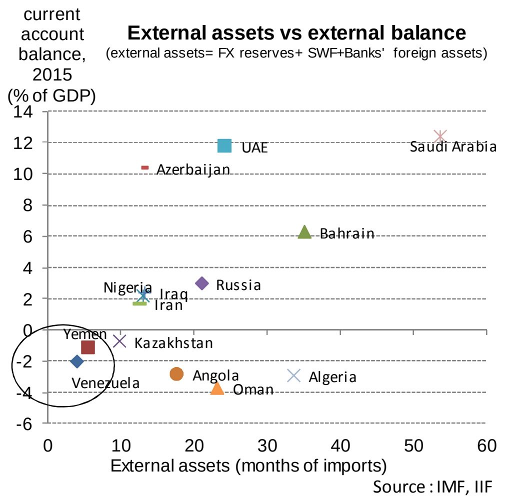


HOWEVER, MOST COUNTRIES HAVE COMFORTABLE FINANCIAL RESOURCES

The vulnerability of countries exhibiting fiscal and/or external deficits must nevertheless be put into perspective given their financial resources. The majority of countries have the ability to mobilise savings accumulated during the period of rising oil price (foreign exchange reserves, sovereign wealth funds (SWF), oil revenue stabilisation funds, deposits at the central bank and at commercial banks) in order to ensure the financing of budget and/or external deficits and prevent a sharp macroeconomic adjustment.

Countries combining a double deficit (fiscal and current account) and limited financial resources appear to be the countries most exposed to the decline in oil price (Venezuela, Yemen).





WHAT WOULD BE THE LIKELY CONSEQUENCES?

CURRENCY DEPRECIATION AND DECLINE IN FOREIGN EXCHANGE RESERVES

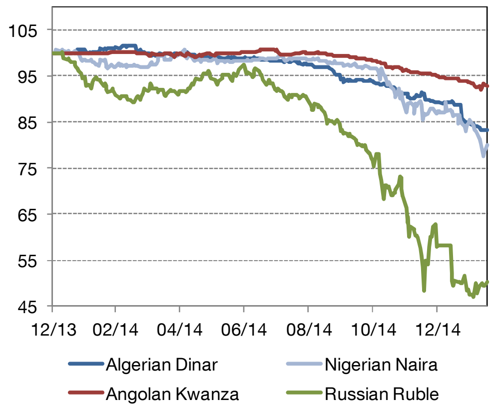
The deterioration of external accounts of emerging oil producing countries will result in depreciation pressures on their currencies and a decline of their foreign exchange reserves. The type of adjustment of each economy will depend on their exchange rate regime.

Countries whose exchange rate is fixed (typically the countries of the Gulf Cooperation Council) will record a decline in foreign exchange reserves and should preserve the parity of their currencies against USD.

In contrast, the currencies of countries whose exchange rate is flexible or "semi-flexible" will suffer from the depreciation of their currencies.

The currencies of countries such as Algeria, Angola, Nigeria, and Russia have depreciated against USD since the middle of 2014. However, the decline in these countries' foreign exchange reserves seems to indicate the authorities' intention to contain currency depreciation pressures. The case of Russia is specific since the depreciation of the ruble and falling foreign exchange reserves are only partly due to lower oil prices.

Exchange rates agaisnt USD (100 = 31/12/2013)



Source : IMF

Fiscal adjustments

The decline in oil price is likely to force some emerging oil producing countries to embark on budgetary adjustment plans, and notably a reduction in capital expenditures. On average, these countries dedicate twice the amount to public investment expenditure (around 8% of GDP in 2012) as other emerging countries. In particular, Oman and Bahrain have already announced a decline in public investment expenditure in the energy, defence and infrastructure sectors. Venezuela plans to increase taxes on luxury goods, alcohol and cigarettes. Angola has also announced a reform of its oil subsidy system.

Slower growth and increase in inflation

The decrease in public expenditure is likely to result in a decline in growth in these countries and in particular a slowdown in non-hydrocarbon sectors. Moreover, currency depreciation is likely to lead to an increase in inflation which in turn could lead to monetary tightening. For instance, Algeria is currently experiencing an inflationary spike (inflation reached 4.6% yoy in average during the second half of 2014 against 1.2% in the first six months of the year).

CONCLUSION

A cross analysis of the fiscal and external accounts and the levels of financial resources of each country enables us to distinguish the countries according to their degree of vulnerability to the decline in the oil price.

- Countries whose vulnerability to a decline in the oil price is medium (Kuwait, Qatar, Saudi Arabia, UAE):

Kuwait and Qatar are expected to continue to post comfortable fiscal and external surpluses. Saudi Arabia and the UAE are expected to post a budget deficit but have substantial mobilisable assets and solid external positions.

- Countries whose vulnerability to a decline in the oil price is average (Algeria, Angola, Azerbaijan, Bahrain, Nigeria, Oman, Iran, Kazakhstan):

The decline in oil price is likely to cause a further deterioration in the public finances and/or external accounts of these countries. That said, their financial resources appear to be relatively comfortable to prevent a sharp economic adjustment. Russia was ranked in this group of countries, but the case is very particular. Indeed, the Russian economy is weakened by the combination of this negative shock with other specific factors (international sanctions, geopolitical risks).

- Countries whose vulnerability to a decline in the oil price is high (Iraq, Libya, Venezuela, Yemen):

These countries combine both current account and budget deficits and limited or rapidly diminishing available resources (Libya).

APPENDIX

			Public finances				External accounts	
			fiscal breakeven oil price, 2015 (USD/bbl)	budget balances, 2014 (% du PIB)	Government deposits (months of spending)	Public debt, 2014 (% of GDP)	External accounts, 2014 (% of GDP)	External assets, 2014 (months of imports)
Vulnérability	High	Yemen	145	-5.7	0.5	48.2	-1.3	5.5
		Venezuela	160	-14.2	3.3	46.1	1.7	4.0
		Iraq	101	-3.0	4.5	30.7	3.0	13.3
		Libya	184	-52.1	15.3	-	-27.1	60.8
	Medium	Algeria	130	-4.9	9.1	9.9	-3.0	33.6
		Angola	110	-4.1	4.4	38.4	-2.2	17.6
		Nigeria	110	-1.7	3.6	10.6	3.7	13.0
		Bahrain	127	-4.8	5.8	47	7.0	35.1
		Iran	131	-2.1	-	11.2	4.2	12.6
		Kazakhstan	68	3.8	1.6	13.7	0.3	9.8
		Azerbaijan	95	0.3	2.9	15.9	14.6	12.8
		Russia	110	-0.9	5.1	15.7	2.7	21.1
		Oman	103	3.0	4.7	8.1	4.8	23.1
	Low	Saudi Arabia	106	5.2	16.5	2.6	15.1	53.6
		Qatar	60	11.4	5.6	25.5	27.0	125.7
		UAE	77	10.5	7.6	11.4	11.1	24.1
		Kuwait	54	28.8	3.2	5.9	40.8	84.1

Governance indicators : Percentile rank among all countries (ranges from 0 (lowest) to 100 (highest) rank)

Sources: IMF, Moody's, Fitch, SG calculations

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