Tundra comment

The oil price effect on frontier markets

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Background

As global economic recovery remains discouraging, oil prices have touched 5-year low with WTI and Brent recently hitting USD 82/bbl and 86/bbl down from USD 106/bbl and USD 112/bbl respectively. Another swing factor has been the resistance of OPEC to cut oil production while demand slumps. OPEC, led by Saudi Arabia, boosted production in September, pumping 30.47 m bbls/day, the most since August 2013. Saudi Arabia seems to be defending it's market share at the expense of lower prices, amid supply threat from shale reserves and possibility of Iran's oil returning to market in case a deal with Western powers is struck. Lower oil prices would push high cost shale oil producers to reduce capex and exploratory activities. Secondly, a generally accepted view also seems to be Russia's weakening role in the world economy in case of prolonged lower oil prices, something the Western part of the world might not object to.

Impact on frontier markets

Lower energy prices will have a positive impact on the global macroeconomic situation which in turn should have a positive effect on demand. We might see some short term pessimism but as no short term additional supply from Iran or shale oil is likely to hit the market, we do not expect oil prices to correct steeply from current levels. Except for the Middle East, Africa, Russia and Venezuela, lower energy prices should lend help in faster global economic recovery as big economies like US, China and India are net importers of energy. We expect a substantial positive impact on import bills of emerging and frontier countries and trickle down effects on macro economic factors such as currency, inflation and budget deficits.

Among frontier markets a lower oil price is negative for Nigeria which is a net exporter of 2.2 million bbls/day. Petroleum products make up 90% of Nigeria's exports. Should oil prices stay at current levels the country's current account surplus will be wiped out. In addition, Nigeria's budget is balanced at USD 79/bbl which is not far from current levels. The Naira is at risk in case prolonged low oil prices which could make equity market investors cautious.

However, for Asian frontier markets, the countries that would be welcoming lower oil prices are Pakistan, Sri Lanka, Bangladesh and to a lesser extent Vietnam. The first three frontier markets heavily rely on imported oil to meet energy requirements and the price of oil remains an important determinant of their current account balance. Moreover, as fuel and energy prices are generally subsidised, lower oil prices would be a breather for the governments of all four abovementioned countries. The current low oil prices provide an opportunity to reduce subsidies significantly, in case it is not completely passed-through to consumers, which will have a positive impact on budget deficit of these countries.

As an example, half of Pakistan's 5% budget deficit of GDP is made up of energy subsidies. The sharp fall in oil prices has provided Pakistan a unique chance to once and for all do something tangible about the structural deficits caused by energy subsidies. Moreover, it's current account would shift from negative balance to positive, having a positive boost to the overall economy, led by currency stability, increasing FX reserves and lower inflation.

The table below shows the annualized effect on the current accounts of Pakistan, Bangladesh, Vietnam, Sri Lanka and Nigeria at current levels of consumption as a result of a USD 30/bbl drop in oil prices (From USD 113 to 83).

Table 1: Effects of lower energy prices on selected frontier markets

	Energy balance*	Gain/(loss) (USD m)	Current account (USD m)**	% of CA
Pakistan	(354,000)	3,876	(3,000)	129%
Bangladesh	(111,000)	1,215	1,500	81%
Vietnam	(30,000)	329	1,650	20%
Sri Lanka	(94,000)	1,029	(2,800)	37%
Nigeria	2,200,000	(24,000)	24,000	100%

Source: EIA, Tundra Fonder; *bbls/day of crude & petroleum products.
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