GLOBAL OIL CRISIS AND AFTER EFFECTS

INTRODUCTION

The oil industry, with its history of booms and busts, has been in its deepest downturn since the 1990s, if not earlier.

Earnings are down for companies that made record profits in recent years, leading them to decommission roughly two-thirds of their rigs and sharply cut investment in exploration and production. Scores of companies have gone bankrupt and an estimated 250,000 oil workers — roughly half in the United States — have lost their jobs.

The cause is the plunging price of oil barrels, which at one point fell more than 70 percent compared with June 2014 levels.

Prices have recovered a few times over the last year, and now appear to be bound by a range of $40 to $50 a barrel. Many wells remain unprofitable, although the industry has managed to cut costs. Many shale wells in Texas that were once profitable at only price levels above $60 a barrel are now profitable at levels above $40. The rig count is inching up again.

But executives think it will be years before oil returns to $90 or $100 a barrel, a price that was pretty much the norm over the last decade.

This is a complicated question, but it boils down to the simple economics of supply and demand.

United States domestic production has nearly doubled over the last several years, pushing out oil imports that need to find another home. Saudi, Nigerian and Algerian oils that once sold in the United States are suddenly competing for Asian markets, and the producers are forced to drop prices. Canadian and Iraqi oil production and exports are rising year after year. Even the Russians, with all their economic problems, manage to keep pumping at record levels.

There are signs, however, that production is falling because of the drop in exploration investments. RBC Capital Markets has calculated that projects capable of producing more than a half-million barrels of oil a day were canceled, delayed or shelved by OPEC countries alone last year, and this year promises more of the same.

Production in Venezuela, a portrait of political instability, is falling fast. Rebel attacks in Nigeria have also curtailed supplies in that region, and the continuing fighting in Libya has stymied efforts to get that country's oil industry back on its feet.

These fluctuations, however, may be short-lived.

On the demand side, the economies of Europe and developing countries are weak and vehicles are becoming more energy-efficient. So demand for fuel is lagging a bit, although there are signs saying that demand is growing in the United States and China.

Any motorist can tell you that gasoline prices have dropped. Diesel, heating oil and natural gas prices have also fallen sharply.

The latest drop in energy prices — As of Oct. 31, regular gas nationally averaged $2.23 a gallon — is also disproportionately helping lower-income groups, because fuel costs eat up a larger share of their more limited earnings.

Households that use heating oil to warm their homes are also seeing saving.

For starters, oil-producing countries and states, Venezuela, Nigeria, Ecuador, Brazil and Russia are just a few petro states that are suffering economic and perhaps even political turbulence.

The impact of Western sanctions caused Iranian production to drop by about one million barrels a day in recent years and blocked Iran from importing the latest Western oil field technology and equipment. With sanctions now being lifted, the Iranian oil industry is opening the taps on production.

In the United States, there are now virtually no wells that are profitable to drill. Chevron, Royal Dutch Shell and BP have all announced cuts to their payrolls to save cash, and they are in far better shape than many smaller independent oil and gas producers. Exxon has reported record-low quarterly profits, and was recently stripped of its top AAA credit rating (leaving Microsoft and Johnson & Johnson as the lone American companies in the rarefied AAA group).

States like Alaska, North Dakota, Texas, Oklahoma and Louisiana are facing economic challenges.

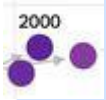
There has also been an uptick in traffic deaths as low gas prices have translated to increased road travel. And many young Saudis have seen cushy jobs vanish.

What happened to OPEC?

Over the last year, Iran, Venezuela, Ecuador and Algeria have pressed OPEC, a cartel of oil producers, to cut production to help firm up prices. At the same time, Iraq is actually pumping more, and Iran refuses to freeze production now that it is finally exporting large loads again.

On Sept. 28, the cartel came to a tentative agreement to moderately lower production later in the year. The cartel, however, did not decide which countries would actually cut production, leaving that decision for OPEC's next formal meeting in Vienna in November.

Analysts have said that setting production caps near current high levels might only have limited value in regulating prices. That is because the oversupplied global market either needs steeper cuts or higher demand to return to a balance of supply and demand that would support higher prices. And previous agreements have been broken by nations, because there is no firm mechanism for enforcement.



Interactive Graphic: How the U.S. and OPEC Have Controlled Prices »

Is there a conspiracy to bring down the price of oil?

There are a number of conspiracy theories floating around. Even some oil executives are quietly noting that the Saudis want to hurt Russia and Iran, and so does the United States — motivation enough for the two oil-producing nations to force down prices. Dropping oil prices in the 1980s did help bring down the Soviet Union, after all.

But there is no evidence to support the theories, and Saudi Arabia and the United States rarely coordinate smoothly. And the Obama administration is hardly in a position to coordinate the drilling of hundreds of oil companies seeking profits and answering to their shareholders.

Oil markets have bounced back considerably since hitting a low of $26.21 a barrel in New York in early February. There was a similar recovery last spring, but that didn't last.

Some analysts still question how long the current recovery can be sustained because the global oil market remains substantially oversupplied. In the United States, domestic stockpiles are at their highest levels in decades, though they are coming down as seasonal driving picks up.

But over the long term, demand for fuels is recovering in some countries, and that could help crude prices recover in the next year or two.

Saudi-Arabia is just at wedge of a river - The main Global oil producer

The Saudi Arabian economy has been jolted by a severe oil shock. Crude oil that sold for over $100 per barrel in 2014 sold for only $26 per barrel in February 2016. The price rose to $50 by June 2016, but it remains half of what it was two years ago. As an extremely specialized exporter of oil, Saudi Arabia is particularly vulnerable to a price decline. Oil revenue paid for 73% of the government's budget in 2015. As oil revenue fell, the budget deficit increased from 3.4% of GDP in 2014 to 16.3% in 2015.
Foreign exchange reserves dropped $116 billion in 2015.

The government sector dominates the Saudi economy. More than 70% of the workforce is employed by the government. Saudi Arabia had the "world's third largest military budget, trailing only the U.S. and China and ahead of Russia" (Yergin). The government has heavily subsidized energy and food. Current levels of government spending and taxation are not sustainable, even with substantial borrowing.

The size of the necessary adjustment to the oil shock depends on how low the oil price will be and how long it will remain low. If the price of oil jumped back to $100 by the end of 2016, only minor economic adjustments would be necessary. However, if the inflation adjusted oil price remained at or below $50 per barrel for the next 25 years, a major transformation of Saudi economic policy would be necessary. In addition to the currently low price of oil, there is also the possibility of a major technological change that would permanently reduce the demand for oil and other fossil fuels.

Persistence of Oil Shocks

Forecasts of future oil prices have been notoriously inaccurate (Baumeister and Kilian), however recent decades have produced periods of persistently depressed oil prices. Saudi Arabia suffered from the sharp and prolonged price decline that began in 1980 and persisted for nearly a quarter of a century. From 1980 to 1986 the real oil price in 2015 dropped from $100 per barrel to $30. The price remained low for years, and it did not rise above $40 until 2004. The "oil glut" had a devastating effect on economies of Saudi Arabia and other oil exporters. Saudi real GDP per capita dropped from $54,500 in 1980 to $31,000 in 1987. This oil shock also harmed other oil exporters, and the period coincided with the disintegration of the Soviet Union. If real oil prices in the next quarter of a century turn out to be similar to what they were during the post-1980 decline, major changes in Saudi Arabia will be unavoidable.

New King and New Government

By coincidence, about the same time oil prices reached their recent low point, King Abdullah bin Abdulaziz died in January 2015. He was succeeded by the new King, Salman bin Abdulaziz, who appointed officials who appear to be committed to major economic changes in the Kingdom. Crown Prince Mohammed bin Salman, the 30- year

old son of the King, has considerable authority over economic and foreign policy. Khalid al-Falih, the new oil minister, replaced 80- year old, Ali al-Naimi, who had been in power since the 1980 oil crisis. The new Foreign Minister, Adel Al-Jubeir has observed that Saudi Arabia has already experienced large changes in the last generation, including large improvements in infant mortality, literacy, and women's educational achievement (Al-Jubeir). However, the simultaneous oil shock and government change provide an unusual opportunity to implement major changes in future Saudi economic policy. This period could be a historical-critical juncture that results in fundamental economic reform, but there is also strong resistance to change from powerful incumbents.

Economic Crisis and Economic Reform

The new government, led by Prince Mohammed bin Salman, has proposed major economic changes called Vision 2030. The current low oil price is the immediate reason for change, but Prince Mohammed has said that the proposal is intended to deal with long-term economic reform (Wall Street Journal 2016d) regardless of the oil price. A basic goal is to reduce the importance of oil to the Saudi economy. Various government subsidies would be reduced, including electricity, fuel, and water. Some retail prices were already raised in 2015. The potential labor force is unusually young, with more than half under the age of 25. They will be seeking employment outside the oil sector. Currently more than 70% of the work force is employed by the government, and the proposal would reduce government employment and make compensation less generous. About 30% of the current work force consists of immigrants who are not citizens, and the proposal would give Saudi citizens preferential treatment over migrants for employment. This kind of employment discrimination could harm economic reform, if more productive immigrants are replaced by less productive citizens, who are often accused of "indolence" (Economist 2016b).

To meet the immediate revenue shortfall, more government borrowing is proposed. The government would issue more bonds, and it would also sell 5% of the national oil company, Aramco. Shares in the company would become publicly traded on some major stock exchange, and investment bankers have already expressed enthusiasm in participating in the initial public offering (IPO) of shares. To sell Aramco shares on public exchanges, Aramco would have to become much more transparent about its revenue, costs, and other aspects of management relevant to prospective shareholders. Interestingly, Aramco was a private company before it was nationalized four decades ago.

The long-run goal of the reform proposal is to reduce the relative importance of oil to the Saudi economy. Specifying what sectors would expand is not so easy. The plan proposes increases in revenue from tourism, although there is a serious current problem with Iranian tourists. Problems with Iraqi Shiites and other Muslim sects considered to be deviants are also barriers to additional tourism. The proposal advocates greater production of non-oil minerals and more processing of raw materials. Additional production from sectors other than oil would require an increase in the currently low

labor force participation rate of women, but this would be difficult to do without increasing the rights of women. Another barrier to new economic activities is the extremely low spending on research and development relative to GDP. Arab countries spending on R&D is far below the average for OECD Countries, and Saudi Arabia has one of the lowest R&D spending ratios among Arab countries (Economist 2016b). Critics have pointed out that top-down proposals to reform economies have rarely succeeded in the past. Nearby Dubai has successfully diversified its economy toward services, but it is considerably smaller and different from Saudi Arabia.

Problem: Diminished Influence in World Oil Market

Saudi Arabia has less influence over the world oil market today than they once had, and the new oil minister and Prince Mohammed appear to be aware of their diminished influence. The Saudi share of world oil reserves fell from 25% in 1990 to 15.7% in 2014. Ali Al Naimi, who was recently replaced as oil minister, also acknowledged the diminished influence of his country over the world oil market. He has publicly stated that he made a mistake in 1980 by attempting to raise the world oil price by decreasing Saudi production. It was not successful, and as a result, the Saudis were harmed by both a lower quantity sold and a lower price. This time al Naimi vowed to continue a high level of production, and his replacement recently publicly committed to the same policy of producing enough to protect the Saudis market share (Yergin, Greenstone et al, Baumeister and Kilian).

As a result of the shale revolution, the US has substantially increased its oil production (Grennes and Strazds). Additions to oil production from the US are one reason why prices have fallen so much. US production has decreased since the price decline, but US shale producers are considered to be more flexible and more responsive to price (Wall Street Journal 2016f). They are smaller firms, and they are expected to increase production more quickly than traditional larger firms if prices rise (Yergin).

Since sanctions against its exports were reduced, Iran has again become a major exporter of crude oil. Some problems related to insurance on oil tankers have been overcome and Iranian exports are now near their pre-embargo levels. As a result of added competition, Saudi Arabia has recently given discounts on oil sold in Europe (Wall Street Journal 2016c). The rivalry between the Saudis and Iran has also made it more difficult to agree on collective production goals for OPEC members.

Problem: High Cost Agricultural Subsidies

When Saudi income was higher, the government provided many subsidies, including costly subsidies for domestic food production. One of the costliest was the subsidy to wheat production, which was rationalized as contributing to food security (Bloomberg). Subsidies made the desert bloom, and the nation went from being totally dependent on wheat imports to becoming self-sufficient in wheat and becoming a minor exporter of wheat. Saudi wheat production reached its peak in 1992 when it produced 4.1 million tons, and was briefly one of the world's ten largest exporters. The country can no longer

afford the costly program, and (World-Grain.com) by 2016 nearly all the wheat consumed in Saudi Arabia is expected to be imported (World-Grain.com). A large part of the subsidy came from using water obtained from a costly desalinization process. According to one estimate, water that cost the equivalent of $100 to produce was sold to wheat farmers for $1 (Grennes and Goodwin). In the name of food security, the government has also bought costly agricultural land in foreign countries, especially in Africa. It remains to be seen whether food produced abroad on land owned by Saudis would be cheaper or more secure than importing food from the lowest cost source. Presumably food exports would be subject to the export controls of African governments. Why would African officials allow food exports in the presence of famine in their own countries? A Saudi agency has also bought a share of the Canadian Wheat Board along with US grain company, Bunge (Globe and Mail).

Problem: Mixing Economics, Politics, and Religion

Separation of religion and state is a sensitive issue in countries with large Muslim populations. The Ottoman Empire had a caliphate that combined religion and state. Ataturk produced a revolution that separated religion from the secular state of Turkey, but supporters of Erdogan are currently trying to produce a counter revolution that would reunite religion and government. When the Ottoman Empire disintegrated, the new state of Saudi Arabia was formed through an alliance between the clan of Ibn Saud and the Wahhab branch of Sunni Muslims. This alliance continues to make it difficult to separate religion and government, and it influences both domestic and foreign economic policy. Wahhabis advocate an austere branch of Sunni Islam that considers religion and the state to be inseparable, and they are strongly opposed to Shiites and branches of Sunni Islam that are considered to be deviants.

The new government's proposal to increase the labor force participation of women is opposed by Wahhabi leaders. They also oppose women's right to drive automobiles, which would increase job opportunities for women. The proposal to increase revenue from tourism is harmed by the conflict between Shiites and Sunnis that has resulted in the cancellation of pilgrimages to Mecca this year by Iranian Shiite Muslims. Many store owners oppose a government proposal to close shops at 9pm. Many customers prefer later hours that allow them to avoid the extreme heat of earlier hours. Some shop owners have threatened to move to Dubai or some other location with a more favorable business climate. The powers of the religious police (Commission for the Promotion of Virtue and Prevention of Vice) have been curtailed recently, but some prominent clerics have spoken in favor of expanding their authority (Wall Street Journal, Conservatives Balk at Saudi changes, 2016d.) Although most Saudis are Sunni Muslims, there is a Shiite population especially, in Eastern Province where most oil is produced, and they claim to be victims of religious discrimination. The alliance between the royal family and Wahhabis is complex, and some extreme Wahhabi leaders have criticized the government for selling out to the West.

Foreign policy is heavily influenced by the rivalry between Sunni Saudi Arabia and Shiite Iran. The bitter rivalry has spilled over to other countries

in the region, including Iraq, Syria, Lebanon, and Yemen. The result is a Saudi military budget that is one of the largest in the world. Saudi Wahhabis have supported madrasas in Pakistan and Kosovo that have produced many volunteer soldiers for Islamic State (News and Observer). Saudi Arabia, itself, has been the second largest source of military volunteers to Islamic State. Saudi Arabia has produced terrorists, including 15 of the 19 who attacked New York and Washington in 2001. It also produced Osama bin Laden. In recognition of some prominent terrorists with Saudi connections, the US Senate passed a bill May 17 that would allow families of Sept 11 victims to sue the Saudi government (News and Observer). The reduced importance of oil imports for the United States has increased uncertainty about the nature of the traditional alliance between Saudi Arabia and the US.

There are conflicts between proposed economic reform and conservative Islam in Saudi Arabia. However, the barriers are not insurmountable. In neighboring Qatar, Wahhabism coexists with a much more modern economy (Economist 2016a). The emir, Tamim bin Hamad al Thani, is sympathetic toward western economies, and even conservative women drive in Qatar.

Conclusion

Cheaper oil is a major shock to the Saudi economy. However, the simultaneous occurrence of the oil shock and a new government provides an unusual opportunity for fundamental economic reform. Barriers to reform include the presence of powerful interest groups that benefit from subsidies, the continued appeal to seek food security at high cost, and the objection of Wahhabi leaders to many aspects of modern economies. Uncertainty about the future political/military relationship with the United States makes it difficult to reduce the large military budget.

The Real Problem behind Low Oil Prices

For a long time, there has been a belief that the decline in oil supply will come by way of high oil prices. Demand will exceed supply. It seems to me that this view is backward– the decline in supply will come through low oil prices.

The oil glut we are experiencing now reflects a worldwide **affordability** crisis. Because of a lack of affordability, **demand** is depressed. This lack of demand keeps prices low– below the cost of production for many producers. If the affordability issue cannot be fixed, it threatens to bring down the system by discouraging investment in oil production.

This lack of affordability is affecting far more than oil products. A recent article in The Economist talks about LNG prices being depressed. LNG capacity ramped up quickly in

response to high prices a few years ago. Now there is a glut of LNG capacity, and prices are far below the cost of extraction and shipping for many LNG suppliers. At least temporary contraction seems likely in this sector.

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If we look at World Bank Commodity Price data, we find that between 2011 and 2014, the inflation-adjusted price of Australian coal decreased by 41%. In the same period, the inflation-adjusted price of rubber is down 58%, and of iron ore is down 59%. With those types of price drops, we can expect huge cutbacks on production of many types of goods.

How Does This Lack Of Affordability Come About?

The issue we are up against is ***diminishing returns***. Diminishing returns mean that as we reach limits, it takes increased resources (usually both physical resources and human labor) to produce some type of product. Oil is a product, subject to diminishing returns. Metals of many kinds also are becoming increasingly expensive to extract. In many parts of the world, a shortage of water makes it necessary to use unusual techniques (desalination or long distance pipelines) to obtain adequate supply. The higher cost of pollution control can have a similar effect to diminishing returns on products with pollution issues.

What happens with diminishing returns is that cost increases tend to be quite small for a very long time, but then suddenly "turn a corner." With oil, the shift to higher costs comes as we move from "conventional" oil to "unconventional" oil. With metals, the shift comes as high quality ores become depleted, and we need to move to mines that require moving a great deal more dirt to extract the same quantity of a given metal. With water, such a steep rise in diminishing returns comes when wells no longer provide a sufficient quantity of water, and we must go to extraordinary measures, such as desalination, to obtain water.

During the time when cost increases from diminishing returns were quite minor, it generally was possible to compensate for the small cost increases with technological improvements and efficiency gains elsewhere in the system. Thus, even though there was a small amount of diminishing returns going on, they could be hidden within the overall system.

Once the effect of diminishing returns becomes greater (as it has since about 2000), it becomes much harder to hide cost increases. The cost of finished products of many kinds (for example, food, gasoline, houses, and automobiles) starts rising, relative to the income of workers. Workers find that they must cut back on discretionary expenditures in order to have enough money to cover all of their expenses.

How Diminishing Returns Affect the Economy

There are at least three ways that diminishing returns adversely affect the economy:

1. Lower wages

2. Less ability to borrow

3. Squeezing out other sectors of the economy

A similar chart would hold for other resources that are becoming more difficult to extract, or whose cost of production is becoming higher because of greater pollution controls. For example, we would expect the wages of coal workers to be falling as well.

Also, as we shift to higher cost types of energy, we become increasingly inefficient in energy production. Based on a 2013 analysis, in the United States, there are more solar energy workers than coal miners, even though we use far more coal than solar energy. The large number of workers required to produce solar energy is one of the reason that solar energy tends to be high-priced to produce.

When we look at wages of workers, we indeed see a pattern of falling wages, especially for workers below the median wage. Figure 3 from the Economic Policy Institute shows that even the most educated workers are experiencing declining inflation-adjusted wages.

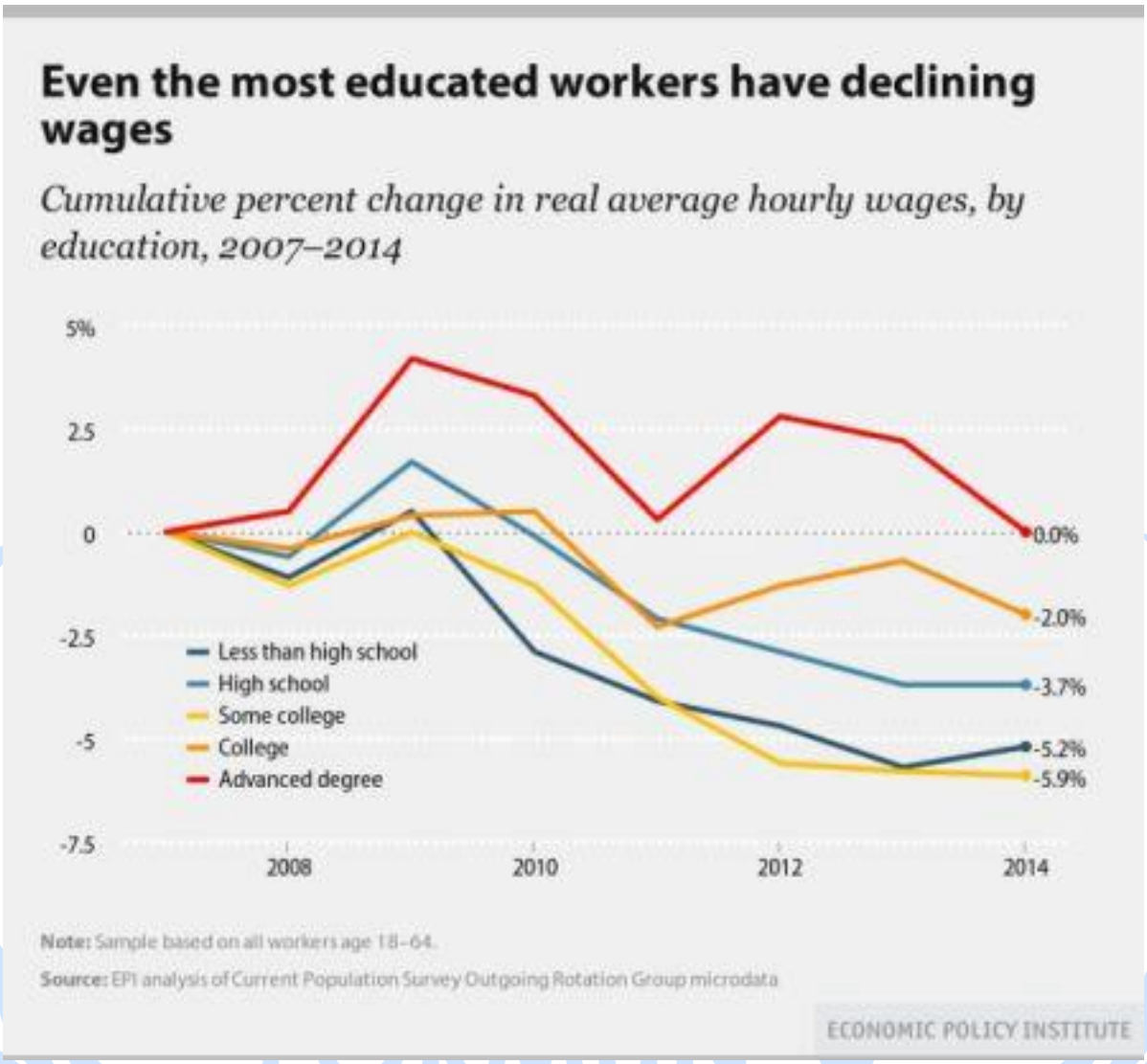

Figure 3. *Source: Elise Gould, [Even the Most Educated Workers Have Declining Wages](#).*

A second major issue affecting affordability is debt saturation. Affordability is favorably affected by rising debt–for example, it is a lot easier to buy a new car or house, if the would-be purchaser can obtain a new loan. If debt levels stay the same or fall, this becomes a problem–fewer goods can be purchased.

Governments in particular are reaching the limits of their borrowing capacity. They cannot keep adding new debt, and remain within historic debt to GDP ratios.

Another way debt saturation occurs relates to young people with student loans. They find it too expensive to borrow more money for a new car or for a home. Furthermore,

the fact that wages are not keeping up with price increases for many workers reduces the borrowing ability of the workers with lagging wages. This is true, even if no student loans are involved.

As mentioned above, a third issue is the fact that the inefficient sectors tend to squeeze out other portions of the economy by gobbling up a disproportionate share of workers and resources. The use of all of these resources doesn't produce a lot of goods in the traditional sense–a desalination plant is expensive, but the amount of water produced per dollar of investment is not large. To the extent that the high costs of inefficient sectors are passed on to consumers, consumers find that they must cut back on discretionary spending. This cut-back in spending, squeezes out discretionary spending, leading to cutbacks in discretionary sectors, and to reduced employment overall.

Wishful Thinking by Economists

Back before diminishing returns started becoming a major problem, economists created models regarding how the economy would react to higher cost of energy production and other symptoms of diminishing returns. In their view, if the cost of oil extraction rises, oil prices will rise to match these higher costs. Alternatively, substitution will take place, or technological changes will allow greater efficiency, or customers will cut back on their use of the high cost product. Somehow, these changes will take place without a particularly adverse impact on the economy. **Related: Big Changes Needed For Big Oil To Survive**
Unfortunately, the models don't correspond very well to what happens in practice–at least not for very long. It takes inexpensive energy to produce goods that workers can afford. Higher priced energy does not work well in this regard. Feedbacks that are not reflected in economic models reduce both wages and debt, making it harder to buy goods requiring the use of more-expensive energy products.

Furthermore, if the price of one commodity, for example oil, rises, the countries with very much oil in their energy mix find themselves handicapped in trade with other countries that use less oil in their energy mix. For example, a country that depends on tourism (which depends on oil use) for very much of its revenue, such as Greece, finds it difficult to find customers when oil prices are high. Lack of revenue can lead to financial problems for the country.

Because of the networked way the economy really works, prices for commodities can't rise for the long-term. They may rise for a while, as consumers and governments borrow more, in an attempt to continue business as usual. Ultimately, though, the situation can't "work." Customers can't afford to buy more homes and cars, unless their

own wages are rising in inflation adjusted terms, and governments can't collect enough tax revenue.

The issue we are dealing with here is lack of ***affordability***. This is what will bring the system down–not the high priced scenario imagined by many. Decline will come through low prices, and a glut in oil supply, even if we are not looking for it from that direction.

Can Commodity Prices Rise Again?
It is not all that clear that they can rise again. It would be a lot easier for commodity prices to rise, if the problem were simply inadequate prices of one commodity, leading to a lack of that commodity. If the problem is inadequate demand for crude oil, coal, LNG, and iron ore the problem is much greater–especially if wages are still lagging.

Why Oil's Recent Drop Indicates Strength, Not Weakness

Everything, so they say, is relative. Over the last two weeks, as WTI crude oil prices have turned tail and once again dived back below $50/Barrel, there has been much talk of an extension of the collapse, with oil moving even lower. When the most fundamental influence on the oil price, the strength of the U.S. Dollar, is taken into account, however, the fact that WTI is still holding above the base formed last month indicates quite the opposite.

That dollar strength is the most fundamental influence on the price of oil is obvious, but bears repeating. Any price is simply a reflection of the relative value of two things. Oil and other major commodities are priced in U.S. Dollars so, while the fundamental value of the commodity is one factor in the price, the fundamental value of the currency must also be considered.

They both cover a six month time period, and the first is for the U.S. Dollar index, while the second is for WTI crude oil. As you would expect given the relative relationship between the two, oil has fallen as the Dollar has risen over that time. Focus now on the last month or so, however, and a different story emerges. As the pace of Dollar gains has picked up strength, oil has actually bounced somewhat, and has still not returned to the lows of early February.

Obviously, oil's decline was not solely the function of Dollar strength. There was also the issue of increased supply due to fracking in the U.S. and elsewhere, along with fears about future demand as both China and Europe showed signs of slowing growth. Demand concerns were also the result of increased conservation efforts following a period of extraordinarily high oil prices. The fact that oil has arrested its decline as the Dollar continued to soar, however, would indicate that all of those factors were at least fully priced in, if not overestimated, in February.

Logically, then, if all else were to remain equal, oil would hold at these levels for a while and then, as the reductions in production caused by lower prices took effect, begin to climb. We should remember that according to the IEA, despite fears of the rate of growth slowing, oil consumption is still increasing and has been consistently since 2009. Given that, if production only stops increasing, let alone actually falls, then the simple laws of supply and demand dictate that the price must increase.

The wild card here, of course, is that the Dollar could continue to strengthen from these levels; indeed that is considered likely by many analysts, especially given the Fed's stated intention of gradually raising interest rates in the near future. In that event, though, the fact that oil has fallen a little less in the last two weeks than the Dollar has risen still indicates some underlying strength in crude; strength that could counter any further rise in the Dollar.

In the modern, interconnected world of finance no price or level can be looked at in isolation. Those seeing oil's decline in the last few days as evidence of more weakness, however, are attempting to do just that. When overall global financial trends are taken into account, oil's drop back below $50, far from indicating further dramatic falls in the price, actually suggest that a recovery of sorts is imminent.

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