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By Valentino Sy

The Game Changer

Last year was full of surprising events, but one event with far-reaching consequences stands out – swiftly plunging oil prices. Not since the 2008 Financial Crisis have oil prices dropped so much and so fast. This paradigm shift from $100 oil to $40 oil is a game changer not just for corporations, but countries as well. With WTI now at $45/barrel and Brent at $46/barrel, oil prices are at levels not seen since 2009. Most analysts did not see this coming, and certainly most of the oil-producing countries were not prepared for such a precipitous drop in such a short amount of time. This shocker of an oil price drop is not only causing much volatility in capital market, but it will also define the destiny of many countries in the years to come.

Conspiracy theories abound

With many speculating as to the timing and magnitude of oil's drop, many conspiracy theories started surfacing to explain oil's plunge. Some of them are listed below.

1. Part of West's sanctions against Russia.
2. Attempt of the US to break the oil cartel of OPEC nations
3. A religious war between Muslim and non-Muslim countries, using crude oil as a weapon
4. OPEC protecting its market share by bringing down prices to force cutbacks in shale oil production

Disruptive technology - fracking

While the swift plunge in crude oil prices did come as a shock, the reason behind the drop has been ongoing for several years – disruptive technology. The advent of fracking and shale oil drastically changed the supply-demand dynamic for crude oil. From practically zero, shale oil production has risen to 4 million barrels per day in just 6 years, bringing US oil production to 9 million barrels per day. Although currently a net oil importer, US oil imports have dropped 30% since the start of the shale oil boom, with many analysts forecasting that the US will become a net oil exporter in a few years. This disruptive technology has allowed the US to export as much as 400,000 barrels per day in 2014.

These advances in technology have also allowed extraction from deep water sources in Brazil and the Gulf of Mexico, as well as oil sands in Canada. With oil prices failing to find a floor and the lack of economic diversification in many of these countries, this reversal of fortune is only beginning.

Oil price war

Before the advent of shale oil, OPEC countries had a stranglehold on oil supply. Declaring an oil embargo in 1973, OPEC precipitated a meteoric rise of crude oil prices, sparking the 1970s oil crisis and ushering in more than 3 decades of prosperity for themselves. With many Middle Eastern countries restricting sales to the US and UK, oil prices skyrocketed from $3/barrel to $35/barrel. By 1980, crude oil had risen more than 10x in 6 years. The persistent economic effect of this oil price war would be felt many years after it ended.

However, these would not be the last time that oil would be used as a weapon. An oil price war can also be waged not just by driving prices up, but by bringing them down as well. In the past months, we have been witnessing such an oil price war in the making.

Deja vu

In 1986, when Saudi Arabia was at risk of losing its position as market leader, it flooded the market with oil in order to increase its market share. As a result, oil prices fell from $30 to below $10 in that year alone.

This is very similar to what is happening now, where Saudi Arabia refuses to cut its production despite dropping prices. By protecting its market share and allowing oil to continue its free fall, the Saudis are hoping that oil would fall to a level where shale oil, oil sands and renewable energy sources, like wind and solar, become unprofitable. This would force other producers to scale back production and capital expenditure, thus restoring their market dominance – and giving them victory in this oil price war.

Make or Break

Not surprisingly, the precipitous drop in oil caused investors to stampede out of energy stocks. However, the plunge in oil price has more complex ramifications than the drop in stock prices. The $50/barrel oil regime, a far cry from the $100/barrel we were all used to, can make or break corporations and countries. While manufacturing and consumer companies, as well as airlines are treating this as manna from heaven, oil drillers and other oil-related companies are experiencing a famine. Smaller, less efficient companies are in a more precarious position, with many already at risk of default as they shut down their loss-making rigs. Oil-producing countries, such as Russia, Venezuela, and some Middle Eastern nations are also facing enormous budgetary pressures and the possibility of an economic recession.

Philippines - The Biggest Winner

The bleak future ahead of countries like Russia comes as a stark contrast to oil guzzlers such as the US, China, India and Japan. A lower energy bill will serve as a tailwind for their GDP, a blessing in this slow growth world. What may come as a surprise to many is the identity of the biggest winner in this low oil environment. According to UBS and the Oxford Institute, among all the countries in the world, it is actually the Philippines that stands to gain the most as oil price drops. UBS estimates that the Philippines could add another 1.4% to its GDP growth, while Oxford says that our GDP growth could hit 7.6% if oil prices stay at these levels.

Domestic consumption will be the ultimate beneficiary of lower oil prices as inflation drops and spending power rises. In fact, Philippine inflation last December slowed to 2.7%, a 16-month low. Corporate margins will also expand as their utilities expense drops. With 75% of our country's GDP coming from domestic consumption, the Philippines is clearly the biggest winner in this low oil environment.

10 straight up days and an all-time high

As the biggest winner of oil dropping more than 60%, it is not entirely surprising that the Philippines is also having a historical win streak. On January 9, the PSEi had its 10th straight up day, its longest streak since 2006. In these 10 trading sessions, the index gained 6.3%. This winning streak, the longest in this 6-year bull market, eventually brought the PSEi to an all-time high close of 7,490.88 and an intraday high of 7,530.41. What makes the PSEi's rise outstanding is that our index made a new high as other global equity indices were dropping, thereby differentiating the Philippines as a beneficiary of low oil prices.

Impact to last for years or decades

Whether it is due to an increase in supply from shale oil, a strong dollar, or a slowdown in China, Europe and Japan, the impact on countries will be felt for years and decades to come. Just as Middle Eastern countries had an oil embargo-driven bonanza that lasted for more than 3 decades, the effect of low oil prices will be felt for a very long time. This is a pivotal event for corporations and countries, spelling their rise or fall. In our case, this low oil regime may well be the game changer that will make our secular bull market last longer and bring Philippine stocks to new highs.

A Blessing in the Papal visit

We would like to thank Pope Francis for all the blessings he has showered on our country.

God Bless you, Pope Francis!

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