Roger Bootle: Can President Putin explain how Osborne conspired to bring down the oil price?

The UK is the real winner in this Christmas story

If current oil prices are sustained, the general election will take place against the backdrop of a strong economy. Photo: ANDREW CATTERALL/ALAMY

By **Roger Bootle**

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In my last column before Christmas, I traditionally have liked to bring some good cheer. As you may recall, there have been some years when this has been a herculean task.

But this is not one of them.

I will leave a review of the year just passed to next week's column. Today, I want to write more about one of the **year's most important developments: low global oil prices**. The tale I tell is about the overwhelming power of markets and prices over politics.

Some weeks ago, I stressed that I thought that oil prices would fall further but even I had not imagined that they would fall as far or as fast as they have. Of course, we still do not know whether this is a flash in the pan. It could be. But it doesn't feel like it.

Three factors have come together to produce this big drop. **The first is the slowdown in the world economy**, led by China, but reinforced by the sluggishness of the eurozone. The second is increased supply, principally due to the shale fracking revolution in the US. And the third is the collapse of cohesion in Opec.

The third of these seems essentially political in origin and, I suppose, could go into reverse. The key player here is Saudi Arabia.

Supposedly, it wants low oil prices to hurt its traditional rival in the area, Iran, which is more vulnerable financially. Yet there are also sound economic reasons behind the apparent fracturing of Opec's power.

For the oil-producing group to work, when there is downward pressure on prices Saudi Arabia, the so-called swing producer, has to cut output.

For it to agree to this, it has to be sure that other producers will not step into the breach and supply the oil that Saudi has cut back. It has always been a temptation for others to do this, and to some extent they always have.

This issue has taken a new twist with the resurgence of US production. Saudi wants to hammer US shale producers to deter long-term supply. This represents a return to traditional Saudi oil policy.

The late Saudi oil minister, Sheikh Yamani, was fond of telling audiences that when the Stone Age came to an end it was not through a shortage of stones. The danger was that the Oil Age would come to an end, not through a shortage of oil, but instead through the production of oil substitutes and increased efficiency.

Saudi Arabia has huge oil reserves which can last for decades, whereas some producers have comparatively small reserves. Their interest might lie in maximising the oil price now, whatever happens in the long run.

The Saudi Arabian interest lies in maximising the oil price over the long run, which may require the price to become lower in the short run in order not to incentivise exploration, innovation and energy efficiency.

Whatever the balance of causes, if the low oil price endures, the Middle East will look a very different place financially. Most importantly, the current-account surplus of the Gulf producers will be eliminated.

Yet this will not cause them to reduce their spending, even if they dip into current account deficit. For they have accumulated foreign exchange reserves of almost $3 trillion, or roughly 165pc of the region's gross domestic product.

The worsening in their income and the reduction in the current account deficit will be mirrored by improvements elsewhere, including here. As I have said before, the world's economic problems have partly originated from the fact that a good portion of the world's income was landing up with people who did not want to spend it. That is now being reversed.

Putting it another way, for a long time the leading Gulf oil producers did not spend all their money because they were aware that lower oil prices might ultimately reduce their income substantially. So they squirrelled a good part of the money away to provide for that possible rainy day. That rainy day has now arrived. The time has come for them to raid their piggy banks.

Similar points apply to Russia, although to a lesser extent because its financial reserves are smaller. The crisis there, of course, is about more than oil but I reckon that low oil prices are **responsible for more of the recent fall of the rouble than anxieties about Russia's domestic politics or its international isolation**.

Oil accounts for roughly half of Russia's exports. It is true that Russia's currency has fallen far more than most oil producers' but most of them manage their currency tightly against the US dollar.

Where oil producers' currencies are free to move, they have fallen a long way. The Norwegian krone has fallen by about 20pc and the Venezuelan currency has fallen by 60pc.

For some time, high oil prices have masked Russia's serious economic and political weaknesses; now low oil prices are laying them bare.
Thinking about how economic forces have a way of throwing a spanner in the works of the political world, closer to home it is only just over three months since the Scottish referendum.
There was a good deal of debate about how much oil was left in the North Sea and about Scotland's vulnerability to oil price fluctuations. But I don't recall anyone imagining that just three months later oil would be as low as $60 a barrel and "Scotland's" oil industry would be in crisis. At this level of oil prices, Alex Salmond and Nicola Sturgeon have some frantic number-crunching to do.
But I said that I had a positive message. What about the winners? In the UK, the effects of low oil prices can already be seen at the petrol pumps and the effects will soon spread far wider across the economy. At long last, the rate of inflation has recently fallen below the rate of increase of average earnings, so that real earnings are rising again.
This is just the beginning. Inflation is set to fall much further. Indeed, for the first six months of next year it will probably be below 1pc.
If current oil prices are sustained, the general election will take place against the backdrop of a strong economy, nicely rising real incomes and probably booming consumers' expenditure.
Talk about the relationship between economics and politics. Perhaps Mr Putin can explain how George Osborne has conspired to bring the oil price lower.
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