The oil price decline and the dollar's dim future

by David Goldman

Early in the week of Oct. 15, Norway's state oil company reduced its selling price by about $1.50 per barrel, and the British National Oil Company immediately followed suit. The most financially pressed of the OPEC producers, Nigeria, responded on Oct. 18 with a $1.00-$2.00 per-barrel reduction in its own crude oil price, prompting fears of a general OPEC price war, and OPEC called an emergency meeting for Oct. 22.

Not one newspaper or wire service has asked the first question that would address the mind of the intelligence analyst who must, simultaneously, consider the dominant role of the Soviet Union in oil price-shaving during the past two years. The analyst would look at the world map and wonder what connection might exist between the Norwegian origin of the present slippage in the oil price, and the mounting Soviet pressure on NATO's Northern flank—pressure which has led many Norwegian observers to fear a Soviet incursion into Norwegian territory, in parallel to the repeated violations of Swedish coastal waters by Soviet vessels.

Only Saudi Arabia's Sheikh Yamani, as reported below, has raised the issue in words addressed to a narrow and well-informed circle.

Oil and depression

There is some truth to Energy Secretary Hodel's remarks on Oct. 17 that the Norwegian and British cuts merely responded to refiners' changeover to heavier crude grades. But the Nigerian announcement, which will cost the near-bankrupt nation about $2.5 million per day, shows the extent to which the continuing depression in world trade has eroded the facade of oil price stability. It is likely that the OPEC ministers will find a formula to prevent an immediate crash of the oil price, but it is virtually excluded that they will prevail for longer than a few weeks. Nigeria has already doubled its oil output from an estimated 750,000 barrels per day in August to 1.5 million barrels per day in September, and is expected to demand higher production quotas (to maintain the same gross revenue at the new, lower price) as its price for remaining inside the OPEC quota structure.

Apart from the sharp contraction of American oil demand starting in August, the dreadful weight upon the oil price is the impossible overvaluation of the American dollar. The overvaluation of the dollar is the pivot of the present world depression, the means by which capital flows have been forced into the United States to maintain the illusion of economic recovery conjured *ad nauseum* at last month's meeting of the International Monetary Fund.

But Federal Reserve Governor Henry Wallich, the Spenglerian Henry Kissinger of the financial world, has warned in various recent statements that the rise of the dollar would, ultimately, destroy its function as a reserve currency—the dollar would price itself out of the market, and other nations would revert to alternative arrangements, leading to an ultimate collapse of the dollar.

Wallich's warning did not, perhaps, flash across the monitor screens of foreign-exchange traders when Nigeria announced a $2-per-barrel reduction in its oil price on Oct. 19. Nonetheless, the decline of the dollar price of oil, which is by no means over, must be considered in the light of the dollar's rise of the past six months. Since April, the dollar has risen by 25% against the West German mark, and Western Europeans are paying effectively that much more for dollar-priced oil; only a comparable drop in the dollar price of oil would compensate Europeans for the decay of their terms of oil trade.

There are some indications that wealthy Arab investors, who, to say the least, are sensitive to the impact of the falling oil price on their investments, are preparing for a decline of the dollar. According to the *Wall Street Journal* on Sept. 24, these investors are drawing down their holdings of long-term securities in order to build up short-term liquidity. That represents a remarkable change in sentiment among a group of investors who formerly showed a strong preference for long-term investments. The *Journal* account concludes: "The liquidity buildup could have implications for the U.S. dollar. One market analyst says it could aggravate a fall that might otherwise be just a correction."

Numerous commentators, including *EIR*'s Montresor, have already noted the near-perfect inverse relationship between the price of gold and the dollar's parity against leading European currencies, that is, that the gold price has been relatively stable against a combination of the German mark, Swiss franc, and Japanese yen.

The rough stability of the gold price in terms of the leading non-dollar currencies reflects a judgement on the part of (mainly) large European gold hoarders that the monetary metal represents an excellent bargain in terms of their own currencies. However, this judgement, with all its implied pessimism for the future of the dollar, draws on an obvious fact of economics: As long as the price of oil and other leading European import items rise with the rising dollar, European economies will not be able to absorb additional oil through economic growth.

The converse is also true. The high relative price of oil in terms of European currency has enabled the dollar credit system to extract capital from Western Europe. The collapse of the oil price reduces this ability. More simply stated, the reduction in the dollar oil price reduces demand for dollars, and adds to the conditions under which the dollar might crack.

Fall of demand

Since the flood of capital flows into the United States subsidize debt creation, both of the Federal government and the private sector, rather than economic expansion, the rise in American oil imports cannot compensate for the generalized depression of the world oil trade. Analysts currently estimate world oil overcapacity at about 2 million barrels per day, against OPEC oil output of about 17.5 million barrels per day. As the means to continue inflating the domestic U.S. credit-bubble has evaporated, so has American oil demand.

Refined products sold in the United States during August rose only 1.2% in August relative to August 1983. Through the first seven months of the year, demand for refined products was up about 5.9%. The fallback to the depressed levels of 1983 reflects the economic slowdown otherwise reflected in September's reported 0.6% drop in industrial production, and the Commerce Department's announcement on Oct. 19 that the estimated 2.7% rise in third-quarter Gross National Product was entirely attributable to inventory accumulation.

Government data of this sort, as *EIR* has demonstrated during the past year, err wildly (and usually with malice aforethought) in overreporting economic activity. Nonetheless, they reflect the aggravated world depression that forms the backdrop for the current decline of oil prices.

Where does oil go from here?

OPEC nations will meet in emergency session in Geneva on Oct. 22 to find means to stabilize the world oil market. According to the Cyprus-based *Middle East Economic Digest,* Saudi Arabia is prepared to reduce its current output from 4.5 million barrels per day to only 3 million barrels per day in the hope of stabilizing the oil market, while Venezuela, Kuwait, and perhaps Libya as well may take additional production cuts.

The newsletter quoted Saudi Arabia's oil minister, Sheikh Yamani, as saying, "I am surprised—just as most industry executives and maybe even some BNOC board members were taken by surprise—by the Norwegian and British decisions. I failed to understand the real motives behind it and I am still trying to find out."

In fact, Yamani has more than a few suspicions on the subject, which led him to plan his first visit to the Soviet Union last month (it is not confirmed whether the visit, reported on Sept. 11, actually took place).

According to the International Energy Agency, the Soviet Union increased crude oil exports to the West by 100,000 barrels per day to 1.8 million barrels per day during the third quarter, according to the International Energy Agency. The Soviets, in every previous instance of weakening oil prices since early 1983, took the lead in price-shaving, using their growing edge on the European market to prevent other producers from controlling the chronic oversupply of oil.

The vulnerability of oil-dependent sectors of the financial system to the oil price decline includes:

1) The British financial market, already shaken by the previous week's failure of Johnson Matthey Bankers, which saw a £6.8 billion decline in the British stock market Oct. 17, the worst ever in a single day;

2) Oil-exporting nations such as Mexico, Nigeria, and Venezuela, all in various stages of debt renegotiation with creditor consortia;

3) The already-battered oil patch in the United States, the subject of a doomsaying analysis in the current issue of *BusinessWeek* magazine.

However destructive the impact on these sectors may be, it is secondary relative to the global unwinding of the strong-dollar arrangement that has held the world financial system together for the past two years. The oil price drop shows the end of the dollar's capacity to function as a reserve currency, and augurs a global credit crisis of proportions which the battered City of London can barely imagine.