

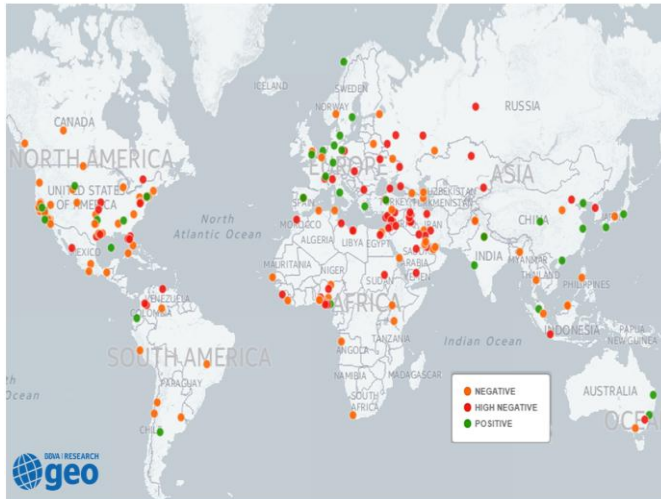
Global Hot Topics

Very low energy prices and geopolitical risks

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Beyond the positive effects of the recent energy prices shock for the world, very low levels of oil prices could have significant economic, social and geopolitical consequences. The oil price crash can have non-linear effects: very low oil prices are raising questions about the economic stability of some key geopolitical areas such as Russia, Eurasia, the Middle East and North Africa increasing the geopolitical risks and with potential de-stabilising effects.

The world sentiment to the drop in oil prices

Source: www.opec.org & BBVA Research

Oil price effects are net positive but...

The effects of the falling oil price on the economy are highly dependent on the underlying forces of the shock (supply & demand). Besides, financial amplifier mechanisms can play an important role, as some commodities have been functioning *de facto* as financial assets ("paper barrels").

The sharp drop in the oil price has been driven by a changing combination of supply shocks (extra oil coming from the US Shale Gas operations, better than expected Libya production and the negative of Saudi Arabia to reduce supply), demand shocks (as demand forecasts' reductions in key Emerging Markets) and financial amplifying factors (US dollar movements) contributing to amplify the decline (see our previous note [the macroeconomic effects of lower prices](#)).

The reversal of transitory factors (i.e. demand and financial factors) should send the oil price back to previous equilibrium levels, while the magnitude of forces of the supply shocks will basically determine the new equilibrium prices. If supply factors dominate and the strong reduction in the oil price becomes more permanent the geopolitical landscape could deteriorate, due to the worsening outlook in "geopolitically sensitive" energy producers and potential spill-overs.

...geopolitical tensions could increase in some regions

Further, extremely low oil prices could trigger important disruptive effects in key geopolitical areas:

- Russia, Eurasia and the Balkans: At the current level of oil prices, the situation of the rouble could become unsustainable with the potential to trigger an even more disastrous economic and social scenario. If this happens, the reaction of both the political and social classes will be highly uncertain and an expansionary nationalistic scenario to hide internal problems cannot be ruled out. This situation could also spread to the Caucasus and Central Asia given their dependence on energy prices, external links with Russia and the importance of Russian ethnic minorities in some of these countries. Finally, trade and banking links and currency mismatches in Eastern Europe (especially the Balkans) could trigger collateral effects in Emerging Europe.

- Middle East & North Africa: The current level of oil prices is near to or well below the breakeven fiscal and external prices. This could have economic but also socially un-desirable effects. Some of the countries are coping with social pressures that began during the Arab Spring by deploying their energy revenues (oil and gas) through subsidies, social housing... If this buffer disappears, a new wave of unrest cannot be ruled out. Besides, key countries in the region, such as Iran, have shown their disagreement with Saudi Arabia's refusal to cut supply. In the current situation, with the ISIS crisis and the P5+1 negotiation with Iran, any mismanagement of the situation could have serious consequences. Lastly, the underlying situation in North African countries is still unstable (i.e. Libya) so contagion to the area could have disruptive consequences.

Summing up

Despite the net positive effects of lower oil prices, the current situation opens up new questions and risks for key geopolitical areas.

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