

The drop in oil price seems like déjà vu for 1985: developed economies bottoming out/ developing countries unstable

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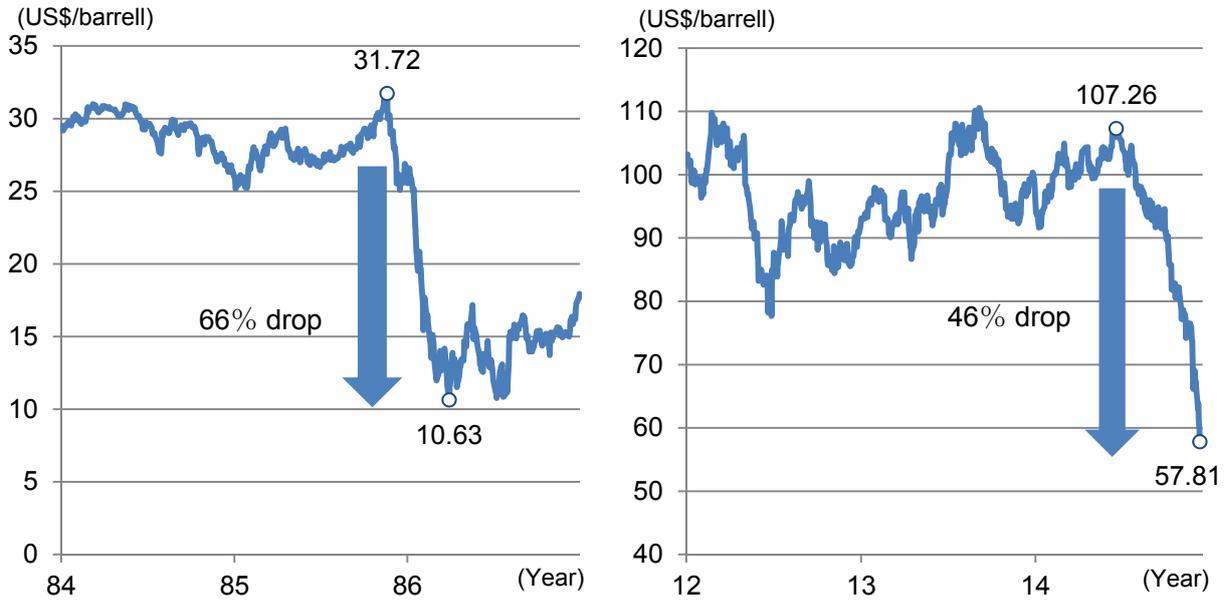
The price of crude oil dropped below US\$60 on a December WTI base. This sharp drop strongly resembles the trend in crude oil prices 30 years ago, from 1985 to 1986. There were aspects at the time of a ‘reverse oil shock’ in reaction to the previous oil crisis of the 1970s. Chart 1 compares the recent movements in the price of crude oil with 1985. The price dropped more than 60% from 1985 to 1986, while this time the drop has been close to 50%.

When compiling our forecast for 2015, Mizuho Research Institute focused on the decline in the price of crude oil by emphasizing ‘triple merits’ of (1) monetary easing; (2) fiscal expansion; and (3) the depreciation of the yen/ drop in the price of crude oil. The same ‘triple merits’ were also noted in 1985 with (1) a strong yen; (2) low interest rates; and (3) the price of crude oil. The global economy was in a low growth period during the early 1980s due to worldwide monetary tightening, which was attributed to the decline in demand. Furthermore, the presence of non-OPEC North Sea Oil contributed to the drop in the oil price as it weakened OPEC’s control on prices.

The drop in the price of crude oil in the latter half of the 1980s led to a bottoming out of developed economies such as Japan, the US and Europe. Lower crude oil prices pushed down prices, providing increased scope for those countries central banks to cut interest rates. This boosted the price of assets, particularly stocks, in each country. On the other hand, developing countries such as oil producing countries suffered serious economic problems with accumulated debt. From a geopolitical perspective, the large drop in the price of oil reduced the influence of the Soviet Union, which was the largest oil producing country at the time. This was also a factor that contributed to the collapse of Soviet Union in the late 1980s.

Even today, the drop in the price of crude oil is helping to boost the economies of developed economies such as Japan, the US and Europe. However, many developing countries such as oil producing countries are susceptible to instability and close attention needs to be paid to Russia, which relies heavily on crude oil. Furthermore, in terms of market impact, the drop in the price of crude oil is once again pushing down prices this time. While this will contribute to lower yields, it will increase the scope that each central bank has for monetary easing. Investment into physical goods is weak, and the tendency for money generated from monetary easing to push up asset prices is similar to the 1980s.

[Chart : Recent movement in the price of crude oil (WTI) compared with 1985]



Note. The most recent data is for December 12, 2014

Source: Compiled by Mizuho Research Institute from Bloomberg materials

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