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Opinion: Falling oil prices will bankrupt the likes of Russia, Saudi Arabia

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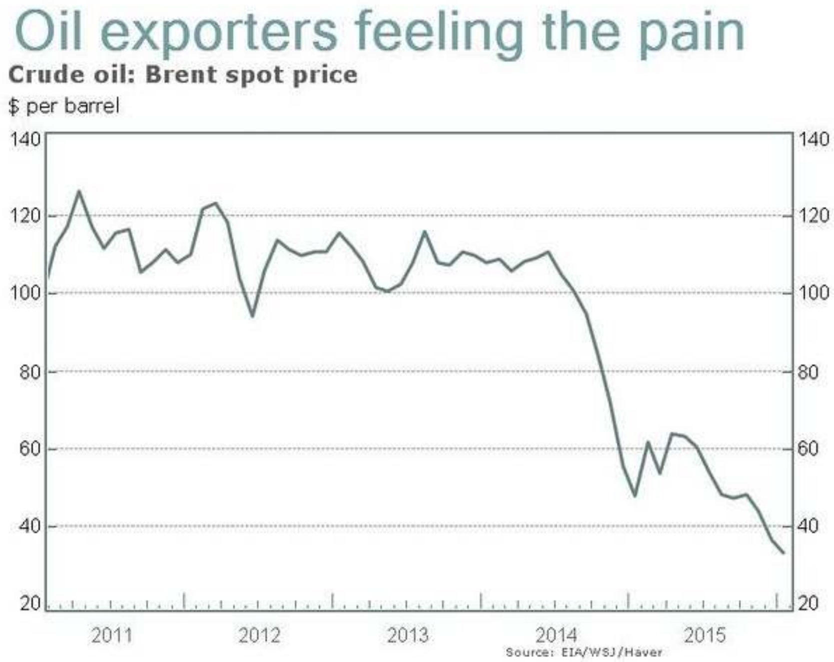
New sovereign-debt crisis could bring down Western banks as well



Oil exporters could default on their debts if oil prices stay low.

LONDON (MarketWatch) — What might be the next big financial crisis? A bursting of the bubble in tech stocks that has built up over the last two years? A total collapse in the stock market, beyond the selloff that has already marked the start of 2016? Any of those could happen. But increasingly it looks as if it will be national bankruptcies caused by collapsing oil and commodity prices.

The International Monetary Fund is discussing a bailout of Azerbaijan, hard hit by tumbling oil prices. Venezuela is out to go bust — again — for the same reason. Ecuador looks about to go the same way. More important countries may follow them — most significantly Russia and Saudi Arabia. Neither of them looks solvent for much longer with commodity prices at these very low levels.

We could soon be back in a full-scale sovereign-debt crisis, except this time it will be commodity exporters that are caught up in the maelstrom rather than peripheral eurozone countries. But just like the eurozone crisis, the losses will soon ripple out to the banking system, and before long there may well have to be series of emergency bailouts.

The key question will be whether that can be used to drive through reforms — because there is not much point in simply bailing out countries that can't rely on energy exports any more.

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The collapse of the oil price CLH6, +5.85% , and of other commodities alongside it, has already dominated the markets all this year. For most of the world, and even most emerging markets, cheaper oil should only boost economic growth. For the oil exporters, however, it is a catastrophe.

The first cracks are starting to appear in Azerbaijan, one of the largest oil exporters among the former Soviet states. It has already opened talks with the IMF about emergency assistance as it burns through the reserves built up during the years when oil was trading at $100 a barrel or more. It has already ripped its way through more than 60% of its reserves, and is discussing a loan package of more than $4 billion.

But Azerbaijan is not the only country that will be in trouble. Venezuela, an economic basket case for years despite its rich natural resources, is in even more trouble than usual. The president has already announced an economic state of emergency, even if that might be not so different from normal life for its long-suffering citizens. Ecuador does not look in much better shape.

Next up, Nigeria. It has already asked for $3.5 billion in loans from the World Bank and the African Development Bank to help it through the squeeze in cash caused by the tumbling price of its oil exports.

What about the two really big oil-driven economies, Saudi Arabia and Russia? Saudi Arabia's finances have never been famous for their transparency. It has some of the lowest production costs in the world, but it also has huge expenses and virtually no other sources of income.

Even on official figures, the country ran a budget deficit of $100 billion last year, and with the oil price still falling, and despite cuts, this year it unlikely to be much better. That amounts to 15% of gross domestic product, which makes Greece look positively frugal.The Saudis have plenty of assets to fall back on but when you are spending 15% more than you earn every year you burn through a lot of cash very quickly.

Russia's budget deficit is not as high as that. Finance Ministry projections put it at $20 billion for this year, or around 3% of GDP. But that was based on oil at $40 a barrel, which seems like a distant memory now.

The economy has slipped into recession — the latest figures show it contracting at an annual rate of 3.7% — the ruble USDRUB, -3.08% has been in free fall, and the country is burning through its reserves. For all his military meddling, Vladimir Putin has miserably failed to diversify or modernize his economy, and left the country at the mercy of the energy markets (funnily enough, we don't hear much about how Putin can hold Western Europe to ransom any more by controlling its oil and gas supplies). Nothing good can come from that.

Which countries go bust, and how long it take them to get there, remains to be seen. But one thing we learned from the collapse of 2008, and the euro crisis of 2011, is that a sovereign-debt crisis quickly morphs into a banking crisis. As Greece, Portugal and Ireland tumbled into bankruptcy, the losses rippled out into the banking system.

That will happen all over again if oil exporters go bust. There are loans to national oil companies, and state-backed construction projects, which could all turn sour very soon. Indeed, one reason why the banks have been hammered in the last few days, with the key index of European banks FX7, +3.33% down by 30% since the start of the year, is the gradual realization that the banking sector could ultimately face enormous losses from the decline in oil prices.

Only this week, Deutsche Bank DB, +4.42% had to put out a statement attempting to reassure investors it was "rock-solid" — but funnily enough they don't usually find statements like that very reassuring at all.

The world's resources, especially those of the IMF and World Bank, have already been stretched by the last sovereign-debt crisis. Ireland may be off the medicine, but Greece and Portugal are still in intensive care. Greece doesn't look like it will be able to stand on its own two feet any time soon.

Another round of rescues will add a huge amount to the bill. Even so, the money will have to found. The key will be demanding reforms in return. No country in 2016 should be dependent on oil exports alone — any that are, and go bust as a result, will have to find new sources of growth. If they can't, unlike the peripheral eurozone, perhaps it would be better to let them fail.