Oil Hedge was a good decision

The Private Sector Organisation of Jamaica (PSOJ) has noted commentary over the past couple of weeks re the oil hedge Jamaica entered into last year, for 8 million barrels of oil at a total cost of approximately US$20 million. This represents approximately 47 percent of the 17 million barrels of oil consumed annually.

One argument is that the hedge was a waste of money, as oil prices have fallen to US$30 per barrel, and the strike price (where we would have started to benefit from the hedge) is at US$66 per barrel. Therefore, the reasoning goes, we made a bad decision to purchase the hedge, and that poor decision has cost us US$20 Million (J$2.4 Billion at current exchange rates).

The PSOJ feels compelled to comment on this, as we were the ones who pressed for the hedge to be made, and hence were in support of the government's decision to purchase the hedge. At that time, all projections were for oil prices to recover in 2016, with most expecting oil to go past US$66 per barrel and settling off at around US$80 per barrel, which at 17 million barrels per year, would have had an annual cost above the strike price of US$234 Million.

If this had happened then we would have saved US$214 million (net of the hedge cost). So for us to even have broken even on the cost of the hedge, oil prices would have just had to gone to US$67.20 per barrel (additional US$20 Million based on our usage above the strike price).

At the time also, there were still restrictions on Iran, China's economy was stronger than it is today, and ISIS was in control of more oil resources than they are today. This is the nature of geopolitics, which changes every day and as governors, we have to be able to adapt to the changing environment while considering the associated risks.

So in fact, the cost risk associated with not purchasing he hedge (based on the market information at the time), would have been far more hurtful to the economy, than the risk associated with the price of oil not going above US$66 and us not benefiting from the hedge.

The only way that we can be sure of an event is after it has happened. In other words much of the commentary today is being made from hindsight (which is 20/20) and when insight is most valuable is before an event happens. In other words, buying a stock after the price has increased will not give you the benefit of the price rise, or what is the sense of buying insurance after a catastrophic event. And because an event might not happen would you then not insure against it. The logic would follow that anyone who does not think the hedge was a good decision is therefore against the principle of insurance.

At the PSOJ, we feel very strongly about commenting on this, because it is important that as a country we move away from chastising decisions after the event, and start taking the bold decisions needed to secure the country's economic and social stability. The fact is that we could ill afford oil moving back to US$80 per barrel, and the cost of US$20 Million to mitigate a US$200 Million risk, like insurance, makes good business sense.

This is the same argument that we apply to the need to lower the tax rate, and move towards indirect over direct taxation. The fact is that if we are to see sustainable development then to move to that next level of progress we must make bold decisions based on rationally projections, and not make decisions based on the fear of failure.