



# Will Oil Spoil the Global Outlook?

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# Disclaimer

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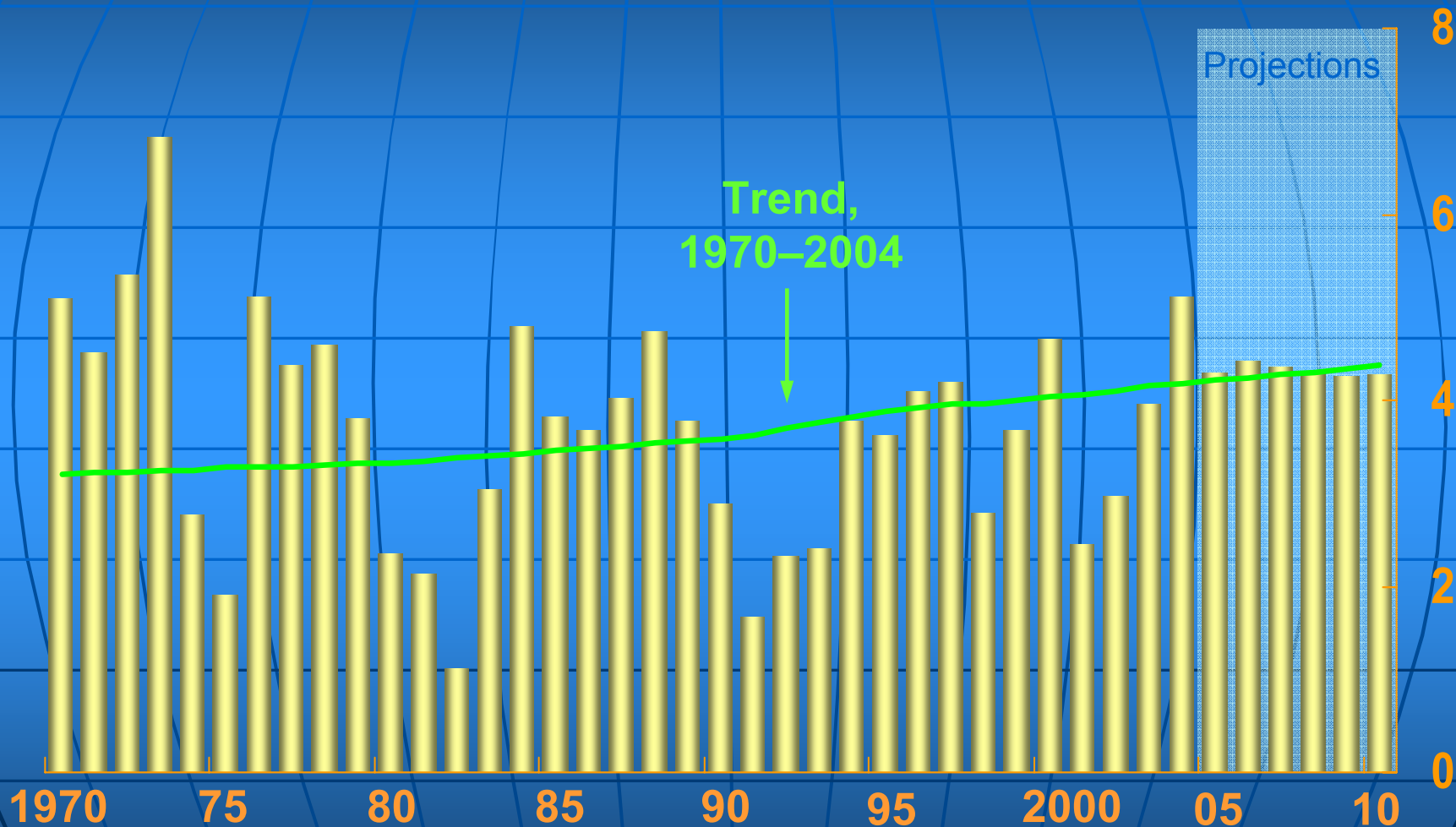
# Outline of Presentation

- A. The Global Outlook
- B. Will Oil Spoil the Outlook?
- C. Policy Response to High Oil Prices

## A. IMF's World Economic Outlook

- Global growth
- Growth: Industrial countries vs. emerging markets
- Outlook for consumption and investment
- Inflation outlook

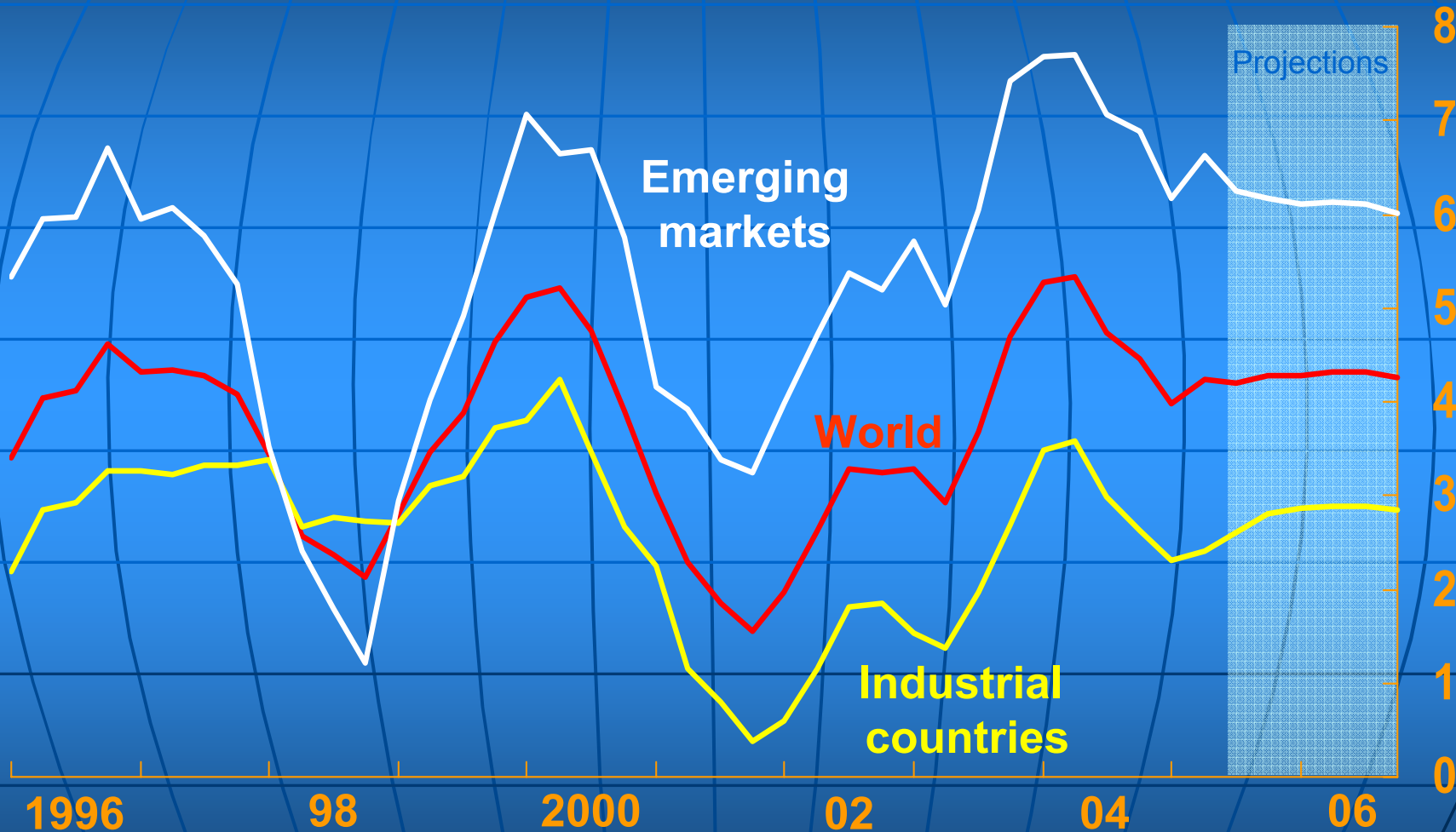
# World Real GDP Growth (Annual percent change)



Source: IMF staff estimates.

# Global Outlook: World

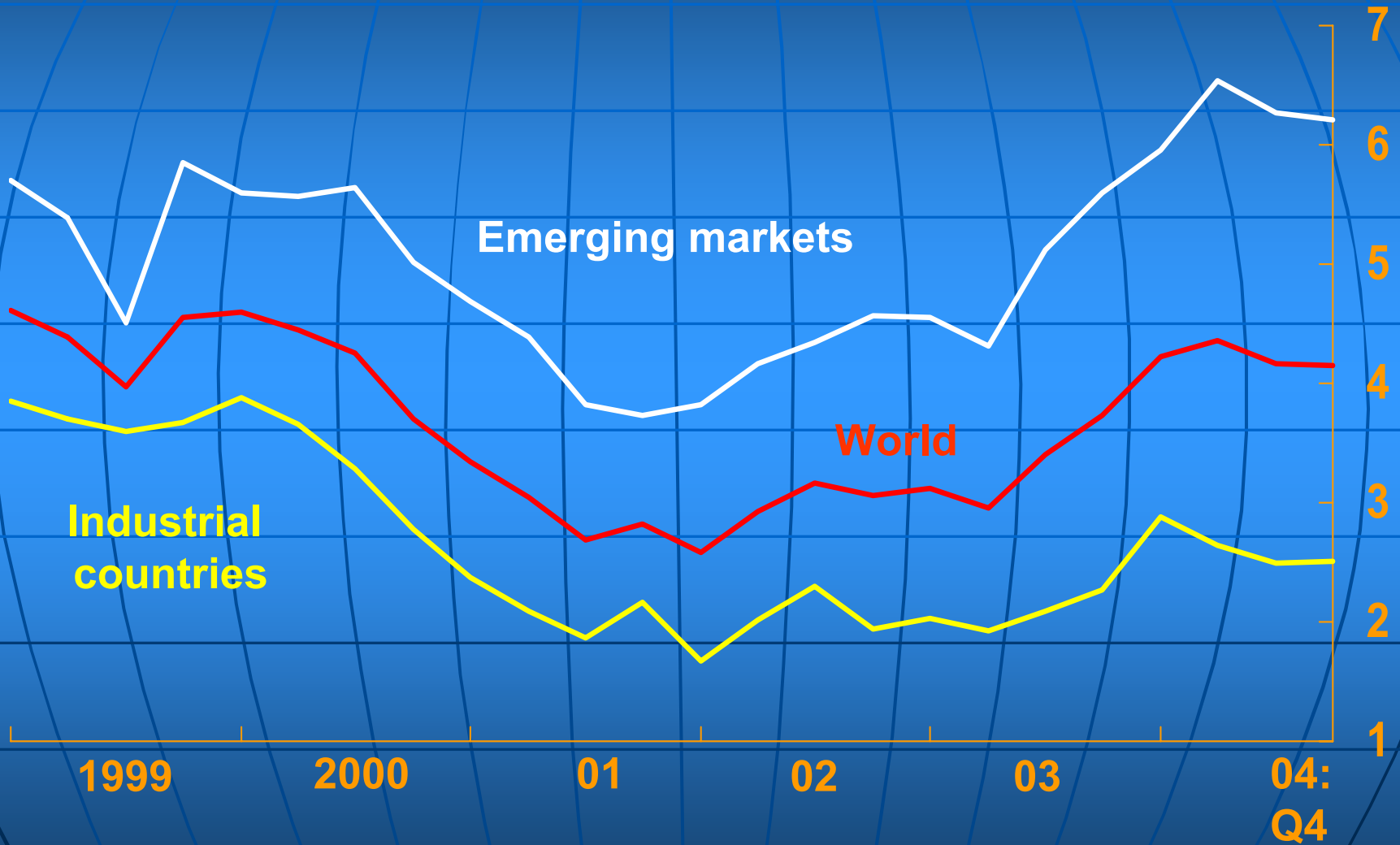
*(Real GDP; percent change from four quarters earlier)*



Source: Haver Analytics.

# Global Private Consumption

(Percent change from a year ago)

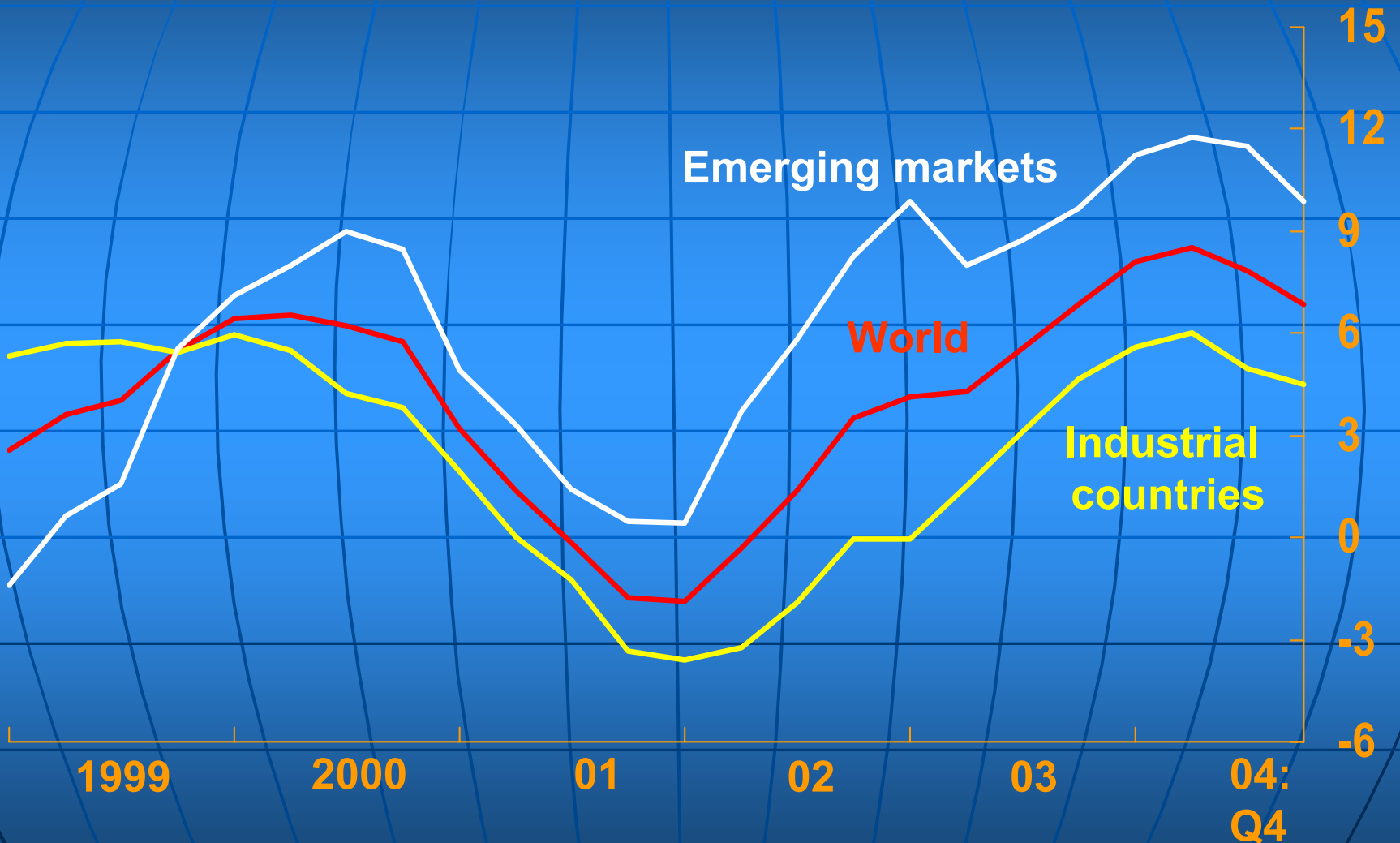


Source: Haver Analytics.



# Global Investment

*(Percent change from a year ago)*

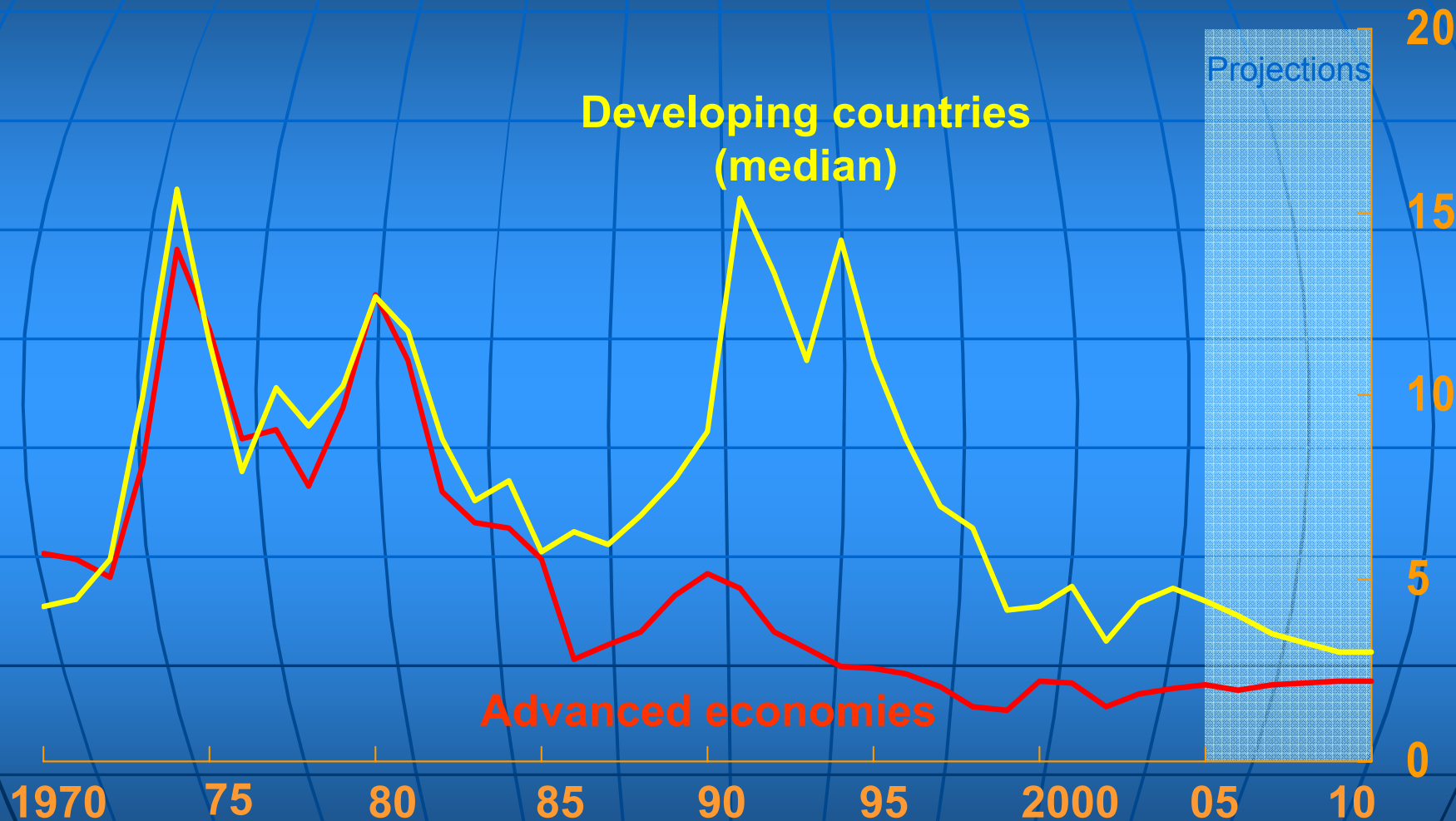


Source: Haver Analytics.



# Consumer Prices

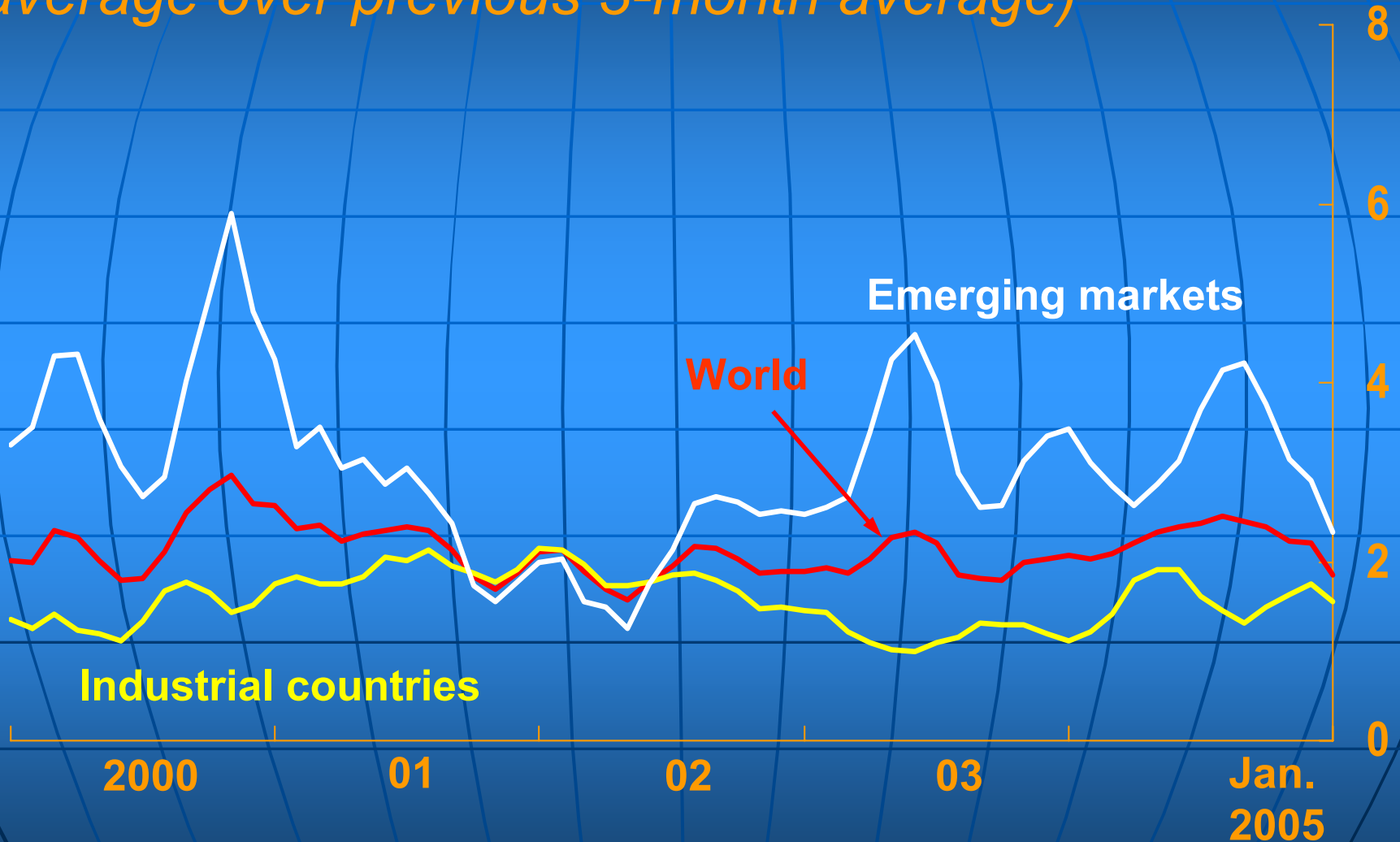
(Annual percent change)



Source: IMF staff estimates.

# Core Inflation

*(Annualized percent change of 3-month moving average over previous 3-month average)*



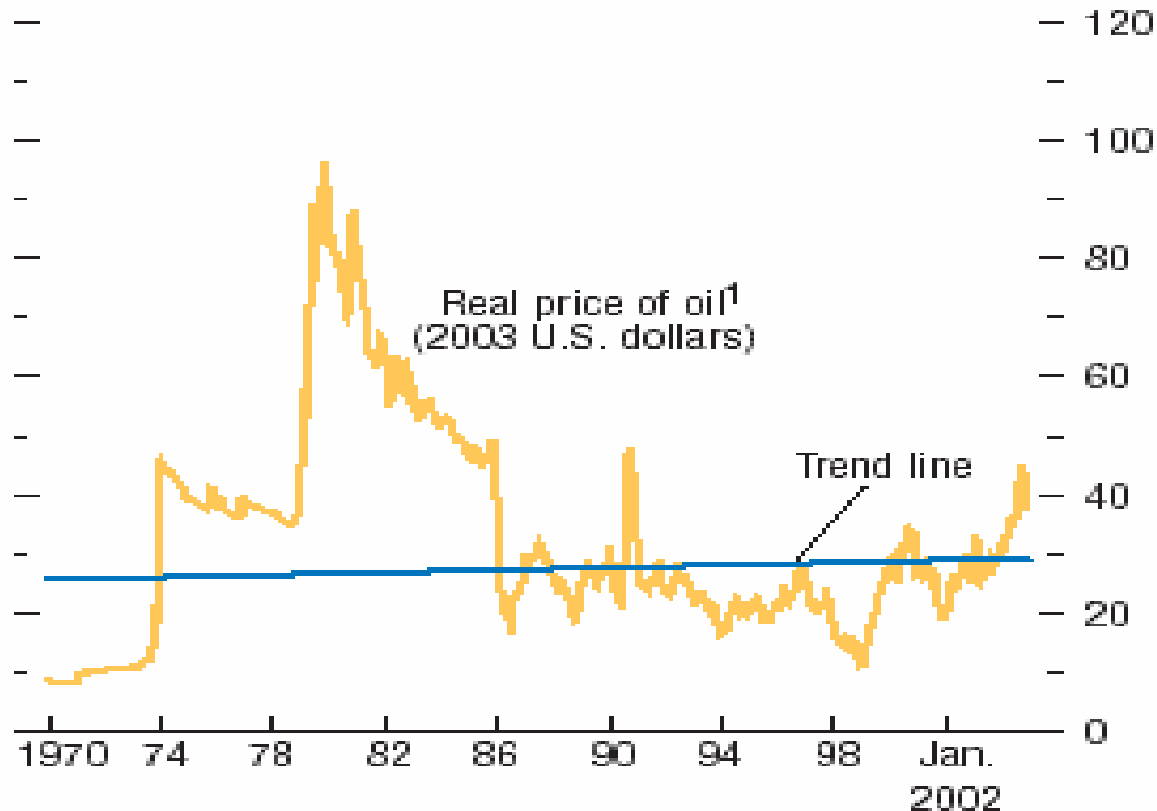
## B. Will Oil Spoil the Global Outlook?

- No, because:
  - Smaller shock than in 1970s
  - Demand-driven price increases
  - Low inflation environment gives central banks more room to act
  - Declines in energy intensity
- Yes, because:
  - Low levels of excess capacity
  - Geopolitical events could lead to major supply disruption
- On balance: at present we expect global expansion to remain robust

# Smaller shock than in 1970s ...

## Real Price of Oil and Trend Line

(Monthly, 1970–2004)

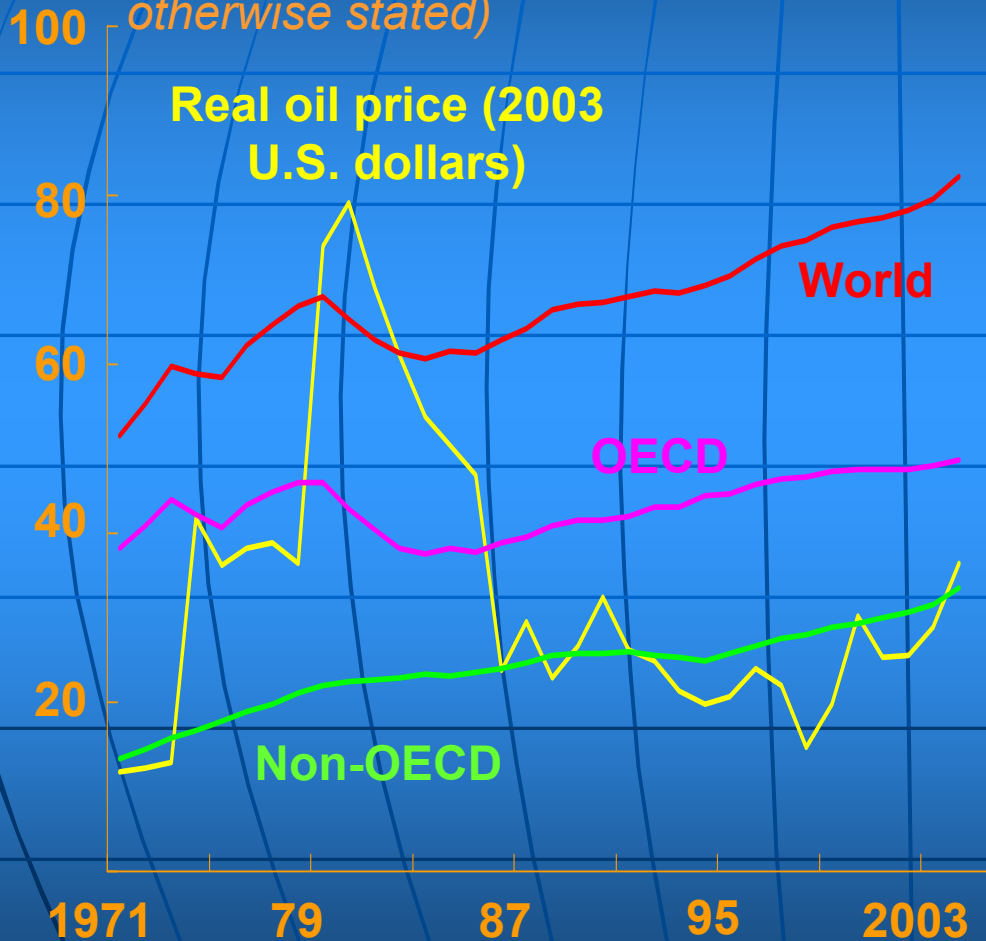


Sources: IMF, *International Financial Statistics*; and IMF staff calculations.

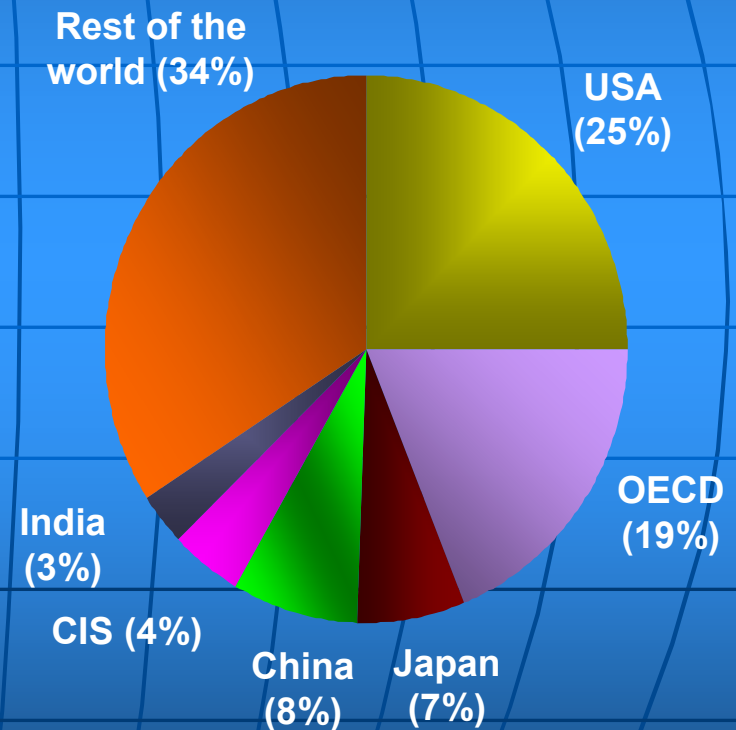
<sup>1</sup>Simple average of West Texas Intermediate, Brent, and Dubai oil prices.

# Oil Price Increase is Partly Demand-Driven ...

Global Oil Demand and Real Oil Price  
(Millions of barrels a day, unless otherwise stated)

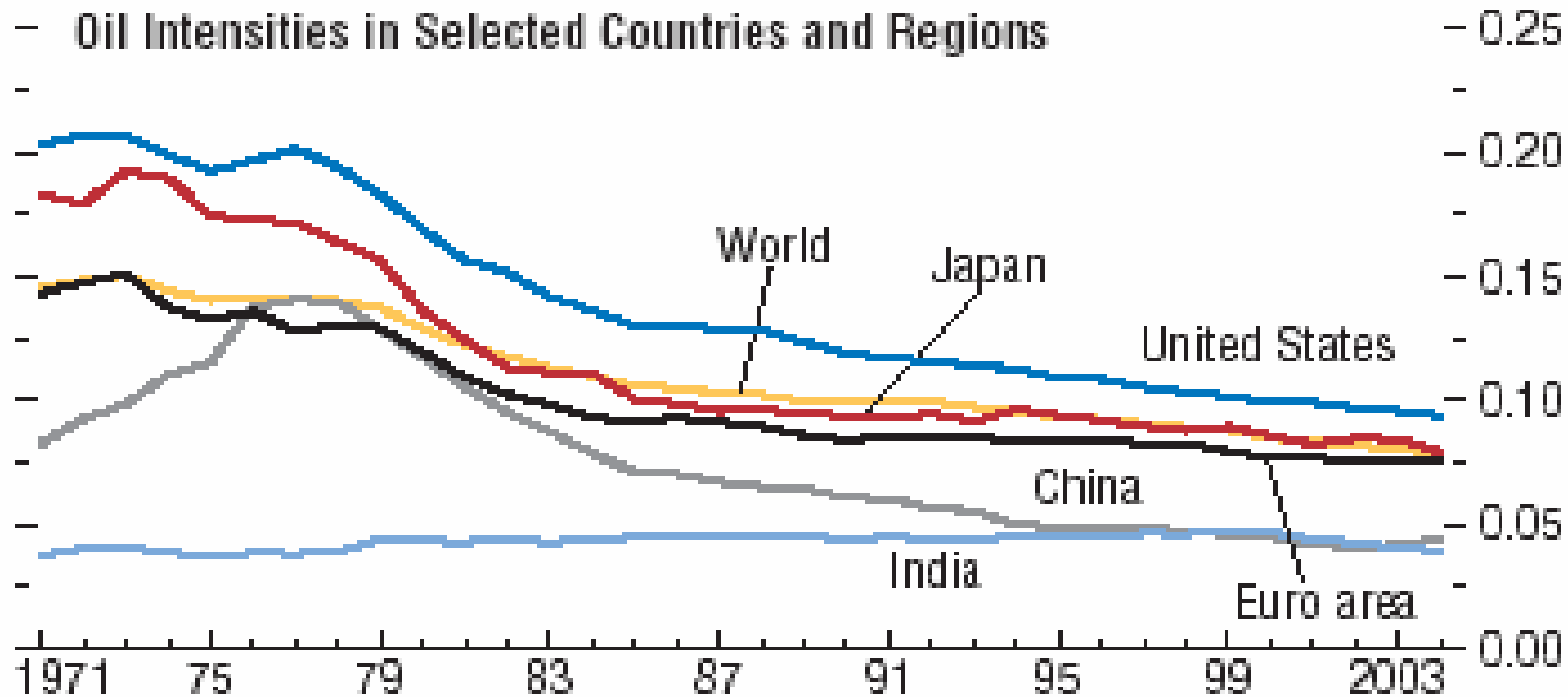


Consumption by Countries and Regions, 2004



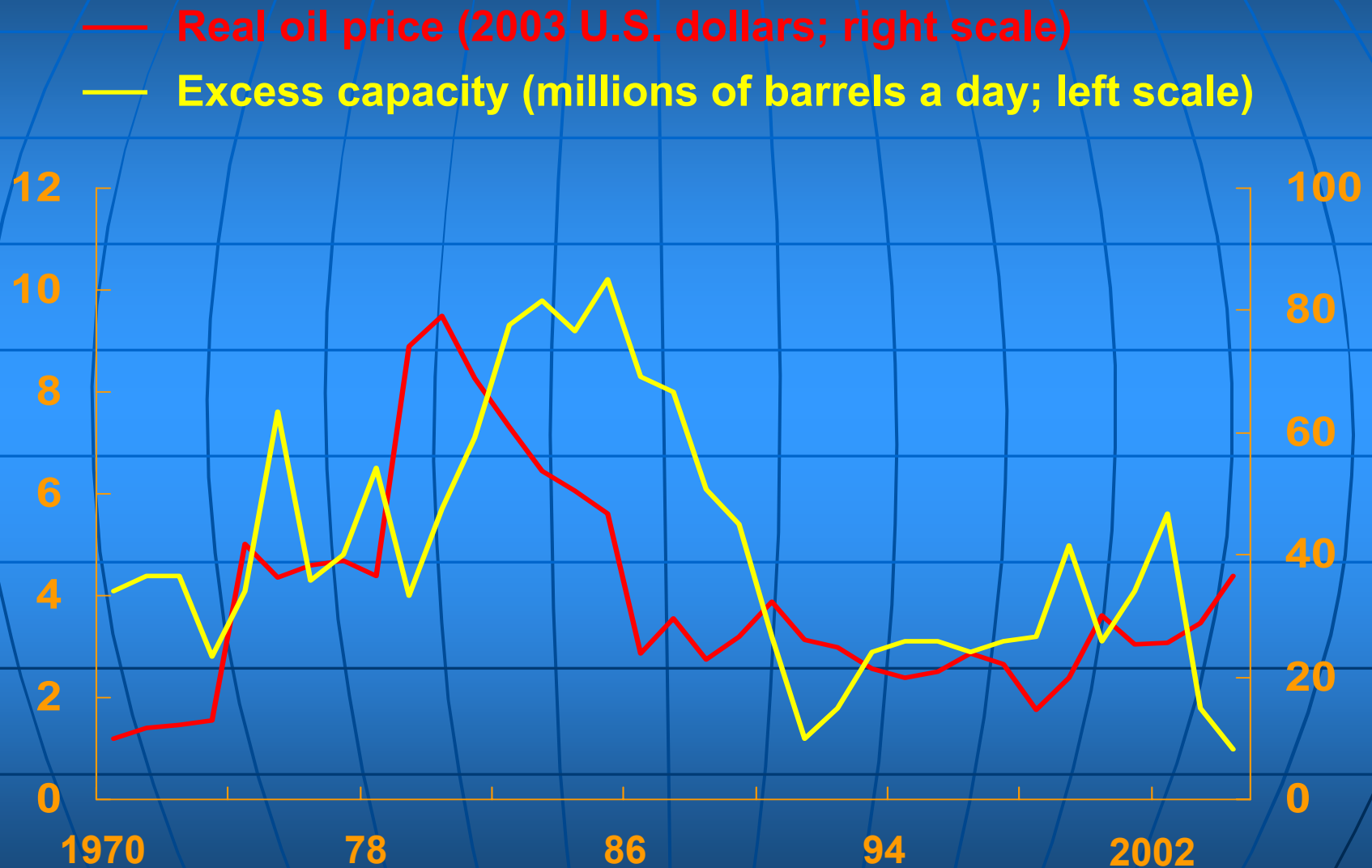
Sources: International Energy Agency; U.S. Department of Energy; and IMF staff calculations.

# There have been gains in energy efficiency ...



Sources: International Energy Agency; OECD analytical database; and IMF staff calculations.

# Excess capacity is lower than in 1970's ...

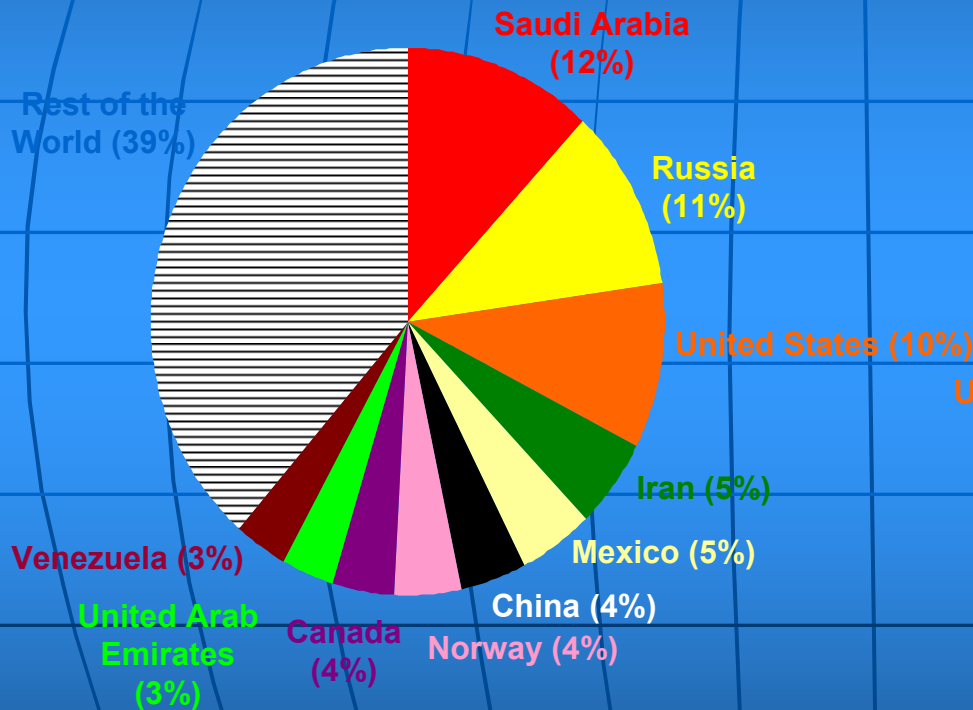


Sources: International Energy Agency; U.S. Department of Energy; and IMF staff calculations.

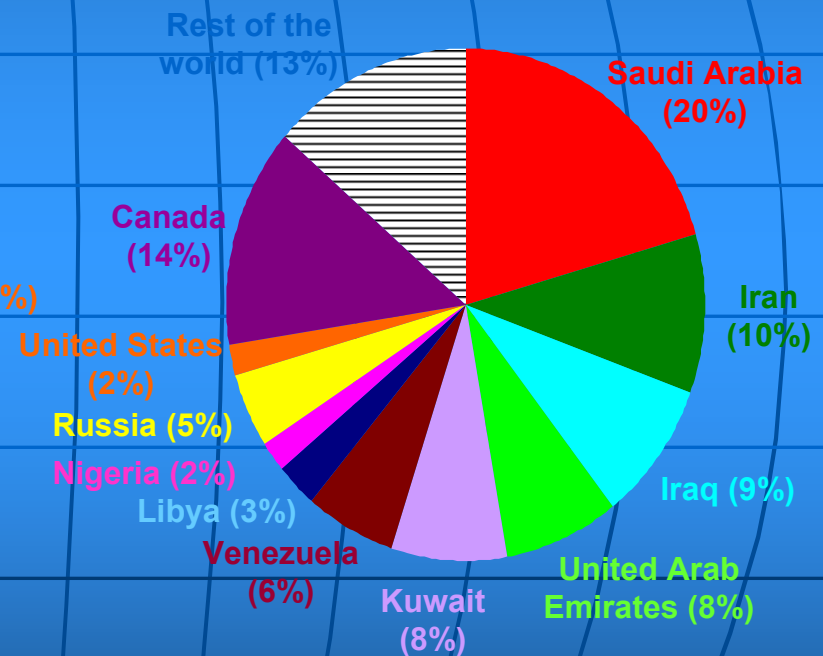


# Geopolitical events can cause major supply disruption ...

## Main Oil Producers, 2003



## Proven Oil Reserves; end-2003 (Total 1,266 billion barrels)



Sources: International Energy Agency; *British Petroleum Review*; *Oil and Gas Journal*; and IMF staff calculations.

# Views of James Hamilton, my Guru on Oil



James Hamilton: "My evidence showed that six of the seven U.S. recessions since 1947 were preceded by a sharp increase in the price of petroleum."

## HAMILTON:

*"Oil is a very important part of the calculations for buying lots of stuff—like what kind of car to buy or what type of machinery will be cost-efficient. People read about events in the Middle East and realize that these events have implications for oil prices. And because they understand the importance of oil in virtually every activity in the economy, they become concerned. **It may be that these psychological effects are what's important in disrupting patterns of consumption and investment spending.**"*

(Source: James Hamilton, interviewed by Prakash Loungani, IMF Survey, August 18, 2003)

# Oil prices and economic activity: Hamilton on the transmission mechanism

**LOUNGANI:** And once you have a demand shock like this, the standard business cycle mechanisms take over?

**HAMILTON:** That's right. **The old inventory-accelerator model of the business cycle kicks in.** You have an unanticipated drop in demand, and it shows up as a piling up of unintended inventories. Production does not actually fall at the moment of the shock to demand, so real GDP is buffered temporarily. Later, when inventories are liquidated, you have the effect not only of a drop in demand but also of a drop from the excess inventories being worked off. That's an old story, but it explains why there is a long lag between the time of the oil shock and the impact on real GDP.

(Source: James Hamilton, interviewed by Prakash Loungani, IMF Survey, August 18, 2003)

# James Hamilton on the present oil price shock

- “ ... this oil price shock differs significantly from earlier episodes, leading me to believe that the economy will be able to adapt to the new pricing environment without a major economic slowdown.”

- “In each of the five biggest previous oil shocks, there was **a dramatic geopolitical event that cut oil flows amounting to nearly 10% of total world oil production**. By contrast, global oil production has increased steadily during the current episode. The run-up has been caused this time not by a shortage of supply but rather by booming world demand ...”

Date	Event	Percent drop in world petroleum production
Nov. 1956	Suez Crisis	10.1
Nov. 1973	Arab-Israeli War	7.8
Nov. 1978	Iranian Revolution	8.9
Oct. 1980	Iran-Iraq War	7.2
Aug. 1990	Persian Gulf War	8.8

Data: James D. Hamilton, 2003, “What Is an Oil Shock?” *Journal of Econometrics*, Vol. 113 (April), pp. 363–98.

- “Both the gradualness of the price move and the circumstances attending it have left consumers and firms substantially less nervous about the current economic situation than they were in August of 1990, with none of the postponing of spending decisions that characterizes most economic downturns.”

# Views of Dan Yergin, my other Guru on Oil



**LOUNGANI:** Your book *The Prize* said that “oil is 10 percent business and 90 percent politics.” Is that still true?

**YERGIN:** That statement is about the oil business in the 1930s, but it underlines the peculiar nature of oil. Politics is still very much a part of the business. Most of the time, oil is just another commodity. But it hasn't lost its ability to quickly become a unique strategic commodity, because it's tangled with geopolitics in a way no other commodity is. For the most part, we have a big, complex, and resilient oil supply system—it's really quite amazing how large it is and how well it works. And it's increasingly driven by the market. ... But **it's a business that is still susceptible to politics** ... “The unexpected happens.” That's a fundamental maxim of energy security. **That's why there has been a “fear premium”** [in the oil price]

Source: Daniel Yergin, interviewed by Prakash Loungani, IMF Survey, June 24, 2002.



# Dan Yergin on the present oil price shock

- “Prices around \$60 a barrel, driven by high demand growth, are fueling the fear of imminent shortage ...”
- “Right now the oil market is tight, even tighter than it was on the eve of the 1973 oil crisis. In this high-risk market, “surprises” ranging from political instability to hurricanes could send oil prices spiking higher. Moreover, the specter of an energy shortage is not limited to oil. ”
- “Yet **this fear is not borne out by the fundamentals of supply**. Our new, field-by-field analysis of production capacity ... leads to a strikingly different conclusion: There will be a large, unprecedented buildup of oil supply in the next few years. Between 2004 and 2010, capacity to produce oil (not actual production) could grow by 16 million barrels a day -- from 85 million barrels per day to 101 million barrels a day -- a 20 percent increase.” (For IMF view on this, see “What Hinders Investment in the Oil Sector?” by Kochhar, Ouliaris and Samiei)
- “ ... **the risks are not the ‘below ground’ ones** of geology or lack of resources. Rather, **they are ‘above ground’ -- political instability, outright conflict ...**”

Source: Daniel Yergin, “It’s Not the End of the Oil Age, Washington Post, July 31, 2005

Impact of an \$80 Price of Oil in 2005  
(Deviations from the WEO baseline in percentage points)

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	CPI Inflation	Real GDP Growth
United States	1.3	-0.8
Euro Area	0.9	-0.6
Japan	0.9	-0.7
United Kingdom	0.9	-0.4
All Industrial Countries	1.0	-0.6

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Source: Estimates by IMF staff

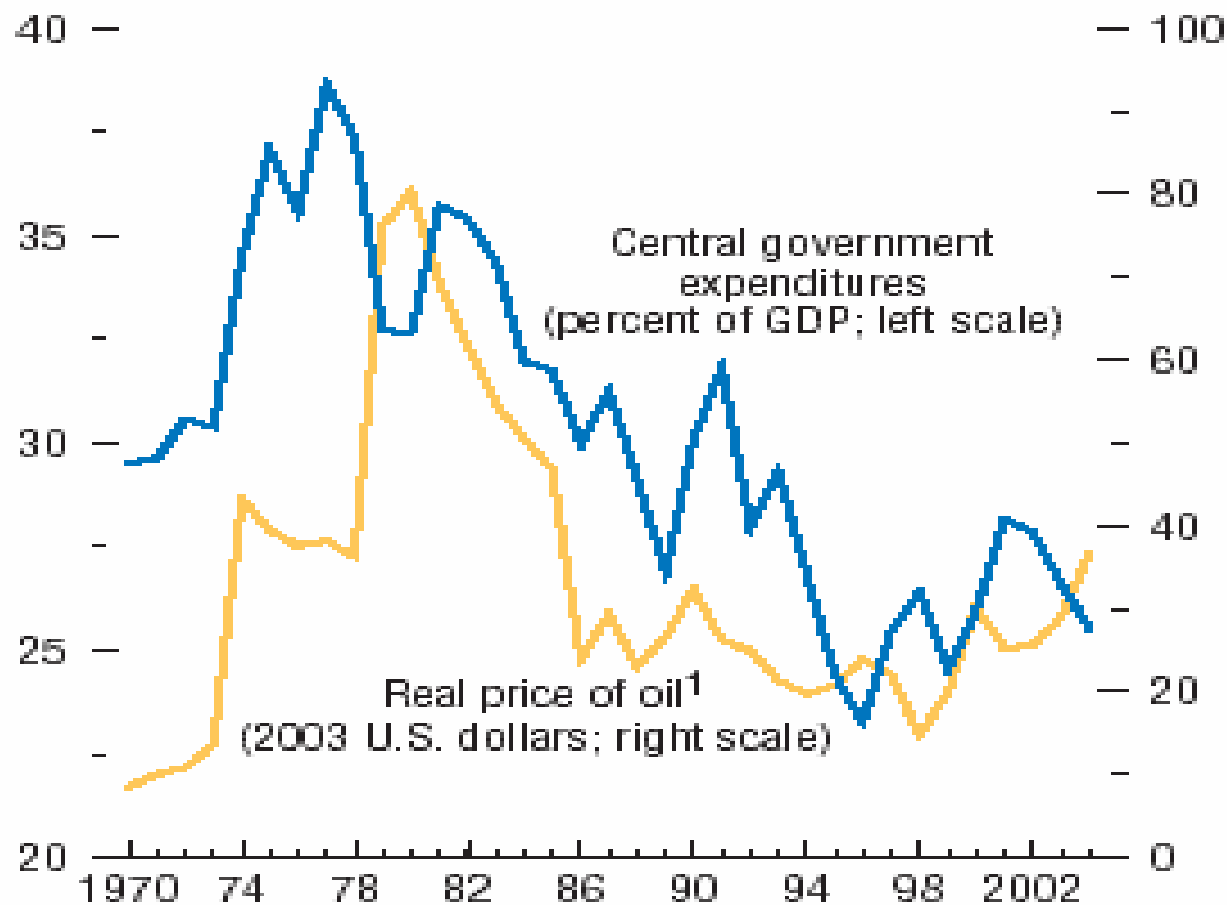


## C. Policy Response to High Oil Prices

- For net oil importers:
  - Appropriate macro policies
    - In countries with access to global capital markets or high reserves, sound debt dynamics, high monetary policy credibility:
      - Private sector can borrow abroad, effectively recycling savings of petroleum exporters
      - Fiscal automatic stabilizers can be allowed to work subject to long-run fiscal sustainability considerations.
      - Monetary policy should prevent second-round impact of increase in fuel prices on other prices and wages
    - Other countries face a more constrained set of options
  - Promote energy sustainability and efficiency

# OPEC-10 Central Government Expenditures and Real Oil Price

(Annual, 1970–2004)



Sources: IMF, *International Financial Statistics*; and IMF staff calculations.

<sup>1</sup>Simple average of West Texas Intermediate, Brent, and Dubai oil prices.

# Policy Response to High Oil Prices (continued)

## ■ For net oil exporters:

### • Fiscal Policy

- Fiscal policy should smooth the response of public spending to the windfall petroleum revenues
- Non-oil primary fiscal deficit should be set in a long-run framework: convert fiscal revenues from oil into assets which will pay off when oil runs out
- For some countries, higher oil revenues provide an opportunity to reduce distortive taxes or increase public spending to achieve socioeconomic goals

### • Monetary and Exchange Rate Policies

- Some amount of sterilized intervention may be appropriate to slow the rate of real appreciation
- Careful demand management to contain inflationary impact