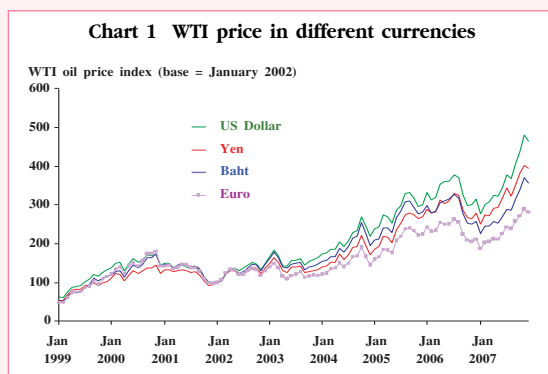


## The resiliency of the world economy: What makes the recent oil price surge different from past oil crises?

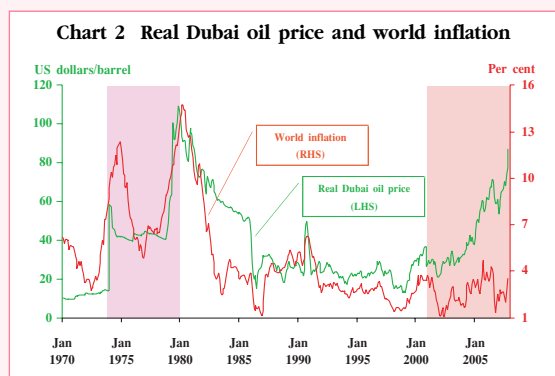
The surge in oil prices over the past 5-6 years had led many to question why the world economy was not in a recession already. This article lists a number of factors that helped lessen the impact of the current oil price hike, as follows:

1. The price of oil that matters to an economy is the local currency price, not the one denominated in US dollar. While the US dollar price of oil was more familiar to observers, the US dollar itself has been depreciating against a broad index of currencies over the past couple of years. Consequently, the rise in the local currency prices of oil in most countries has been more moderate; and the impact on that economy is lessened as a result (Chart 1).



Source: Bloomberg

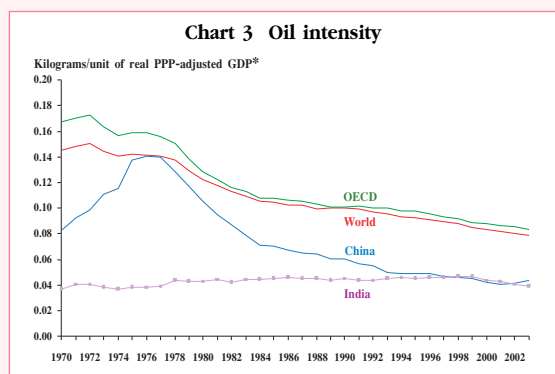
2. In contrast to the two previous oil crises, which were driven exclusively by supply restriction, the current surge in oil prices has been driven partly by rising oil demand,



Source: PTT and Reuters

which emanates from stronger domestic demand in emerging markets like China and India. Demand-side factors help explain why the recent increase has been more gradual compared to the sharp surging pattern of past episodes.

3. The pass-through of oil prices to consumer price inflation has diminished compared to the 1970s due to the change in market structure. Higher competition has reduced the ability of producers to raise prices. Moreover, the adoption of inflation targeting by many central banks has allowed them to better manage inflation expectations (Chart 2).



Note: \* Purchasing Power Parity

Source: International Monetary Fund (IMF)

4. The world economy's dependency on oil has been declining over the years thanks to technological advances, which allow for more efficient oil usage, as well as greater use of alternative energy sources (Chart 3).

5. According to a recent study by Blanchard and Gali (2007)<sup>1/</sup>, the world economy today faces no other significant disturbances. In previous oil price hikes during the 1970s, commodity price shocks and monetary policy tightening exacerbated the impact of oil price surge on the world economy.

More recently, however, the upswing in commodity prices as well as the subprime crisis in the US have increased the probability of a recessionary outcome in the US.

<sup>1/</sup> Olivier J. Blanchard and Jordi Gali (2007), "The Macroeconomic Effects of Oil Shocks: Why are the 2000s so different from the 1970s?" NBER working paper

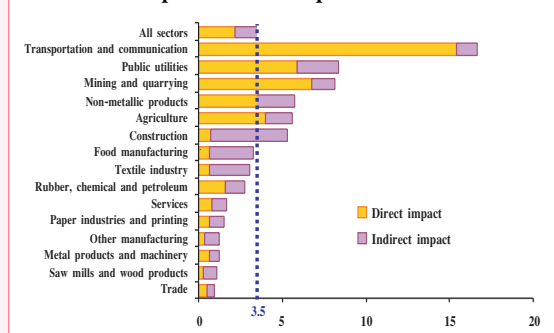
## Impact of Oil Price Surge on the Thai Economy

Under the assumption that Dubai crude oil price would hover between 85 to 86 US dollars per barrel in 2008 and 2009, the MPC projected that the Thai economy would continue to expand while inflation would accelerate but remain manageable. The MPC's assessment was drawn from the Bank of Thailand's Macroeconomic Model (BOTMM) and a Vector Auto Regression (VAR) analysis. The estimated impact of an oil price surge is summarized in the Table. According to the VAR, a 1 per cent increase the price of crude oil should lower GDP growth by 0.01 per cent in the first quarter and 0.06 in the fourth quarter subsequent to the shock. The same shock would push inflation up by 0.02 and 0.06 percent in the first and the fourth quarters, respectively. BOTMM also delivered similar results with minor discrepancies.

**Table : Effect on economy of a 1 per cent increase in crude oil price** (in \$ tonne)

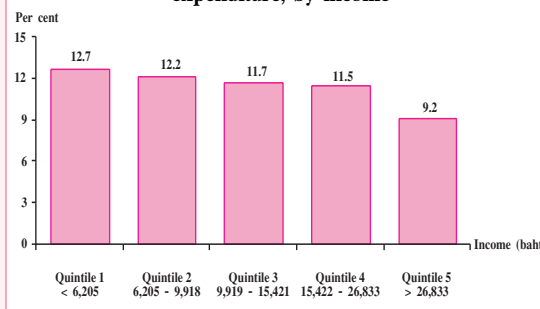
	Thailand				OECD Country	
	VAR analysis		BOTMM		IEA working paper <sup>2</sup>	
	Quarter 1	Quarter 4	Quarter 1	Quarter 4	That year	Next year
GDP	-0.01	-0.06	-0.02	-0.04	-0.01	-0.01
Headline inflation	0.02	0.06	0.03	0.05	0.0125	0.015

**Chart 4 Proportion of oil expenditure to total cost**



Source: Input-Output Table 2000,  
National Economic and Social Development Board

**Chart 5 Proportion of energy expenditure to total expenditure, by income**



Source: Household Socio-Economic Survey, National Statistical Office

At the firm-level, oil is mainly used for transportation purposes rather than as a direct input. The impact of rising oil prices on Thai manufacturers appears to be limited because the proportion of oil expenditure to total cost is less than 10 percent (Chart 4). Nevertheless, industries using chemical material and substances in the production process are heavily affected as their raw material prices vary closely with crude oil prices. The agricultural sector, on the other hand, faces rising transport costs. In any case, the recent oil prices has rendered alternative energy fuels such as ethanol and biofuels commercial viable. This phenomenon helps cushion the impact on farmers as the demand for palm oil, maize, soybean and grains, which can be processed into ethanol, rose.

The impact on Thai households has also been limited as expenditure on oil represents a relatively small portion of total household expenditure and cheaper alternative energy sources are also available in the market. Nevertheless, a distributional concern exists because the impact on households has been unevenly distributed; as low-income households tend to spend a larger portion of their expenditure on oil and transportation expenses (Chart 5).

<sup>2</sup> International Energy Agency (2004), "Analysis of the impact of the oil prices on the global economy".