Oil prices rises could trigger cut in growth

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Higher oil prices could lead to a fall in world economic growth and even a recession in some regions, according to reports from the World Bank and its sister organisation, the International Monetary Fund.

In its semi-annual report on Asia, released on Monday, the World Bank said that while Asian "recovery" from the financial crisis of 1997-98 was well underway, soaring oil prices could threaten economic growth.

The World Bank's regional chief economist Mashiro Kawai said that the oil-producing countries Indonesia and Malaysia would benefit from the 10-year oil price highs, but "the risk must be seen of the possible negative effect on growth in East Asia."

"If oil prices continue to stay at a high level of $35 per barrel or more for a sustained period, this could negatively affect East Asia," he said. Recovery in the region was also dependent on the ability of the US and Japan to suck in imports, a process which could be threatened by a downturn in America or a failure of the Japanese economy to achieve consistent expansion.

In its latest World Economic Outlook, due to be released next week, the IMF said it expects oil prices to increase because of the approaching northern winter and the failure of supplies to keep pace with additional demand.

The report said that even if prices were to stabilise at $32 per barrel, below their present level, oil importing nations would have to pay $140 billion more for crude this year than they did in 1999, amounting to 0.4 percent of their gross domestic product.

Earlier this month UN Secretary General Kofi Annan urged the OPEC group to increase production and bring down prices. Annan's spokesman, Fred Eckhard, told reporters: "The Secretary General urges them to be especially sensitive to the impact of their decision on the world economy and particularly the poorest countries."

The OPEC producers have agreed to lift output by 800,000 barrels per day, but this is not expected to do much to increase supplies.

According to one analyst, Stephen Lewis as Monument Derivatives: "It hardly matters how much OPEC raises production because there is no time to get the oil out of the ground, into refineries and eventually into power stations before (the northern) winter."

One reason for the supply problems is the spate of mergers and restructuring carried out by the major oil companies in recent years.

According to a September 10 editorial in the *Financial Times*: "The industry has been so focused on cost-cutting and consolidation in recent years that it has left itself with inflexible refineries and a permanent vulnerability to shortages of specific oil products."

One of the factors behind the series of protests and blockades in Europe is the extreme vulnerability of farmers and smaller transport companies to increases in fuel costs. Under a more inflationary environment, such as that which prevailed in the mid-1970s, firms facing higher oil bills were able to pass on their increased costs in the form of higher prices.

The situation is entirely different in today's generally deflationary environment. Faced with intense competition in the market, firms are forced to absorb cost increases or risk losing their markets if they attempt to raise prices.

While the governments of Europe are being hit by the protests against higher prices—in particular over the impact of government taxes and charges—they could face even bigger problems in the future.

A recent article in the British magazine *The Economist* expressed concern that rising oil prices could be a trigger for a slide on Wall Street.

While the prevailing opinion appears to be that the price increases will not induce a recession, the article noted that "economists have repeatedly underestimated the impact of previous oil shocks."

"For instance, in December 1990, after oil prices had soared, the OECD forecast growth in rich economies for 1991 of 2 percent; in the event growth turned out to be only 0.8 percent, as America and other countries dipped into recession. Alarmingly, some economists are now arguing that higher oil prices may even be good news for the American economy (and for Wall Street), because they will help to slow consumer spending and so reduce the need for higher interest rates.

"This may partly explain why share prices are rising yet again. And here lies the biggest risk of all. Even if the direct impact of higher oil prices is more muted than it once was, they may prompt even the most fervently bullish investors to notice such things as America's gaping current account deficit and dismally low saving rate—and to realise that there is still such a thing as bad news. That might just be the trigger for a long overdue slide in share prices. The effects of that would be far more widespread than higher petrol prices."