



Islamic Development Bank

**IMPACT OF GLOBAL ECONOMIC RECESSION ON OIL MARKET AND
IMPLICATION FOR OIC MEMBER COUNTRIES**

**Paper distributed at the 25th Session of COMCEC Ministerial Working Session
Istanbul, Turkey**

19 Dhul Qa'da 1430H (7 November 2009)

IMPACT OF GLOBAL ECONOMIC RECESSION ON OIL MARKET AND IMPLICATION FOR OIC MEMBER COUNTRIES¹

I. INTRODUCTION

1. The recent global economic recession has been the most serious one after the Great Depression of the 1930s. The recession has seriously affected the global output and volume of world trade. Virtually no country, developing or developed, has escaped from the impact of economic recession.

2. Due to economic recession, the slump in global economy and world trade, which started from late 2008, has adversely affected global oil demand, which declined by 3.4 million barrels per day (mbd) from first quarter 2008 to second quarter 2009. Consequently, the oil prices, which peaked \$147 per barrel in July 2008, sharply dropped to \$42 per barrel by end-December 2008 but has rebounded strongly during the first 10 months of 2009 with current oil price hovering around \$75 per barrel. The recent rise in global oil prices appears to be caused by modest global economic growth and increase in the volume of world trade. The other contributing factors to recent oil price increase seem to be oil production cuts by the Organization of the Petroleum Exporting Countries (OPEC), oil inventory adjustments, and depreciation of the US dollar.

3. The impact of economic recession and development in oil markets has been increasingly felt in OIC member countries which have been affected directly or indirectly. A large number of these countries had already been affected by the high food and fuel prices and the global economic recession has added to economic strains seriously affecting their socio-economic development. In particular, these countries have been affected by slowing down in economic growth and deteriorating current account balances.

4. The paper focuses on OIC 57 member countries (as a group) disaggregated into two major blocks of 22 oil-exporting member countries² and 35 non-oil exporting member countries³. It describes the impact of global economic recession on oil market in terms of oil demand and oil prices. In particular, it focuses on the impact of development in oil market on economic growth, current account balances, and inflation in both oil exporting and non-oil exporting member countries. Finally, the paper suggests a number of measures to be considered by member countries.

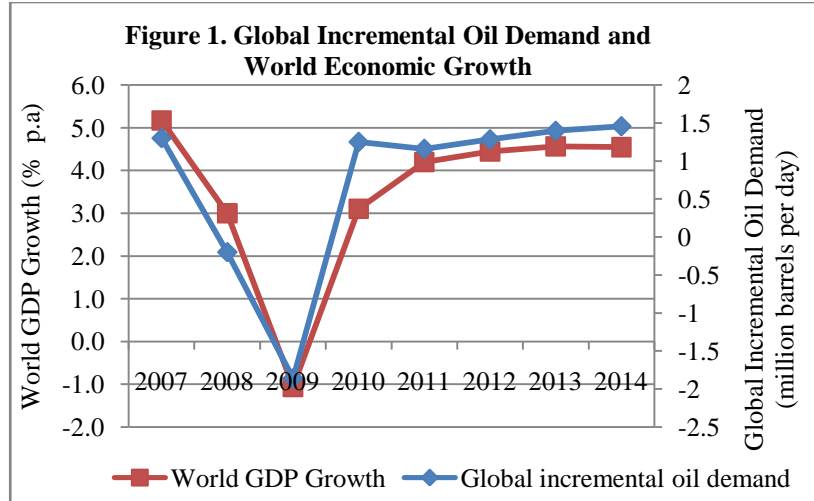
¹ The Paper has been prepared by Zafar Iqbal, Senior Economist, Economic Policy and Research Department under the supervision of Ifzal Ali, Chief Economist, Islamic Development Bank. Abdullateef Bello, Director, Data Resources and Statistics Department, is gratefully acknowledged for his constructive comments and data support.

² Oil-exporting member countries include Algeria, Azerbaijan, Cameroon, Chad, Cote d'Ivoire, Egypt, Gabon, Iran, Iraq, Kazakhstan, Kuwait, Libya, Malaysia, Nigeria, Qatar, Saudi Arabia, Sudan, Syria, Turkmenistan, U.A.E, Uzbekistan and Yemen.

³ Non-oil exporting member countries include Afghanistan, Albania, Bahrain, Bangladesh, Benin, Brunei, Burkina Faso, Comoros, Djibouti, Gambia, Guinea, Guinea-Bissau, Guyana, Indonesia, Jordan, Kyrgyz, Lebanon, Maldives, Mali, Mauritania, Morocco, Mozambique, Niger, Oman, Pakistan, Palestine, Senegal, Sierra-Leone, Somalia, Suriname, Tajikistan, Togo, Tunisia, Turkey and Uganda.

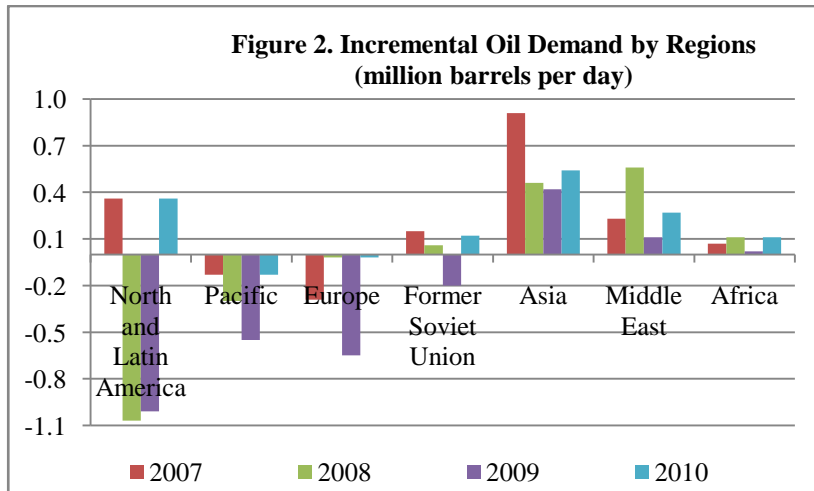
II. IMPACT OF GLOBAL ECONOMIC RECESSION ON OIL MARKET

5. **Economic recession has depressed global oil demand.** Given the close link between global GDP growth and oil demand, slow down in global economy and world trade have resulted in sharp drop in global oil demand by 3.4 mbd (declined from 87.5 mbd in the first quarter 2008 to 84.1 mbd in second quarter 2009). In 2010, global oil demand is expected to rebound by incremental 1.2 mbd as a result of moderate world economic recovery and pick up in world trade. However, the signs of an improving global economic outlook should not be mistaken for a full-fledged recovery, and risks remain due to resurgent global oil prices, among other factors, in the medium-term (Figure 1).



Data source: Oil Market Report, International Energy Agency, 10 September 2009

6. **Among various regions, Asia and Middle East have helped containing further fall in global oil demand.** In 2008 and 2009, the decline in oil demand has been mainly in North and Latin America; Pacific; Europe; and Former Soviet Union, while Asia and Middle East are major driving regions of global oil demand due to their somewhat stronger growth dynamics⁴ (Figure 2)



Data source: Oil Market Report, International Energy Agency, 10 September 2009.

7. Among various large oil markets, oil demand has continued to decline in USA, Japan and Europe. The oil demand in USA declined by 1.2 mbd in 2008 and is estimated to decline further by 0.9 mbd in 2009. Similarly, oil demand in Japan declined by 0.3 mbd in 2008 and further to 0.6 mbd in 2009 and in Europe-5 (France, Germany, Italy, Spain and UK) by 0.3 mbd in 2009. However, in Asia region, China and India led oil demand which first rose by 0.4 mbd in 2008 and expected to further reach 0.5

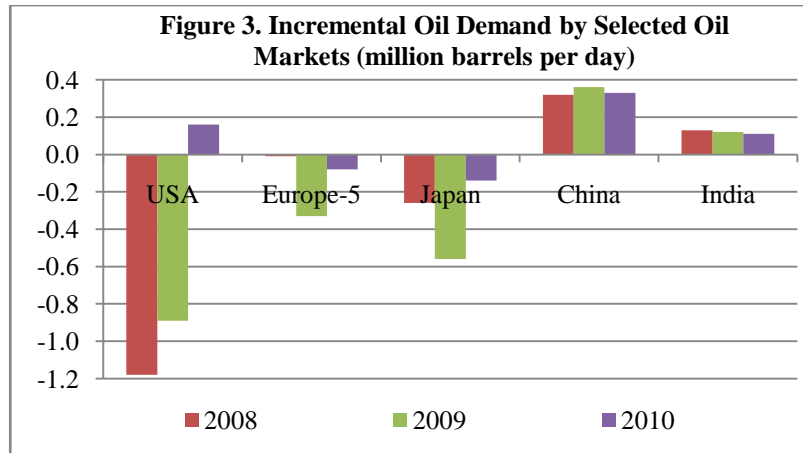
⁴ For further detail on this issue, see IDB (November 2009), Paper on “Impact of Global Financial and Economic Crisis on OIC Member Countries”.

mbd in 2009. Both countries will also lead in terms of global oil demand in 2010. They were also the key drivers of rising global oil prices in 2007 and 2008 and both remained resilient to economic recession (Figure 3).

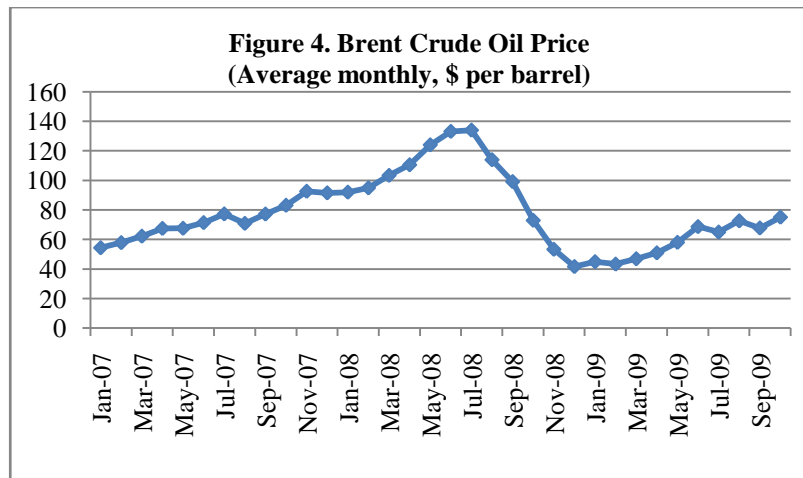
8. ***The decline in world oil demand has put downward pressure on oil prices.*** The crude oil price reached its peak level of \$147 per barrel in July 2008. However, the economic recession, which started in September 2008, put downward pressure on world oil demand, which resulted in collapse of oil prices reaching \$42 per barrel in end-December 2008. Since the beginning of 2009, the oil prices have responded strongly to expected global economic recovery. The oil prices

started rising in January 2009 averaging \$45 per barrel and has increased to \$77 per barrel by end-October 2009 (Figure 4).

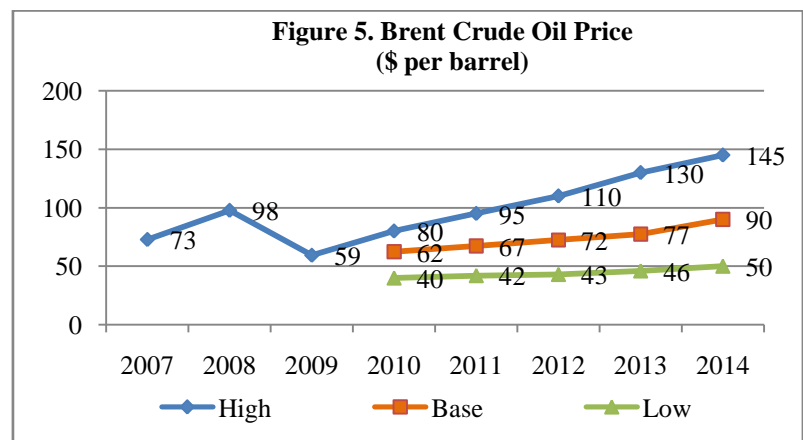
9. ***Medium-term outlook of oil market will depend upon the scale and speed of global economic recovery*** Although, in the short-term, economic recovery has reversed, plunging oil prices, the



Data source: Oil Market Report, International Energy Agency, 10 September 2009.



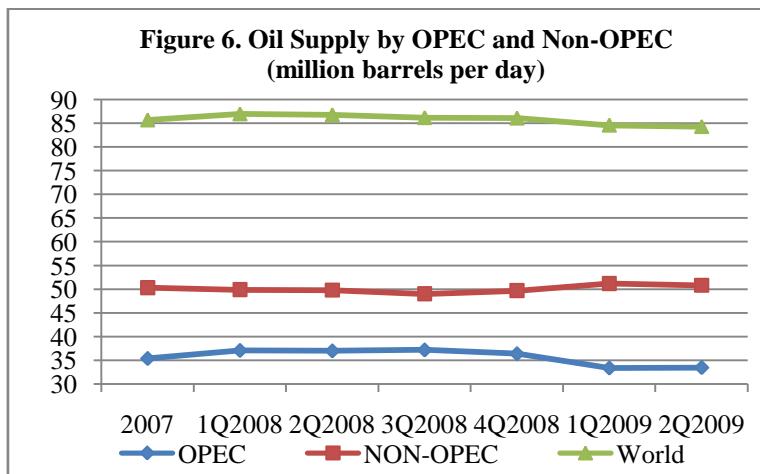
Data source: <http://www.indexmundi.com> (downloaded on 28 October 2009)



Data sources: <http://www.indexmundi.com> (downloaded on 28 October 2009) and FACTS Global Energy Group, *Oil Price Outlook: Updated Analysis of Critical Factors Driving the Oil Market*, March 2009.

movement in oil prices in the medium-term will depend upon the speed and scale of global economic recovery. According to Global Energy Group (March 2009)⁵, the fast global economic recovery (high case scenario) is projected to increase oil price to \$145 per barrel; robust economic recovery (base scenario) to \$90 per barrel; and slow economic recovery (low case scenario) to \$50 per barrel by 2014⁶ (Figure 5)

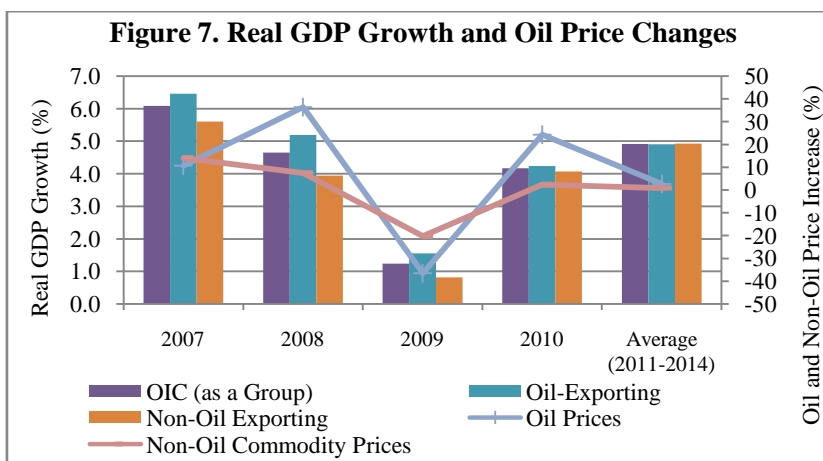
10. *Medium-term oil price will also depend upon oil supply-demand balance.* Oil production cuts by the OPEC along with oil-inventory adjustments and a weakening of the US dollar are also seen as playing a role in oil market development. Due to weak demand of oil, OPEC has implemented a series of production cuts to stabilize oil prices. From third quarter 2008 to second quarter 2009, the OPEC oil supply has been reduced by 3.7 mbd, while oil supply by non-OPEC has been increased by 1.8 mbd during the same period. Therefore, the medium-term outlook of oil price will also depend upon the oil supply-demand balance, particularly from the OPEC supply response.⁷ It is worth noting that the OPEC has substantial spare capacity of 6.5 mbd with about 3.5 mbd by Saudi Arabia as of August 2009, which can help stabilize prices in the event of any supply shock⁸ (Figure 6)



Source: Oil Market Report, International Energy Agency, 10 September 2009.

III. IMPLICATIONS OF OIL MARKET DEVELOPMENT FOR OIC MEMBER COUNTRIES

11. *Economic prospects of both oil-exporting and non-oil exporting OIC member countries are closely linked to oil and non-oil commodity prices.* Given the close link between growth and the oil and non-oil commodity prices, the economic performance of oil-exporting and non-oil exporting member countries



Data Source: IDB estimates based on IMF WEO Database (October 2009)

⁵ Source: FACTS Global Energy Group (March 2009), Oil Price Outlook: Updated Analysis of Critical Factors Driving the Oil Market.

⁶ For further detail on this issue, see Asian Development Bank, Asian Development Outlook 2009.

⁷ For further detail on this issue, see IMF World Economic Outlook October 2009.

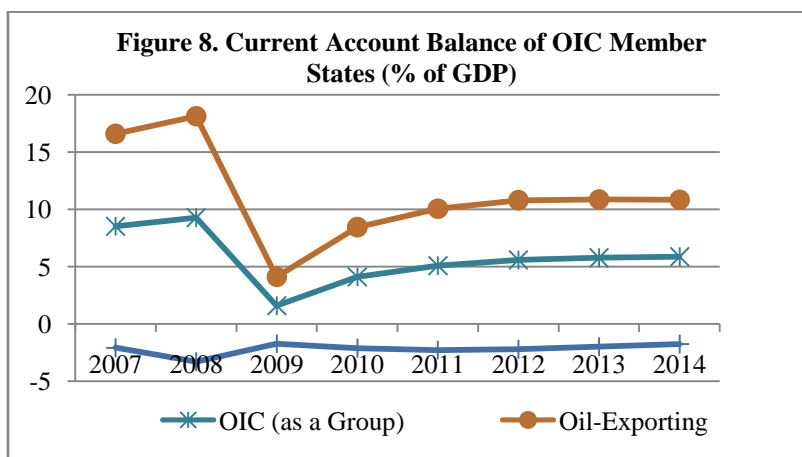
⁸ IMF, World Economic Outlook October 2009.

depends on the developments arising from these prices. The oil price, which increased by 36.4 percent in 2008, was accompanied by real GDP growth of 5.2 percent in oil-exporting member countries. In 2009, oil prices are estimated to decline by 36.6 percent, dropping their real GDP growth rate of 1.2 percent.

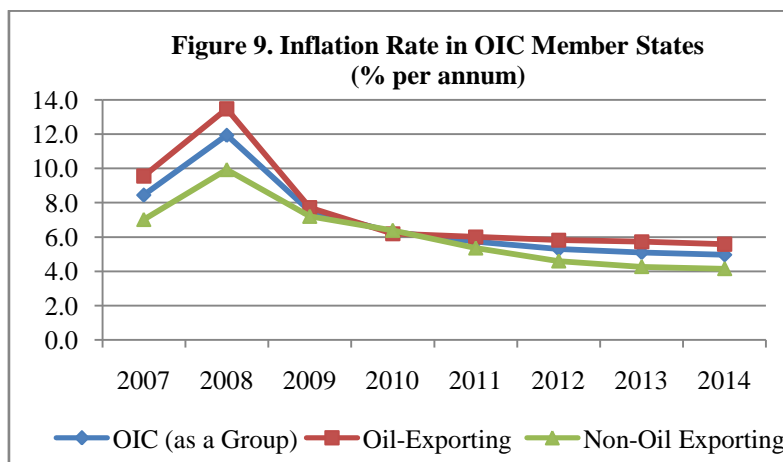
12. Similarly, non-oil commodity prices, which increased by 7.5 percent in 2008, are estimated to fall by 20.3 percent in 2009; consequently growth in non-oil exporting is expected to decelerate from 3.9 percent to 0.8 percent. With the moderate global economic recovery and increasing demand, the oil prices are expected to rise by 24.3 percent and non-oil commodity prices by 2.4 percent in 2010, which is projected to accelerate output in oil-exporting member countries (from 1.6 to 4.2 percent) and non-oil exporting countries (from 0.8 to 4.1 percent). In the medium-term, the movement in oil- and non-oil commodity prices will depend on the speed and scale of global economic recovery (Figure 7).

13. *In terms of current account balance, decline in oil price benefits the non-oil exporting member countries at the cost of oil-exporting member countries.* The surge in oil prices in the first half of 2008 helped explained the improving current account surplus of oil-exporting member countries (from 16.6 percent in 2007 to 18.1 percent of GDP in 2008) and widening current account deficit of non-oil exporting member countries (from 2.1 percent to 3.3 percent of GDP). By the same token, the sharp decline of oil prices since July 2008 can be expected to have different impacts on the current account positions of both oil- and non-oil exporting member countries. Current account surplus of oil-exporting member countries has sharply declined to 4.1 percent of GDP while non-oil exporting member countries' current account deficit has improved to 1.7 percent of GDP in 2009.

14. *Rebound in oil prices may increase inflationary pressure.* Rising oil price is one of the biggest risk to building inflationary pressure (i.e. cost push inflation),



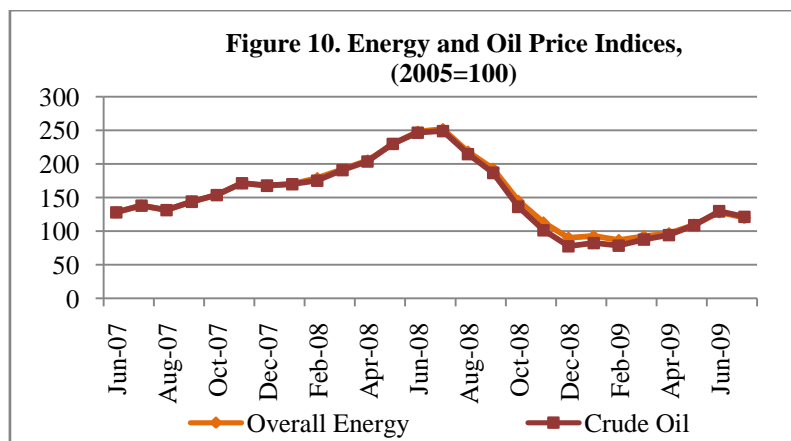
Data Source: IDB estimates based on IMF WEO Database (October 2009)



Data Source: IDB estimates based on IMF WEO Database (October 2009)

particularly in non-oil exporting member countries. Inflation has been contained following the drop in oil prices in the second half of last year, with some member countries even starting to record deflation in recent months (i.e. demand depressed deflationary pressure from continuity of recessionary forces). In the medium-term, inflation is to continue moderating in both oil-exporting and non-oil exporting member countries. Thus, any increase in oil prices can help trigger inflation, particularly in Asia as the region has pursued expansionary fiscal and monetary policy⁹ (Figure 9).

15. ***Any development in oil prices has also impact on prices of other components of energy.*** The factors affecting oil prices have also impact on other energy commodity prices, particularly coal prices. The index of energy commodity prices (oil, coal, and natural gas) closely mirrors global oil prices (Figure 10).



Data Sources: Asian Development Bank Update 2009 and World Bank, *Commodity Price Data (Pink Sheet)*, available: <http://econ.worldbank.org>, downloaded 14 August 2009.

IV. POINTS FOR CONSIDERATIONS OF OIC MEMBER COUNTRIES

- Fuel subsidies were raised as global oil prices surged in the first half of 2008, aggravating a shortage of public funds for essential social services. Moderation in oil prices in 2009 is an opportunity for non-oil exporting member countries to rationalize, if not significantly reduce, oil subsidies.
- Global economic recession has delayed some investment in oil-exporting member countries. Therefore, they need to increase investment in both upstream and downstream oil infrastructure.
- If the global economic recovery follows the high case scenario path (reaching oil prices \$145 per barrel by 2014), one can expect the next round of inflationary in the medium-term. In that case, the current expansionary fiscal and monetary policies, which are reaching their limits, would have to be adjusted accordingly.
- Climate change considerations will significantly impact on both oil producers and consumers in the medium-to long-term.

⁹ For further detail on this issue, see Asian Development Bank, Asian Development Outlook 2009 Update.