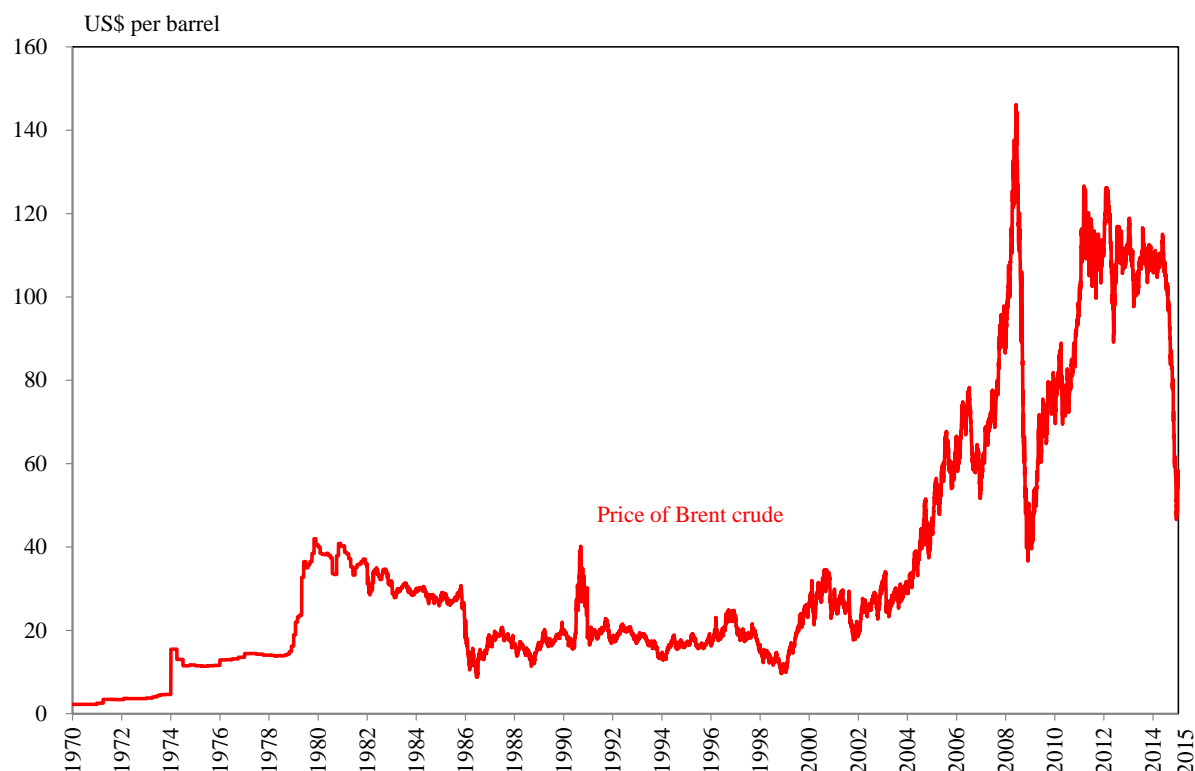


**Box 2.2****Oil price fluctuations and its impact on the global economy**

International crude oil prices fell drastically since the latter half of 2014. While volatility in oil prices is not uncommon from past experience, such sharp fall in oil prices is still unprecedented and unusual (*Chart 1*). This note attempts to examine the possible reasons behind the latest plunge in oil prices and to highlight its impacts on the global economic situation.

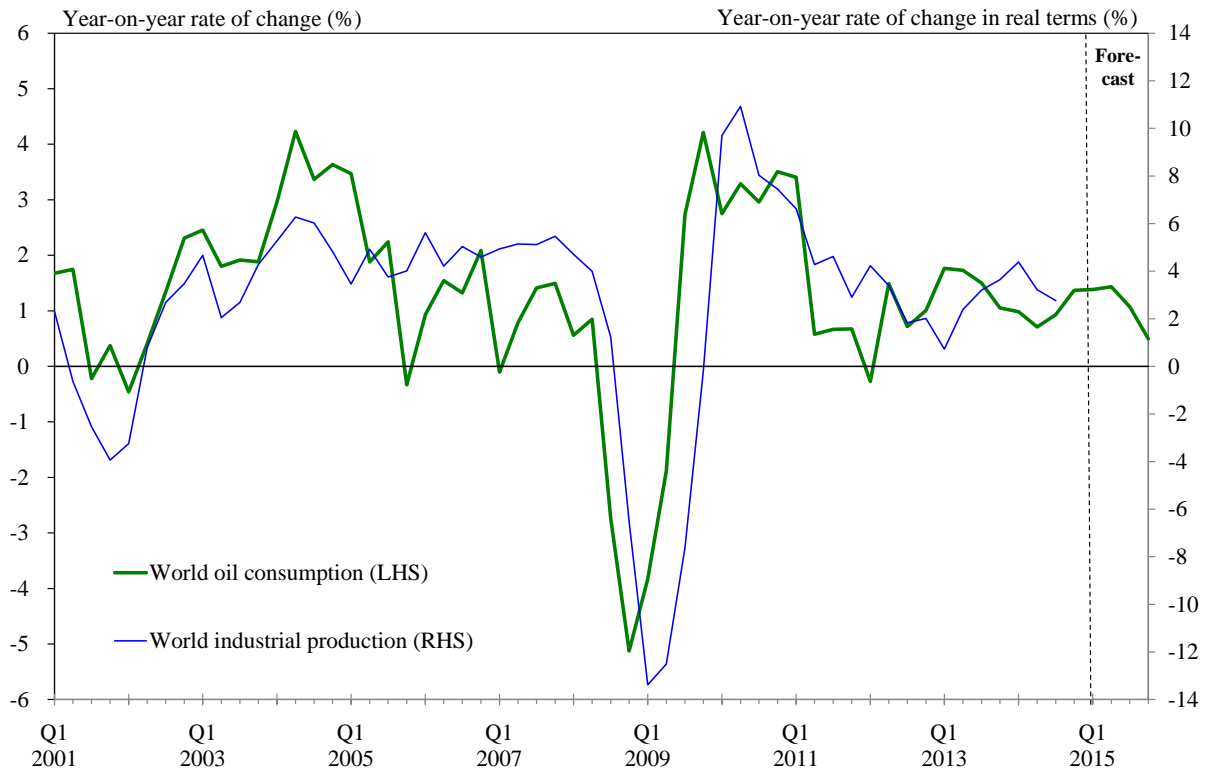
**Chart 1 : The recent plunge in oil prices is unprecedented and unusual****Possible reasons behind the oil price plunge from a supply-demand perspective**

Simultaneous changes to factors determining the global demand and supply of oil have possibly contributed to the recent slump in oil prices:

- **Demand-side factors:** Demand growth for oil has been rather subdued. As can be clearly seen from *Chart 2*, oil consumption is indeed highly related to the global economic sentiment. World industrial production slowed down alongside the below-trend growth of the global economy after the Global Financial Crisis of 2008, thereby reducing the demand for oil. It should also be noted that the strengthening of the US dollar over the course of 2014, to a certain extent, has also put some downward pressure on the dollar prices of commodities including crude oil.

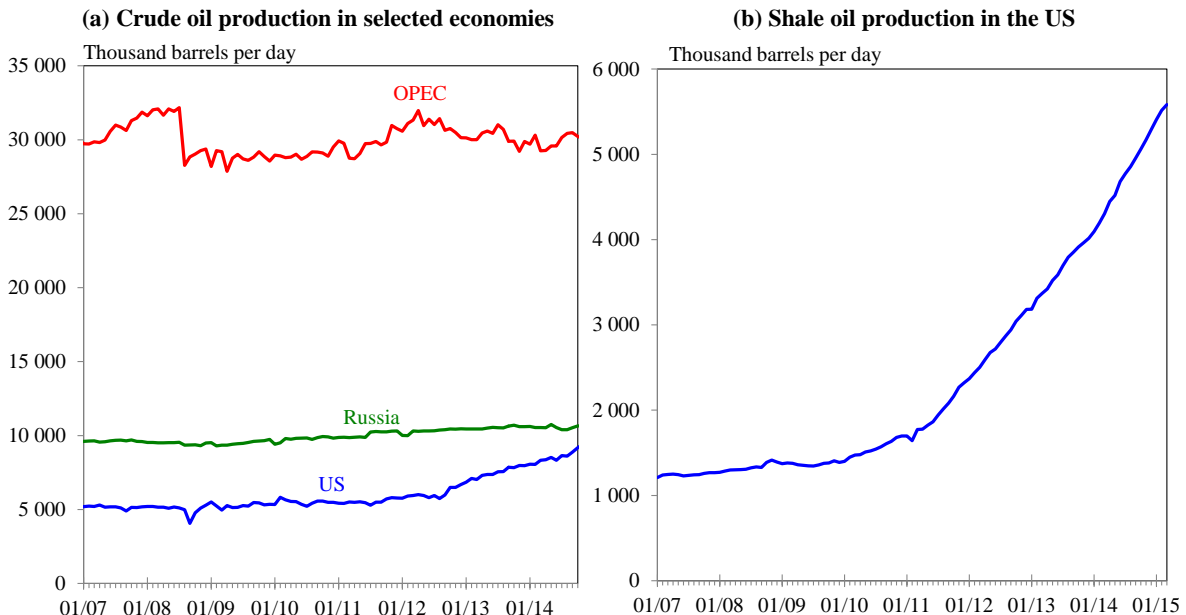
**Box 2.2 (Cont'd)**

**Chart 2 : Lower oil demand amid weaker global industrial activity**



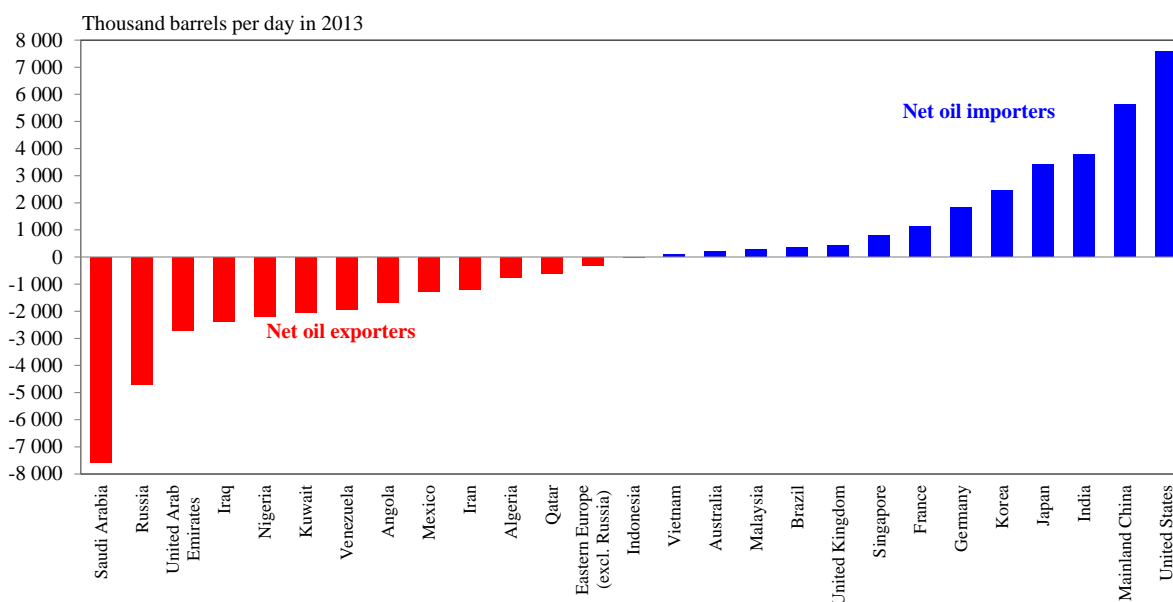
- Supply-side factors:** The global oil supply has been increasing visibly in recent periods. The production of the Organization of the Petroleum Exporting Countries (OPEC) was rather stable at high levels (*Chart 3(a)*). This, coupled with the announcement of keeping their production ceiling unchanged in end-November 2014, has supported market expectations that oil supply will remain abundant relative to demand in the foreseeable future. Concurrently, Russia’s oil production also expanded modestly. Those of the US surged in tandem with the spectacular growth in shale oil production, thanks to massive investments incentivised by high oil prices in recent years and the subsequent technological breakthrough (*Chart 3(b)*).

**Chart 3 : Abundant global oil supply given OPEC’s unchanged production ceiling and US’ increased shale oil production**



**Box 2.2 (Cont'd)****Impact on the global real economy**

The recent plunge in international oil prices will not only affect the global inflation outlook (as mentioned in *Box 2.1*), but will also have potential impacts on the global economy, with likely polarised real impacts among countries. For **net oil-importing countries**, comprising many advanced and Asian economies, lower oil prices could be conducive to bolstering economic growth, as consumers will have more household income to spend, and firms will face lower production costs, and hence better profit prospects. For **net oil-exporting countries**, a sharp decline in oil prices will dampen investment and capital flows on oil-related activity and cut export revenues, which will eventually translate into a reduction in their government revenues. Those with weaker fundamentals, fragile external positions, and dependent on oil revenues to fund their fiscal budgets will be particularly vulnerable, weighing on growth and posing downward pressures on their currencies, as was the case with Russia in late 2014 (*Chart 4*).

**Chart 4 : Net oil-importing countries would likely benefit from the recent oil price adjustments****Concluding remarks**

Whilst lower oil prices could be beneficial to the economic growth of those net oil importers, the future path of oil prices remains highly uncertain. A sharp disruption to oil supply from the elevated geopolitical tensions in the Middle East or a sudden change in the amount of oil production by OPEC could escalate oil prices markedly. Hence, the possibility of a rebound should not be ruled out. The recent price slump has added uncertainties to the already volatile global economic and financial situation. A further downturn in oil prices may lead to growing bankruptcies or defaults of oil producing companies. Possible contagion risks via the financial channels to international financial markets and the global economy need to be watched over.