Overview

The 2008/2009 collapse of the global economy has been described as the worst recession since World War II (Verick and Islam, 2010). Like most previous recessions, it was preceded by a sharp increase in commodity prices, particularly oil. The unemployment rate in the United States and many of the world’s major economies remain at historically high levels. Although oil prices dropped dramatically during the recession period, this did not last long. Dropping from almost $150 per barrel in mid-2008 to about $40 per barrel in early 2009, oil prices increased to about $120 by March 2012. It is now generally agreed that the world is entering a period of sustained high oil prices. This represents a major threat to the global economy, which is just beginning to recover from the devastating effects of the 2008/2009 recession. Although the economic recovery in the United States has seen 15 straight months of positive new private sector jobs or 2.1 million jobs, increases in the price of oil represent a major source of uncertainty. In addition, recent geopolitical tensions, including the Arab Spring and other sources of disruptions threaten to further exacerbate the tight global oil market. The above suggests the emergence of a new order in energy markets that must be carefully managed to prevent devastating consequences for the global economy. There is a need to understand these implications as a basis for designing policies that can help prevent another deep recession.

Methods

This study builds on a previous effort which used a new approach to evaluate the interrelationship between oil prices and the economy (Oladosu, 2009). The methodology involves a decomposition of relevant oil and economic variables into short to long run components. Under the current study, these components are used to specify an econometric model of the relationship between the oil market and a number of other economic variables. The resulting Vector Auto-Regression (VAR) model is used to examine the consequences of an increasingly tight global oil market for the USA economy, as well as the effects of other sources of oil supply shocks.

Results/Conclusions

The model will be used to evaluate historical and potential shocks to the oil market. Simulations of potential shocks would be conducted under scenarios of developments in variables, such as oil production, oil prices, and rest of world demand. The approach for these simulations will be similar to those employed in Cologni and Manera (2008).

References