

Pandemic, War, Inflation: Oil Markets at a Crossroads?

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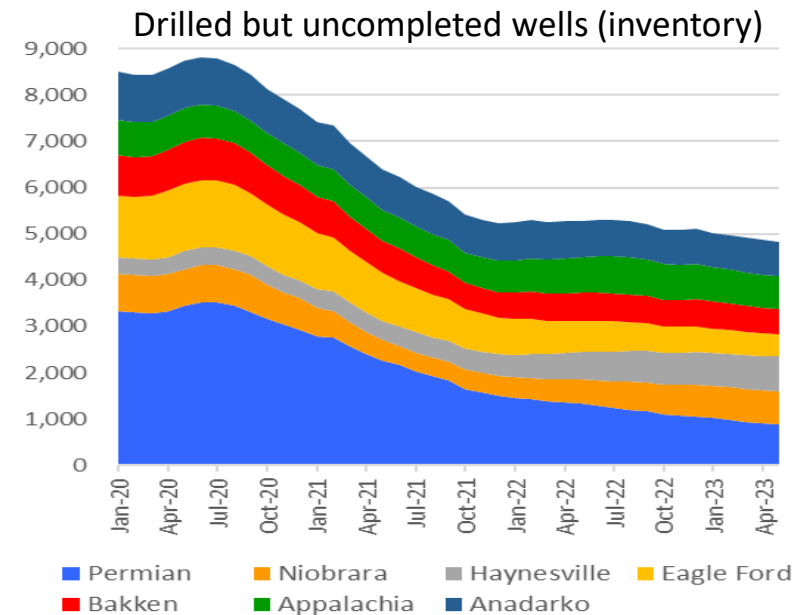
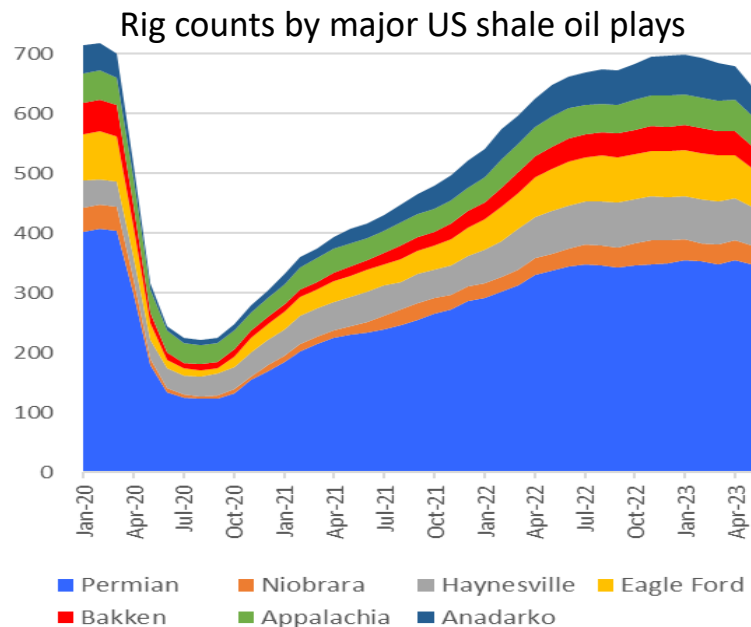
Macroeconomic Stabilisation in a Volatile Inflation Environment

June 27, 2023

Helicopter View of Structural Changes in Oil Markets

- US shale oil sector

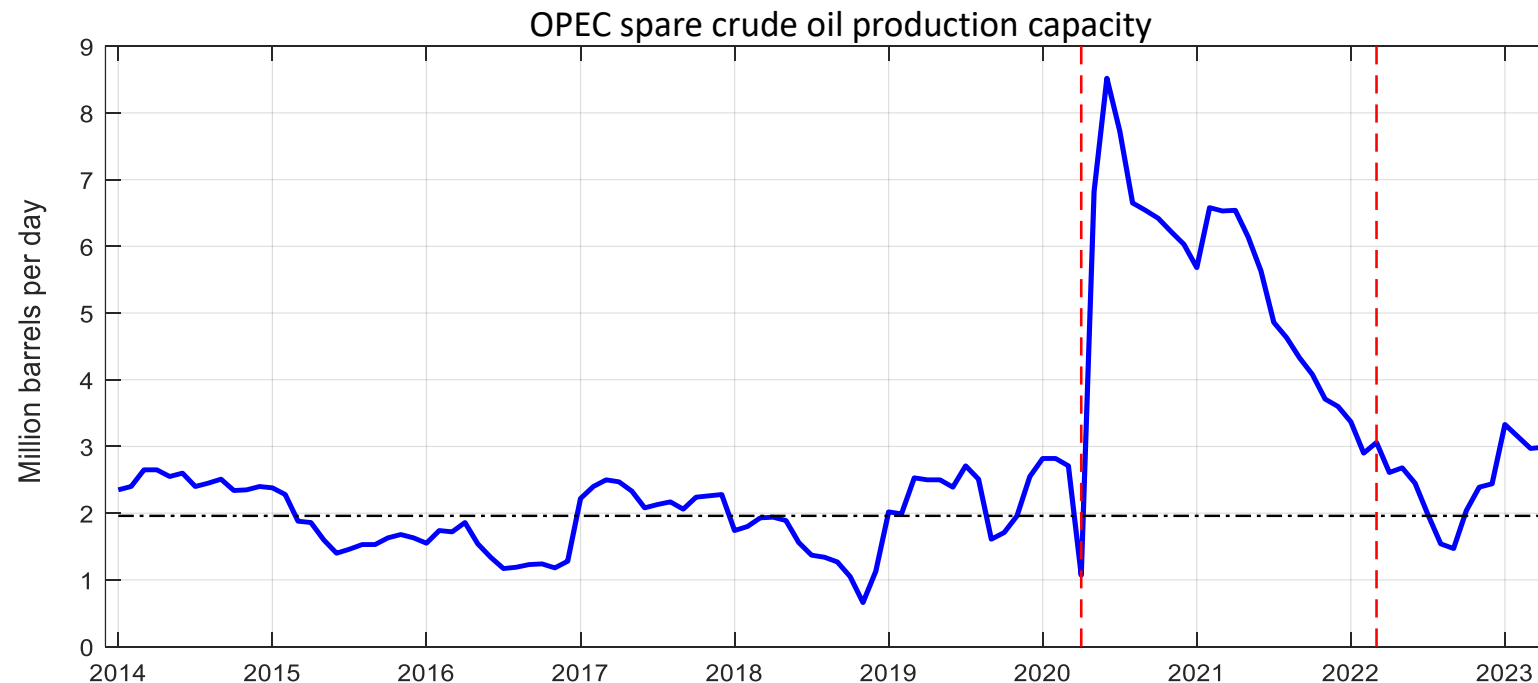
- Slow production growth since pandemic crisis
 - Physical barriers: supply chain bottlenecks, rising costs, labor shortages
 - Corporate barriers: investors demand capital discipline and returns
- New business model: **shift from new drilling to creating shareholder value**
- Moderate-growth strategy reflected in investment in production capacity



⇒ no longer swing-producer role

Helicopter View of Structural Changes in Oil Markets

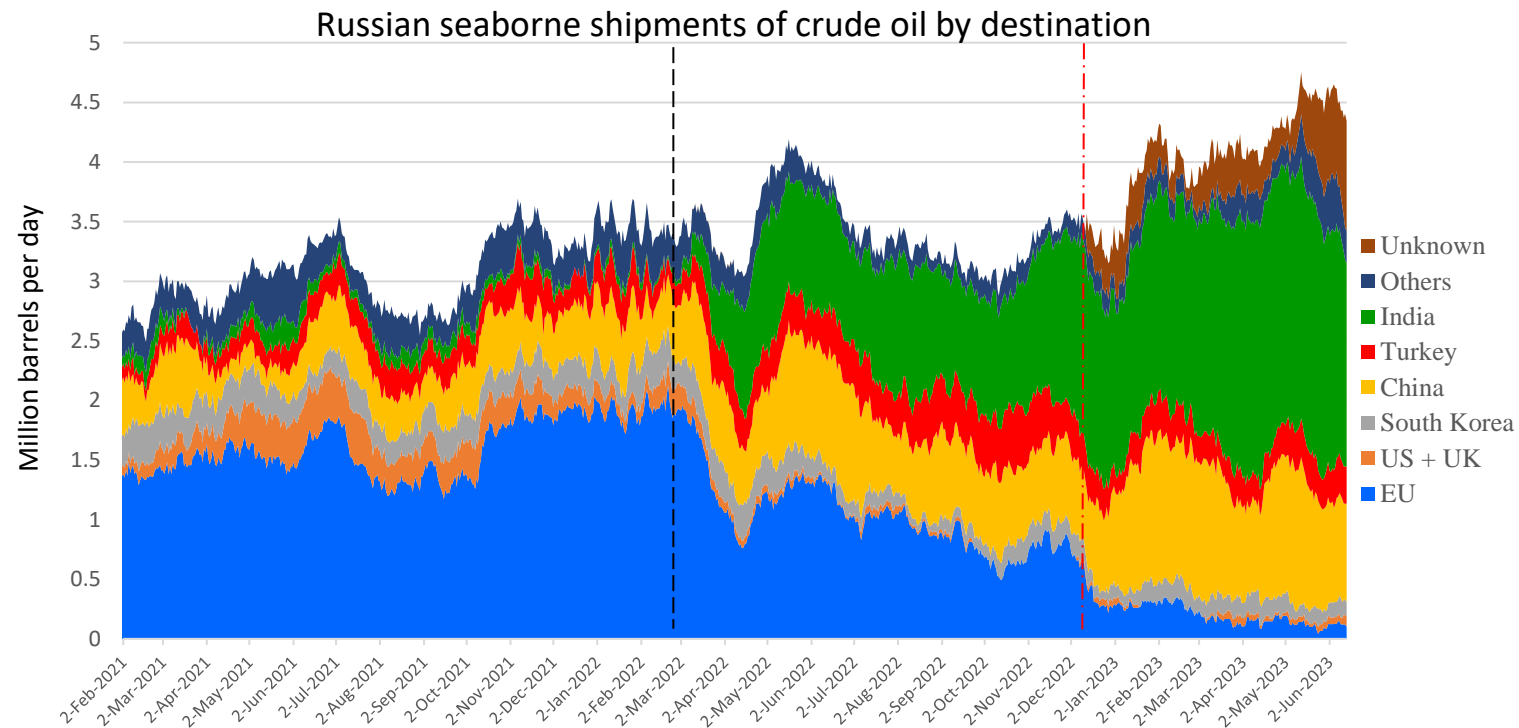
- OPEC under leadership of Saudi Arabia
 - Balance of power has shifted back to OPEC(+)
 - Members consistently miss production quotas: underproduction
 - Low levels of spare capacity **limit OPEC's flexibility** to balance the market



Helicopter View of Structural Changes in Oil Markets

- **Russia**

- Fundamental transformation of Russian crude oil market after invasion
- Change in composition of importing countries
 - New pattern of global oil trade flows
 - **Fragmentation of export market** for Russian oil into two geographic segments with different price and demand dynamics



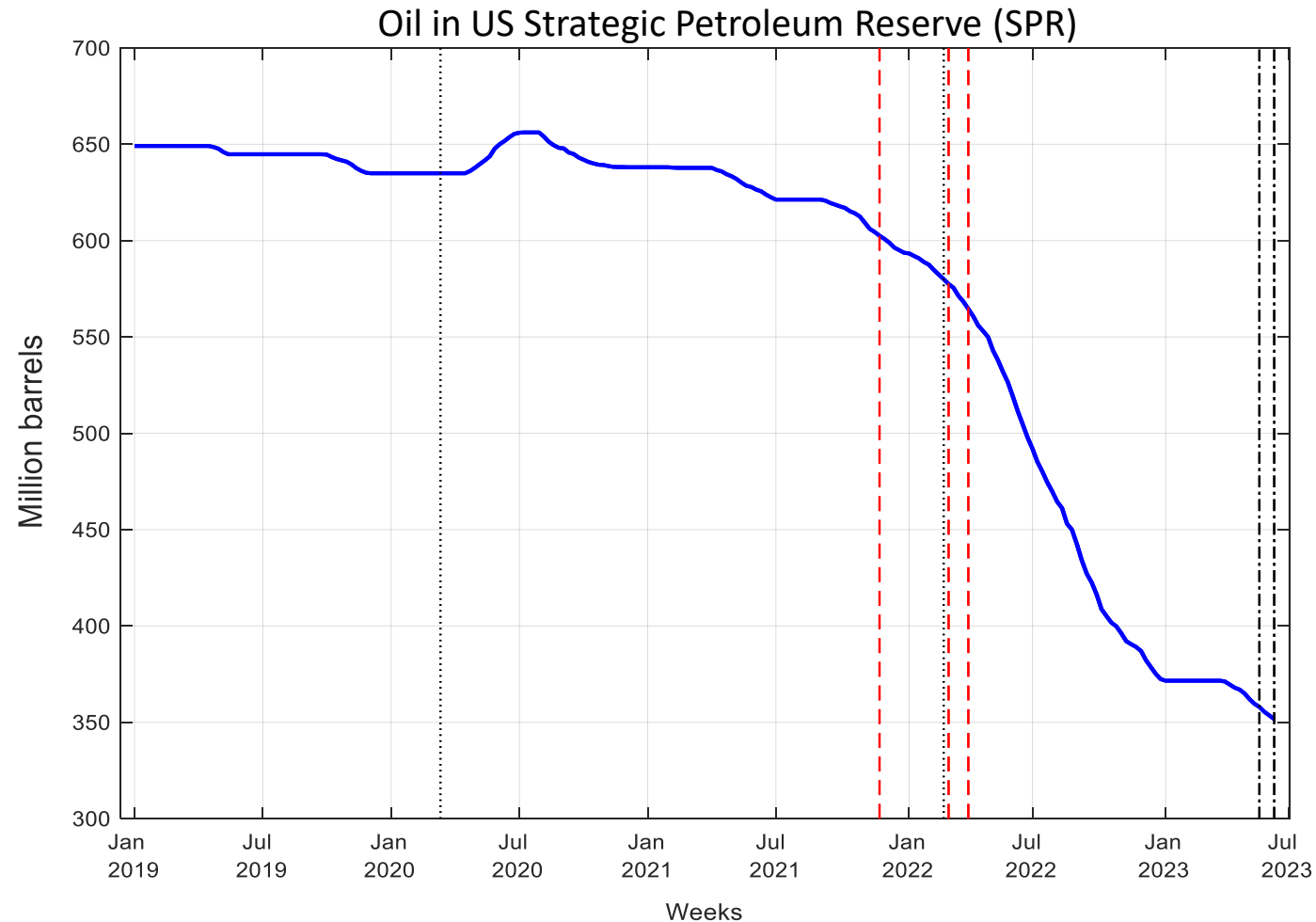
Policy Interventions

- To promote stability of the global oil market and to counter inflationary pressures:
 1. EU embargo and G7 oil price cap
 - Insurance for cargoes carrying Russian oil only if oil is sold at or below cap
 - Intended goals:
 - Keep oil flowing to global markets to avoid price spike
 - Curtail fiscal revenue from oil sales that contribute to financing the war
 - Assessment:
 - Seaborne export volumes remained stable, no material impact on global oil prices
 - Prices for Russian oil differ across locations (two-tier market):
 - ✓ Shipments from Baltic Sea and Black Sea sell at discount
 - ✓ Pacific Ocean transactions exceed price cap
 - At first decline in government revenue, recently on the rise

Policy Interventions

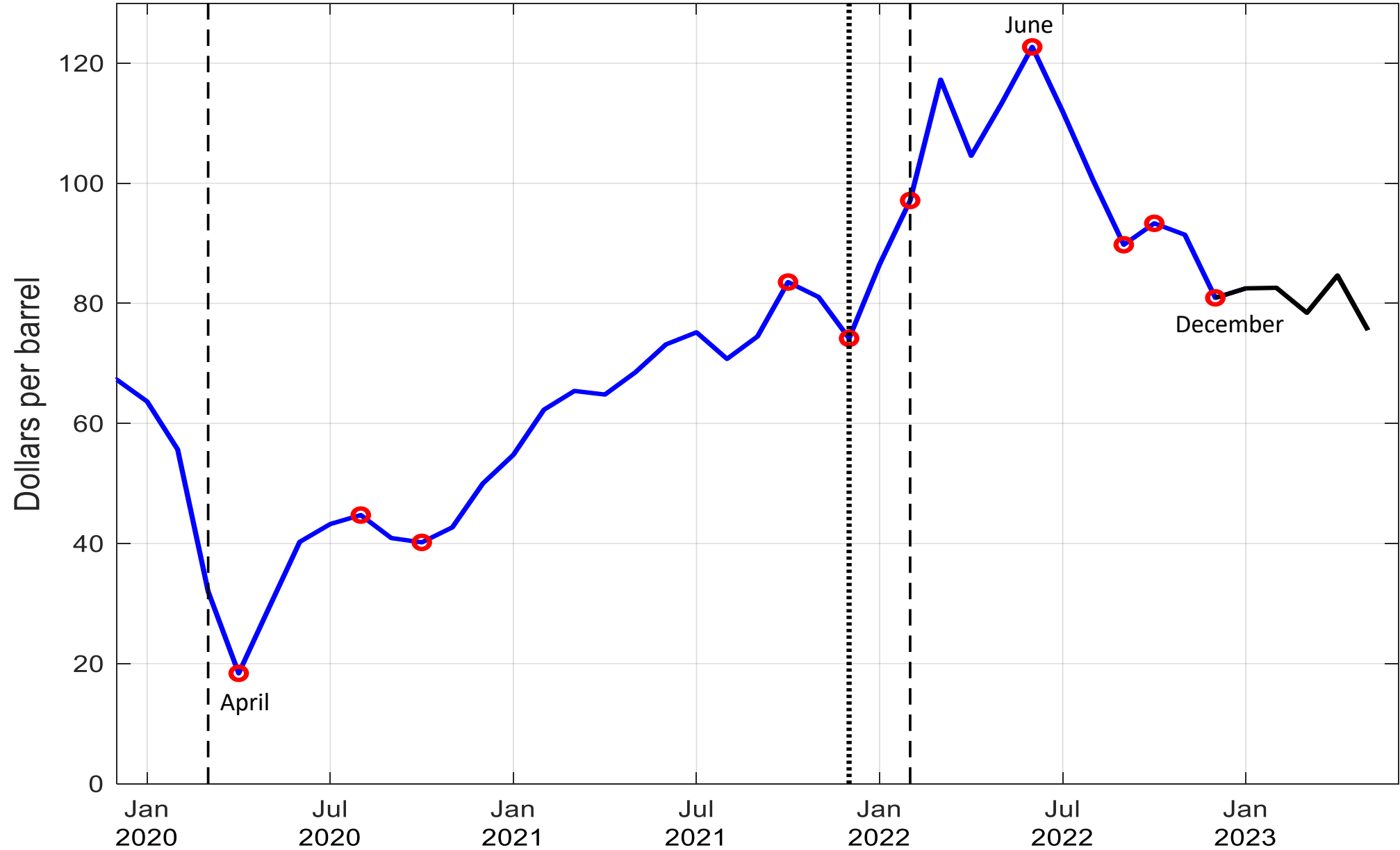
- To promote stability of the global oil market and to counter inflationary pressures:

2. Unprecedented releases from emergency stockpiles of crude oil

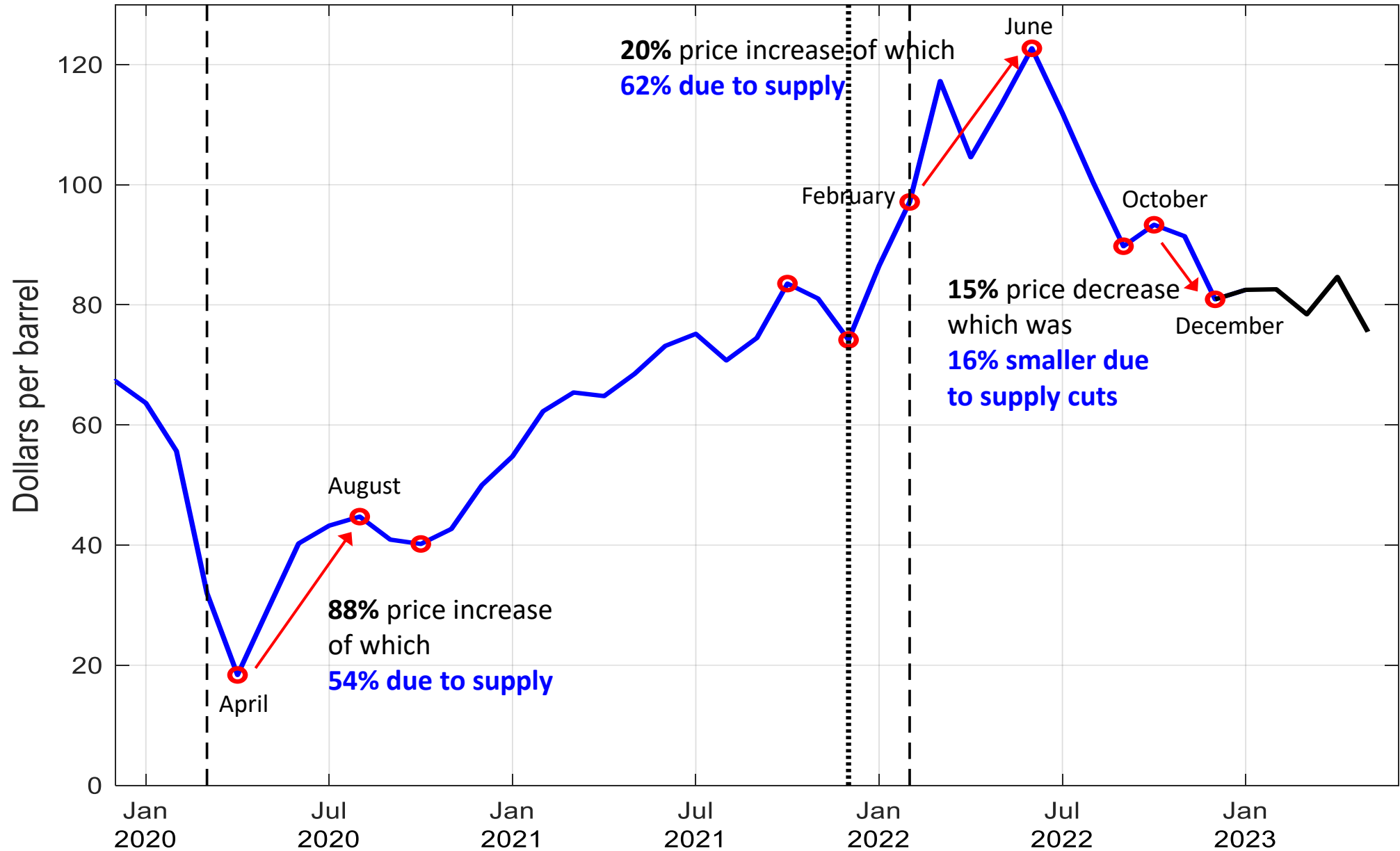


- Record size and duration of drawdowns
- SPR is at historic low of 350 million barrels
- US initiated process of replenishing SPR recently which creates additional demand

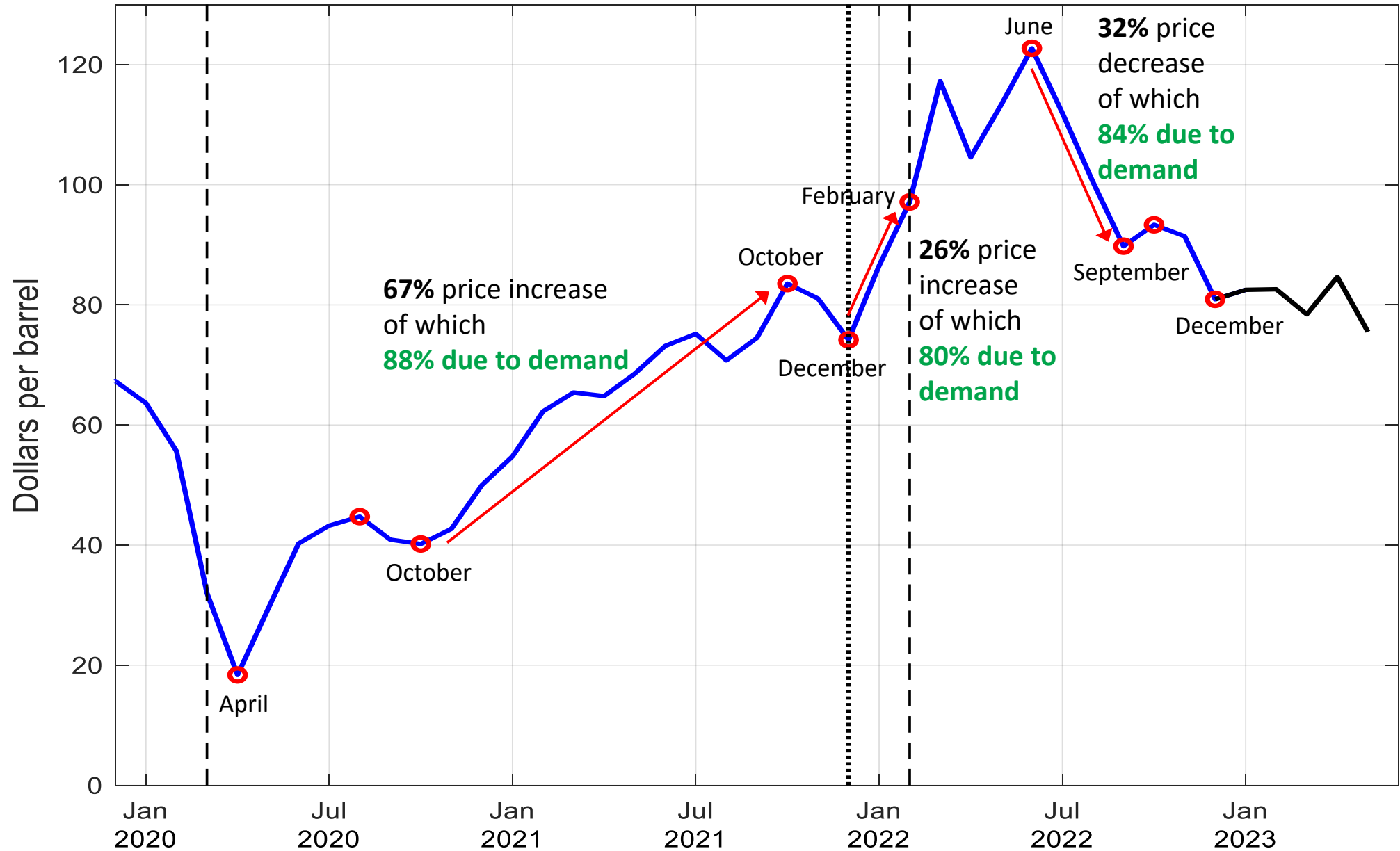
Drivers of Oil Price Fluctuations



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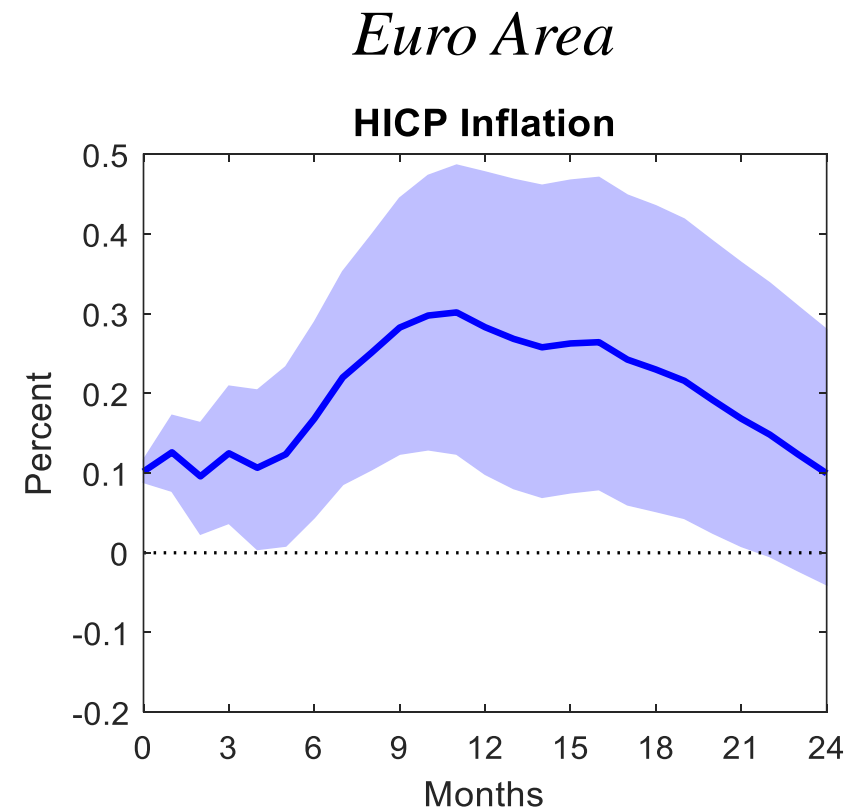
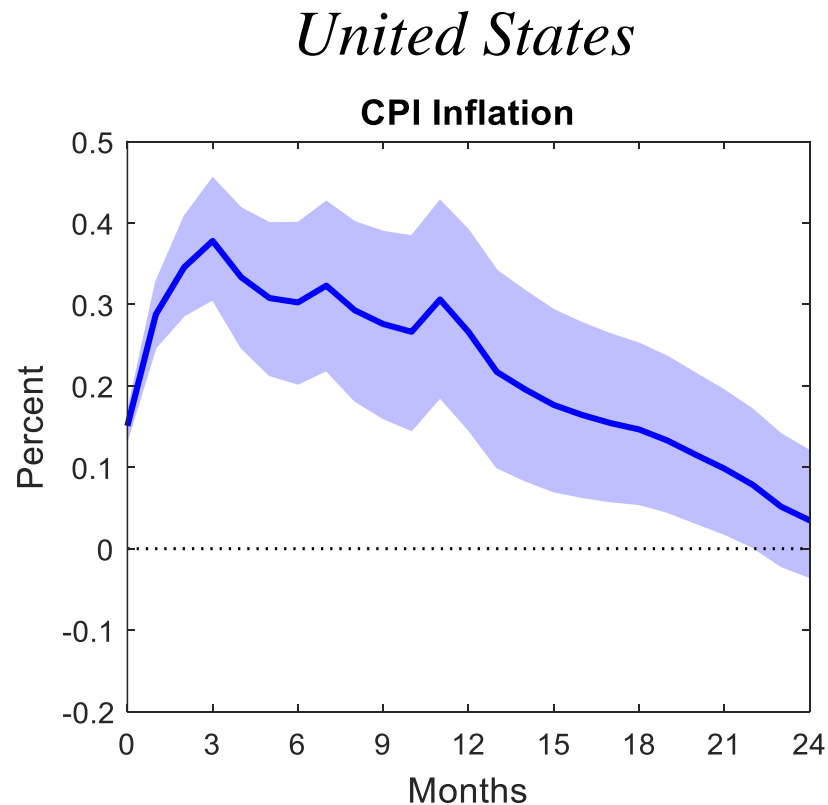


Linking Oil Price Shocks to Inflation Dynamics

Time period	Actual change in inflation	Contribution of	
		<i>oil supply shocks</i>	<i>demand shocks</i>
United States			
Feb-Oct 21	4.5	0.10	1.42
Dec 21-Feb 22	0.8	0.03	0.31
March-June 22	0.4	0.29	0.06
June-Sept 22	-0.7	-0.15	-0.12
Oct-Dec 22	-1.3	0.05	-0.58
Euro Area			
June-Oct 21	2.1	-0.06	1.11
Dec 21-Feb 22	0.9	0.03	0.69
March-June 22	1.2	0.20	0.22
June-Sept 22	1.3	-0.08	0.29
Oct-Dec 22	-1.4	0.02	-0.24

Inflationary Effects of Oil Supply Shocks: Headline

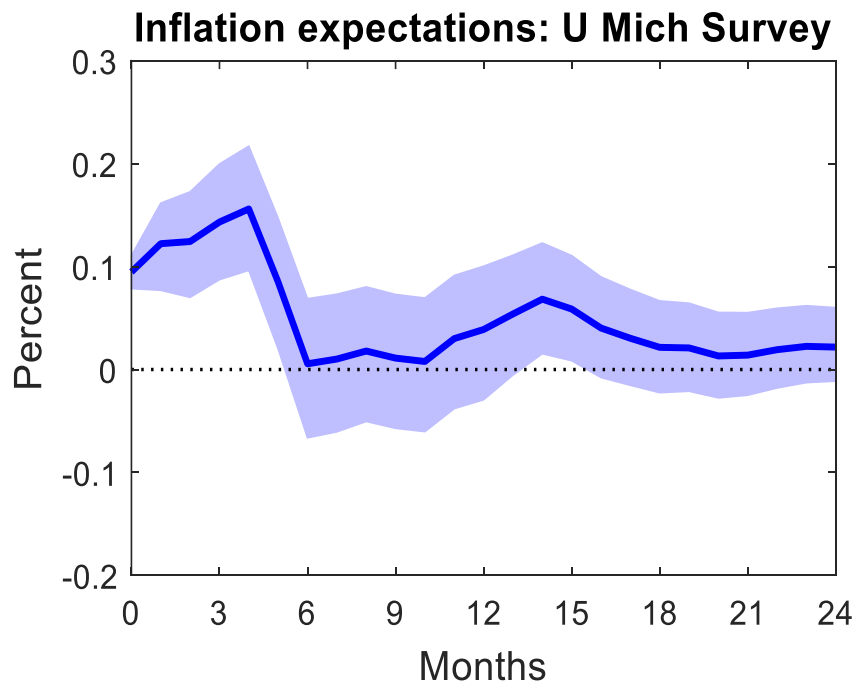
- Both US and Euro area inflation jump on impact by similar amounts.
- Pass-through is much faster in the US, while inflationary consequences are more persistent in the Euro area pointing to important second-round effects.



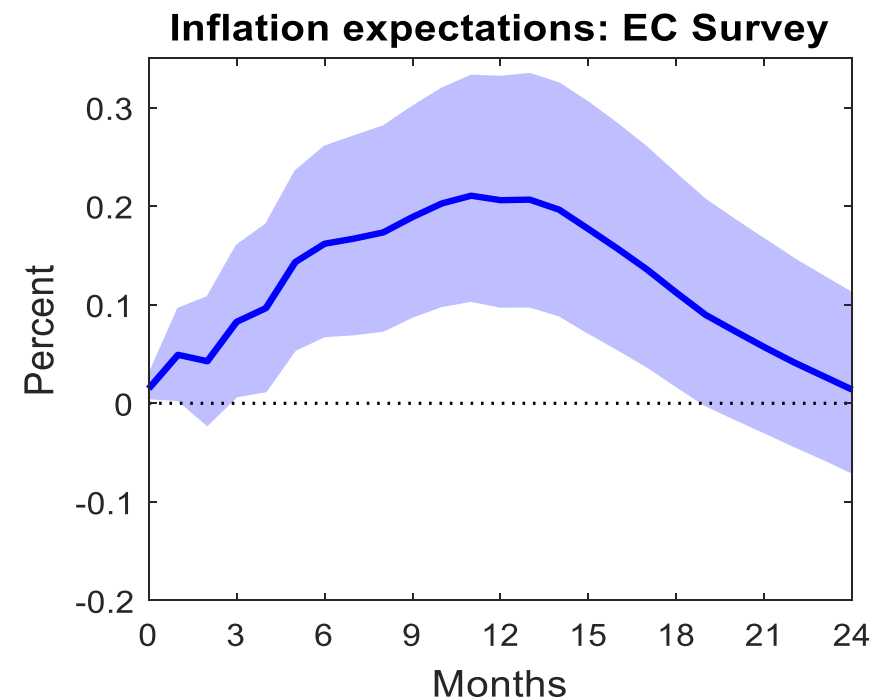
Inflationary Effects of Oil Supply Shocks: Expectations

- Household inflation expectations react more strongly on impact in US, but initial rise fades away quickly.
- Inflation expectations build up more gradually in the Euro area indicating that higher oil prices get more ingrained in expectations

United States



Euro Area



Cross-country Heterogeneity in the Euro Area

- Sensitivity of inflation expectations varies greatly across member countries both in terms of magnitude and dynamics (speed of pass-through).

