The impact of the oil price in the EU economy

Talk at Bruegel, 2nd June 2015 at 12:30pm

Participants:

- **Lutz Kilian**, professor of economics, University of Michigan
- **Cristiana Belu Manescu**, economic analyst, European Commission DG ECFIN
- Chair: **Georg Zachmann**, research fellow, Bruegel

Notes:

The price of crude oil has dropped by $49 from June to December 2014, which has raised hopes of an economic dividend for the EU. This could be supported by the apparent relationship between oil prices and GDP in many oil-importing economies over the past 60 years.

Lutz Kilian from the University of Michigan, who has published extensively on oil prices, oil shocks and the links between oil and the wider economy, explored the potential impact of oil price changes on the EU economy.

Since an oil price shock is the difference between what we expected the oil price to be (ex-ante) and what it turned out to be (ex-post), the two questions that arose were: To what extent was the oil price decline predictable, and to what extent was it caused by shocks since June 2014?

State-of-the-art models of the global oil market are successful in predicting such a large decrease, and the authors also checked that the model did not predict large price declines by construction or chance. Their conclusion was that half of the decline was predictable, due to decline in real activity known in June 2014 and positive surprises on supply before July 2014, and half was unpredictable due to unexpected reduction in storage demand in July 2014 and unexpected weakening of global economy in December 2014.

For the following months (Jan-Feb-March), the Kilian-Murphy model had a pretty good estimate of the Brent price of oil.

Concerning the impact on GDP in the EU, both Kilian and Manescu expect a growth stimulus of about 0.5%. One participant argued that relative to the estimated 1.4% growth in real GDP for 2014 this is substantial, but Kilian highlighted that the stimulus is only a one-time effect. In addition, Kilian emphasized that the one-time nature of the decline in price can only cause a one-time decline in the price level of oil-importing economies and should therefore not bring any additional deflation risks.

Event notes by Augustin Lagarde, Research Assistant.