

ASEAN Fiscal and Monetary Policy Responses to Rising Oil Prices

REPSF Project No. 06/004

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Final Report

May 2007

The views expressed in this report are those of the author, and not necessarily those of the ASEAN Secretariat and/or the Australian Government

ABSTRACT

Through 2004 to 2006, the ASEAN countries were hit by the largest oil price increases since the 1970s. ASEAN countries are far more oil intensive in production than other countries and hence more sensitive to oil price increases. They are also, as a group far more trade intensive than other economies and highly integrated into global production chains. Consequently, the impact of oil price shocks on the ASEAN economies could potentially be very large, even though the present shock has only been modestly disruptive to growth.

This paper looks at the impact of the present oil price shock on the ASEAN economies, examining the channels of transmission both direct and indirect, and examining why the experience of the current oil price shock has been different to the experience of previous shocks, (and why future oil shocks might be different again). In doing so, it looks at how the oil price shock has impacted on the world economy and why there have only been relatively modest effects on inflation, activity and interest rates this time around. The experience of the oil price shock more broadly also provides some valuable policy lessons particularly in relation to the importance of having well established medium-term frameworks for monetary and fiscal policy, and well anchored inflation expectations. The paper then goes on to examine fiscal and monetary responses to the impacts of higher oil prices, and how appropriate policy response to the shocks differs according to the circumstances of different types of country.

In reality macroeconomic policy decisions would be very simple if the future were known (in the same way as a decision to bet on a horse would be simple if one knew which one was going to win). The complications for monetary and fiscal policy arise because the impacts of any given increase in oil prices are uncertain, and the channels of response are many and varied. Consequently, this paper places its main focus on attempting to understand the transmission mechanisms of an oil price shock, with the aim in turn of informing fiscal and monetary responses in ASEAN economies.