Box 1

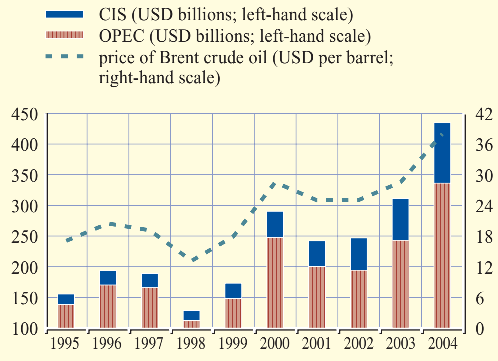
OIL-BILL RECYCLING AND ITS IMPACT

Oil price increases and rising production volumes have generated substantially higher oil export revenues for most oil-producing countries. This box focuses on two groups of countries, the Organization of the Petroleum Exporting Countries (OPEC) and the Commonwealth of Independent States (CIS), which together produce approximately 70% of internationally traded oil. Combined OPEC and CIS oil revenues are estimated to have increased from USD 250 billion in 2002 to more than USD 430 billion in 2004 (see Chart A). This has strengthened the fiscal position in some of the OPEC and CIS economies. Since 2001 both OPEC and CIS economies have noticeably increased their import activities, thus limiting the initial negative effect on the current accounts of some oil-importing economies. This box looks at the feedback effects stemming from rising oil revenues, also referred to as "oil-bill recycling", and in particular at two main transmission channels: (i) financial markets and (ii) trade.

One possible scenario associated with the reallocation of wealth following a period of sustained high oil prices is that oil-exporting countries increase their deposits in the international banking system and/or their investments in fixed income and equity securities.

While this was an important channel of oil-bill recycling during the first and second oil crises, it has not been so significant in recent years. Although OPEC economies deposited a considerable proportion of their additional oil export revenues with international banks after the rise in oil prices in 1999, this did not occur to the same extent during the most recent surge from 2002 to 2004. Banking statistics, as reported by the BIS,[1] suggest that the rise in oil prices from mid-1998 to end-2000 was accompanied, with a slight lag, by a near doubling of the real stock of international banks' net liabilities vis-à-vis the OPEC – a measure of the net funnelling of OPEC funds into deposits with international banks. This was no longer the case in the most recent cycle, as the real net stock of liabilities of BIS reporting banks vis-à-vis the OPEC rose by only 3% between the second quarter of 2002 and the second quarter of 2004 (the latest available data).

Chart A Oil export revenues



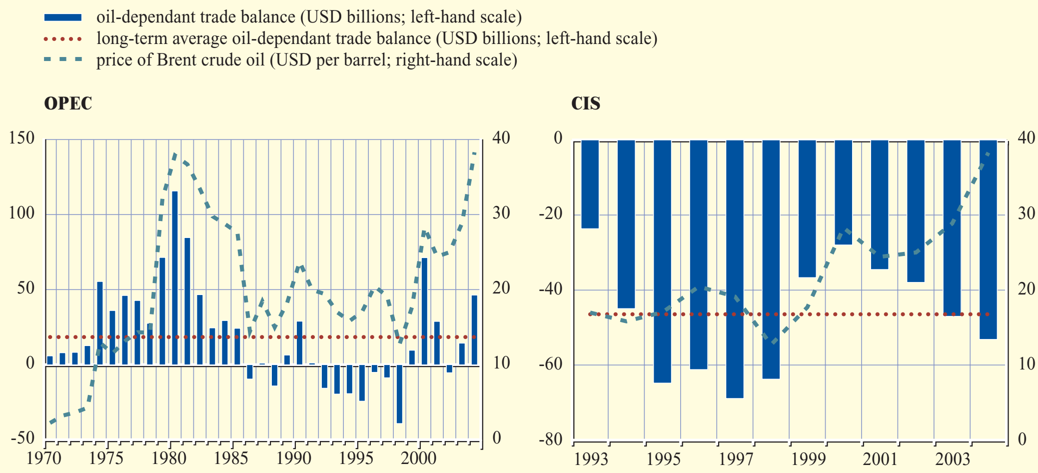
Sources: FMDB and ECB staff estimations.

Although the overall bank net liabilities vis-à-vis the OPEC remained relatively flat throughout the latest surge in oil prices, their decomposition has changed as the OPEC have moved away from US dollar-denominated deposits into deposits denominated in euro and other currencies. Indeed, the share of funds denominated in US dollars and deposited by the OPEC with BIS reporting banks fell from 75% of total deposits in the third quarter of 2001 to 61.5% in the second quarter of 2004, while the share of euro-denominated deposits rose from 12% to 20% over the same period. This move towards a more balanced deposit portfolio in terms of currencies may signal oil producers' intent to safeguard their purchasing power at times when their imports are shifting away from the United States towards Europe and other countries (see below). The investment pattern which can be observed by monitoring banks' balance sheet positions may, however, not give the full picture. Indeed, looking at cross-border capital flows, the US Department of the Treasury reports an increase of 46% in OPEC holdings of US Treasury securities from April 2003 to April 2005 (from USD 41.5 billion to USD 60.6 billion). In addition, some oil export revenues may have been channelled through financial centres into US Treasury securities.

International trade represents the second potential recycling channel of increased oil revenues. Recent trade data for both the OPEC and the CIS point to a higher recycling through oil-exporting economies' imports. During the first and second oil price shocks, the OPEC persistently ran relatively large surpluses between its oil export revenues and total imports ("oil-dependant trade balance"), which turned into small deficits in the mid-1980s when the price of oil plunged back to about USD 15 (see Chart B, left panel). The large surplus appeared again in 2000 when oil prices started to pick up sharply. However, in the most recent period from 2001 to 2004, the OPEC's annual oil-dependant trade surpluses remained relatively moderate despite the strong rise in both oil prices and oil export volumes. A similar trend can be

1 See BIS Quarterly Review (December 2004).

Chart B Oil-dependant trade balance [1]



Sources: CHELEM, IMF and ECB calculations.
1) The oil-dependant trade balance refers to the difference between a country's oil export revenues and its total imports.

observed for the CIS (see Chart B, right panel). Although the CIS recorded oil-dependant trade deficits throughout the entire observation period, the rise in oil prices in 1998 was followed by a relatively sharp reduction in deficits in 1999 and 2000. The strong increase in oil prices from 2001 onwards led to an even more severe deterioration of the CIS oil-dependant trade balance, although higher oil prices boosted oil export revenues.

Total OPEC and CIS imports registered an annual average increase of 18% and 22% respectively between 2001 and 2004 in nominal dollar terms. During this period, OPEC and CIS imports increased more than their long-run income and price elasticities of imports would suggest. The euro area seems to have benefited from the strong demand originating from oil-exporting countries. The annual growth of OPEC and CIS imports from the euro area was, on average, 22% and 34% respectively between 2001 and 2004, resulting in an increase in euro area market shares in both oil-exporting regions (see table). China also succeeded in increasing its relative share in total OPEC and CIS imports. These figures contrast sharply with those of the United States, which experienced a significant loss in market share in OPEC and CIS imports.

Import market shares of selected economies in the OPEC and the CIS

(as a percentage of total imports)

	OPEC			CIS		
	1998	2001	2004	1998	2001	2004
Euro area	26.0	24.8	27.1	32.0	31.6	39.6
United States	15.4	12.5	7.9	7.0	6.5	3.3
United Kingdom	5.9	5.0	4.5	2.5	2.3	2.6
Asia excl. Japan and China	9.8	10.7	12.5	2.8	2.5	2.8
Japan	9.2	8.3	8.0	1.4	1.8	3.0
China	3.7	4.8	7.8	1.9	2.9	6.3

Sources: IMF and ECB calculations.

Overall, from 1999 to 2004, different patterns emerged as to how oil-exporting economies, in particular the OPEC economies, allocated their additional oil export revenues. First, in the aftermath of the substantial rise in oil prices in 1999, OPEC countries deposited large shares of their oil revenues with international banks, keeping their investment in financial assets and import spending low. However, between 2001 and 2004, OPEC economies increased their imports substantially. A similar increase in import activity since 2001 can also be observed in the case of the CIS economies. It appears that the euro area benefited from this recent rise in imports. Thus, while the elevated price of oil certainly dampens economic activity in oil-importing countries such as the euro area, it appears that the mitigating feedback effects associated with oil-bill recycling have been somewhat more favourable for the euro area in the current oil price cycle than in previous episodes of price increases.