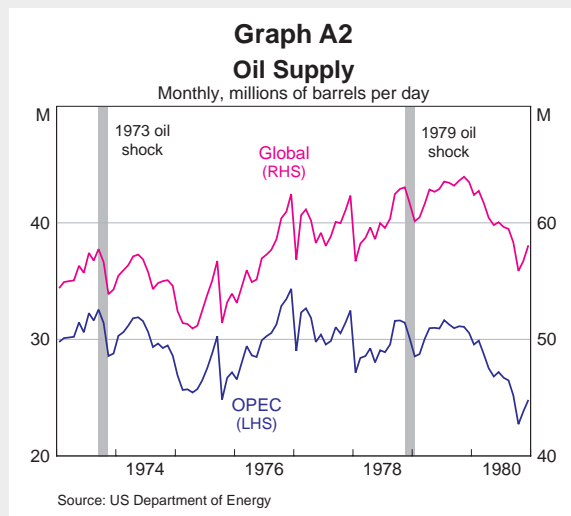
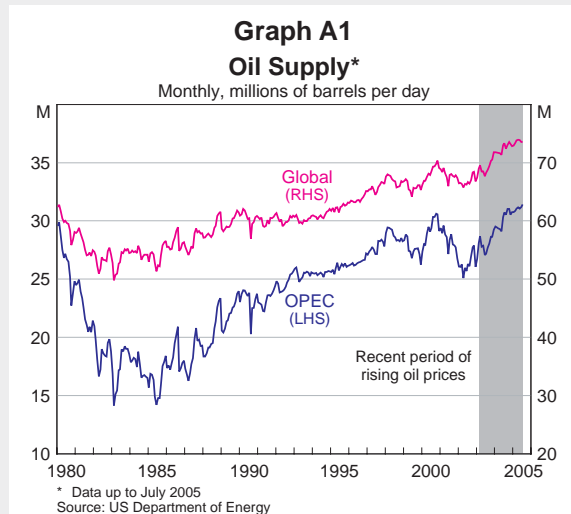


Box A: Oil Price and Supply Developments

Benchmark oil prices have more than doubled over the past two years, and have risen by around 40 per cent since the end of 2004. Disruptions to extraction and refining facilities resulting from hurricanes in the US Gulf Coast region led to a spike in prices in late August and early September, with prices briefly exceeding US\$70 before retracing to around US\$60 by early November.

Aside from the hurricane-related volatility, the significant increase in oil prices over recent years has generally been viewed as driven by strong global demand, rather than restraints on supply. Between late 2003, when prices began rising sharply, and July this year (the latest period for which world oil supply data are available) world oil production rose by 6.0 per cent, or 4.1 million barrels per day (bpd) (Graph A1). OPEC producers accounted for 3.3 million bpd of this increase, boosting their production by 12 per cent over this period. Despite this supply expansion, benchmark oil prices roughly doubled in US\$ terms over the same period.

These developments contrast with those in earlier episodes, such as the OPEC oil shocks of the 1970s, when supply declined and the increase in prices was substantially larger and more sudden. Over the period September to November 1973, OPEC nations cut production by around 12 per cent, reducing overall world supply by about 7 per cent (Graph A2). Similarly, OPEC oil supply fell by around 9 per cent over the period October 1978 to February 1979, leading to a decline in total supply of 4 per cent. Subsequent sharp increases in prices, such as that seen in late 1990 prior to the first Gulf War, were also associated with falls in production.



An additional perspective on the current shock is provided by developments in futures prices for oil. Over the past decade or so, swings in spot oil prices have typically been viewed as temporary, so longer-term futures prices normally reacted little to them. In contrast, the strength in demand that has recently driven prices higher is generally expected to be sustained, especially given that more than one-third of the increase in demand has come from China and other fast-growing parts of Asia. Six-year futures prices have therefore risen sharply, from US\$37 per barrel in late 2004 to US\$55 in early November. Futures prices are now around 110 per cent higher than at the end of 2003, similar to the increase in spot prices. ✎