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Fears Growing over Future World Economy and Its Impact on the International Energy Situation

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As fears grew over the future course of the world economy in the first half of August, we saw plunges, wild fluctuations and destabilization in global stock markets. The Dow Jones Industrial Average on the New York Stock Exchange posted a steep decline of 1,322 points or 10.9% from 12,132 on August 1 to 10,810 on August 8. It went up or down by more than 400 points for consecutive four days on end, indicating a very unstable market situation. As noted above, the stock market plunge was not limited to the United States. Stock prices nose-dived in Europe, Japan and Asia as well, indicating a global stock market decline.

A direct trigger of the global stock market plunge is the U.S. federal debt ceiling problem taken up in my previous report: "A Japanese Perspective on the International Energy Landscape (53)." Although any breakthrough over the problem had been viewed as difficult, Democrats and Republicans reached a compromise deal before the August 2 deadline, averting the federal government's default, the worst expected development. But U.S. debt rating agency Standard & Poor's downgraded the rating of U.S. government securities by one notch from the highest level of Triple A on August 5, claiming the planned budget deficit reduction as insufficient. The downgrade of the rating for U.S. government securities positioned as the most liquid and safe assets in the world shook confidence towards the U.S. economy and led to growing fears over its future course, triggering the steep stock market decline.

The latest stock market decline, which mirrors fears over the future world economy, is serious because structural factors exist behind the decline. Factors behind the latest stock market decline and destabilization are budget crisis and government debt problems, compared with financial institutions' debt and nonperforming loan problems behind such developments after the September 2008 Lehman Shock. This may mean that industrial and emerging countries adopted a sharp budget expansion and monetary easing to fight against a global recession after the Lehman Shock, resulting in government debt and budget crisis problems, particularly in industrial countries, three years later.

These problems have become the biggest factor behind the economic destabilization in the United States and Europe. In this sense, I am concerned that the measures that governments could take in response to the current economic fears are limited.

Meanwhile, doubts exist with regard to whether we can expect China and other emerging countries to play a role in driving the world economy as seen after the Lehman Shock. Although China swiftly overcame its economic stagnation with its big economic stimulus package, worth 4 trillion yuan, and drove the world economy in the wake of the Lehman Shock, it is now plagued with inflation and asset bubble fears. The Chinese side now fears that quantitative easing III, as rumored as an economic stimulus in the United States, could add fuel to the inflation and bubble problems in China. Even the Chinese economy has great challenges regarding its future course.

In the international energy market, crude oil prices have declined in response to the growing recession fears. The benchmark West Texas Intermediate crude oil futures price on the New York market fell by $15.59/barrel or 16.4% from $94.89/barrel on August 1 to $79.30/barrel on August 9. The North Sea Brent futures price also plunged from $116.81/barrel to $102.79/barrel during the same period. Later, the WTI and Brent prices recovered in line with stock market developments. On August 12, the WTI futures rose back to $85.38/barrel. Crude oil prices have thus kept step with stock markets in the latest destabilization.

Unless financial market turmoil and fears over the future world economy are solved, crude oil and other energy prices may remain unstable. Downward pressures may be stronger than upward ones on energy prices. Energy price drops themselves can be expected to have positive effects on energy consuming or importing countries. If energy price drops are attributable to the destabilization of the world economy and a recession, however, these drops themselves may have to be viewed as a matter of concern.

We may have to take note of another point. That is the present turmoil’s macro impact on international energy supply and demand, particularly a slack energy demand. In 2010, demand for all energy sources expanded steadily in the world on an economic recovery. In 2009, however, global demand for all energy sources other than renewable and hydroelectric energy decreased amid a global recession following the Lehman Shock. This is still fresh in our minds. A sharp demand decline in the international energy market can lead to dramatic global landscape changes through an glut supply/demand relationship and price drops. It may bring about not only energy supply/demand balance changes but also great impacts on international relations and the balance of power, including relations between resource producing and consuming countries, between energy consuming countries and between resource-rich countries.

Given structural problems or factors behind the current fears over the future world economy as described above, I feel that no optimism can be warranted about the future. We may not be able to deny that great turbulences could emerge in the international energy market from the second half of 2011 to 2012.

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