

Global Economic Prospects

HIGHLIGHTS from Special Focus 2: Russia's Invasion of Ukraine: Implications for Energy Markets and Activity

Key Points

- *The Russian Federation's invasion of Ukraine has disrupted global energy markets and damaged the global economy. Compared to the 1970s, the current energy shock has led to a surge in prices across a broader set of energy-related commodities.*
- *Higher energy prices will trigger a shift in global income from energy importers to energy exporters. On net, model-based estimates suggest that the war-driven surge in energy prices could reduce global output by 0.8 percent after two years.*
- *The experience of previous oil price shocks has shown that these can provide an important catalyst for policies to encourage demand reduction, the substitution to other fuels, and the development of new sources of energy supply.*

Surge in prices across energy-related commodities. Russia's invasion of Ukraine has disrupted the supply of energy commodities as Russia is the world's largest exporter of natural gas and accounts for a significant share of global coal and crude oil exports. All energy prices rose sharply in 2022, in contrast to earlier episodes where oil prices rose much more sharply than those for coal and gas. In nominal terms, crude oil prices have increased by 350 percent from their pandemic low in April 2020 to April 2022, making this the largest increase for any equivalent 2-year period since 1973, while coal and gas prices have all reached historic highs. Since price increases have been broad-based across all fuels, there is less room now than in the past to substitute towards cheaper fossil fuel alternatives.

Impact on global activity. Energy prices affect growth and inflation through direct effects on prices and activity for both importers and exporters as well as through indirect effects via trade and other commodity markets; monetary and fiscal policy responses; and investment uncertainty. On net, model simulations suggest that the upward revisions to energy prices, including to prices of oil, natural gas and coal, could reduce global output by about 0.5 percent in 2022 and cumulatively by about 0.8 percent by 2023. Advanced economies would experience a cumulative reduction in output of 0.9 percent by 2023 and oil-importing EMDEs an output reduction of 0.6 percent. The outsized impact on advanced economies reflects a particularly large drag in Europe from surging natural gas prices as a result of the war in Ukraine.

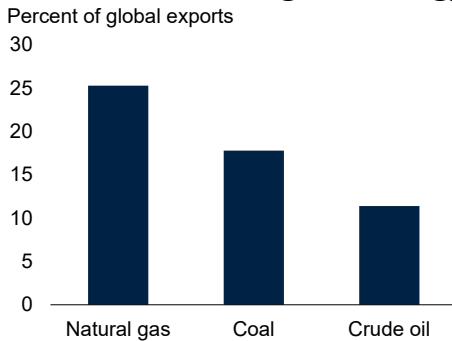
Policy implications. In the near-term, higher prices threaten to disrupt or delay the transition to cleaner forms of energy as several countries have announced plans to increase production and use of fossil fuels. Policy responses to previous energy shocks have shown that some measures can be highly effective and beneficial (such as increasing energy efficiency and renewable energy mandates), while others can lead to market distortions and environmental problems (such as price controls and the promotion of fossil fuels). In responding to the current shock, policymakers need to prioritize policies that encourage greater energy efficiency and accelerate the transition towards low-carbon energy sources. To cushion the adverse effects on households, temporary targeted support to vulnerable groups needs to be prioritized rather than energy subsidies, which could delay the transition to a zero-carbon economy, result in distortions, and lead to fiscal imbalances.

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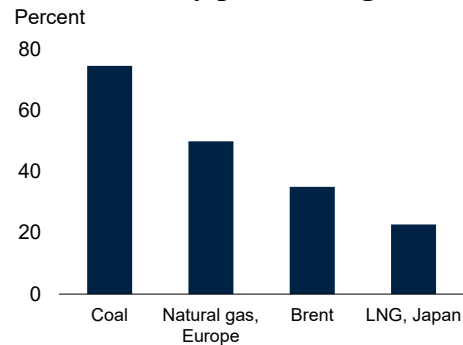
Figure 1. Energy price shock and implications for global economic activity

Russia is a major exporter of energy commodities. Coal and natural gas prices have all reached historic highs in nominal terms. However, in real terms, only the European natural gas price has reached an all-time high, and it is substantially above its previous peak in 2008. Coal prices are close to their 2008 peak, while oil prices remain some way below. Prices of oil and natural gas are expected to remain elevated over the near term. As a result, combined supply-driven upward revisions to the prices of oil, natural gas and coal could lower global output by a cumulative 0.8 percent by 2023.

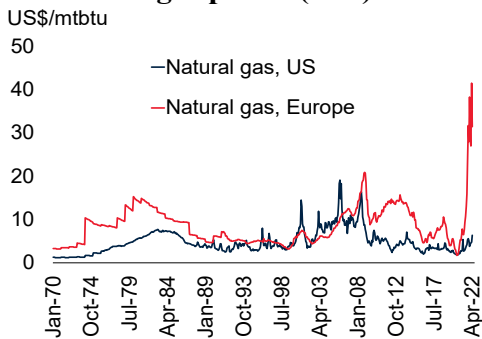
A. Russia's share of global energy exports



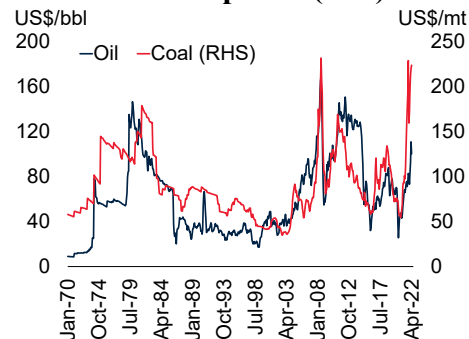
B. Commodity price changes in 2022



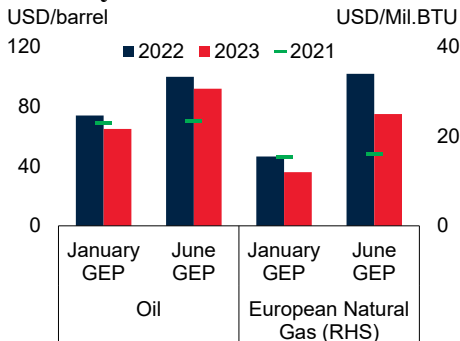
C. Natural gas prices (real)



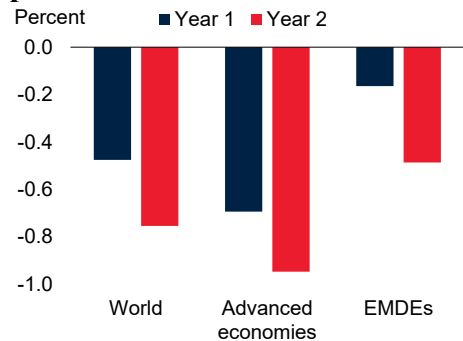
D. Coal and oil prices (real)



E. Energy price projections: June 2022 vs January 2022



F. Impact on activity of higher energy prices



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Sources: BP Statistical Review; Eurostat; Haver Analytics; JP Morgan; Oxford Economics; Comtrade (database); World Bank.

A. Data are in trade volumes for 2020.

B. Three-month change in commodity prices through end March 2022. LNG stands for liquefied natural gas.

C.-D. Monthly data from 1970 to April 2022. Prices deflated by the U.S. Consumer Price Index.

C. Oil price is the simple average of Brent, Dubai, and West Texas Intermediate prices.

E. GEP refers to the Global Economic Prospects report. Oil price is the simple average of Brent, Dubai, and West Texas Intermediate prices.

F. Chart combines the impacts on global output of the supply-driven increases in Brent oil prices, natural gas prices, and coal prices over a two-year period (2022-2023). Brent oil prices average 40 percent above baseline, natural gas prices average 70 percent above baseline, and coal prices average 87 percent above baseline. Simulations prepared using the Oxford Economics Global Economic Model.