FAZ
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The drop in oil prices will fuel growth, not deflation
by Michael Heise

The slide in oil and other commodity prices is creating a new environment for the global economy and economic policy. Even if the OPEC oil cartel manages to stabilize prices soon, as is expected to be the case, a large number of oil-importing countries can already report substantial gains. These "winners" include virtually all of the world's industrialized nations, such as Japan, Korea, the US or countries in Europe, but also a number of emerging markets, including the large Asian countries of China, India and Indonesia. The downward trend in oil prices, which have tumbled by 40 percent in dollar terms since June, translates into lower production costs and results in a direct increase in consumer purchasing power. In the euro area, this alone is likely to boost growth by 1/2 a percentage point next year. The depreciation of the euro is expected to provide an additional 1/4 of a percentage point. The oil-producing countries will be hit by growth losses as their income goes down. Most of the countries blessed with oil reserves, however, have substantial assets to fall back on in order to keep their economy running smoothly. This certainly applies to the Gulf states, but also holds true for the northern oil producers and even for Russia.

The drop in oil prices will also have a real impact on the monetary policy pursued by the major central banks, because lower input prices will nudge the general price level down. The ECB could very soon be faced with zero or even negative inflation rates. It will then come under even more pressure to adopt further expansionary measures. The ECB should not, however, bow to this pressure. Faced with such sharp changes in commodity prices, it needs sufficient room for maneuver in monetary policy terms – and it has to tolerate deviations from its price norm of "below, but close to 2 percent" in both directions if necessary. Back in 2011 – when commodity prices skyrocketed – the ECB did the right thing in accepting a rate of inflation that was well above the two percent mark.

Similarly, it now has to accept low inflation rates insofar as these are attributable to the drop in oil and energy prices. Purchasing power gains like these fuel growth, not deflation. The same applies to the necessary price adjustments in the countries on the eurozone periphery. Combined, these effects are likely to have sliced around one percentage point off the price level. The ECB would be well advised to emphasize this more in public to prevent its credibility being called into question when it appears to have fallen short of its targets. In the medium term, it should also consider a return to what was standard practice up until 2003: namely defining price stability as a rate of inflation of below two percent. This would give the ECB much more scope, although short-term deviations above the 2 percent mark could also be necessary, as in 2011. Inflation expectations will also be subject to short-term fluctuations in the event of marked changes in commodity prices. The tools available to a central bank can only control inflation and inflation expectations in the medium term.