

Box I

**POLITICAL TENSIONS IN THE MIDDLE EAST AND NORTH AFRICA: ECONOMIC IMPLICATIONS FOR THE EURO AREA**

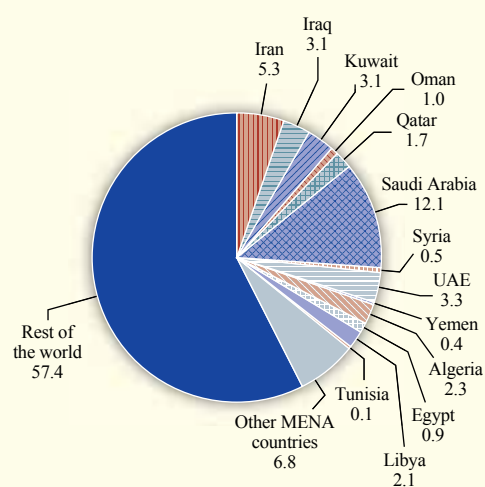
This box reviews the potential impact of recent political turmoil in several countries in the Middle East and North Africa (MENA) on the euro area economy. It presents the main channels through which the turmoil may affect the euro area and specifically considers the impact of higher oil prices on the euro area economy.

Oil prices are the key link between political developments in the MENA region and the euro area and the global economy. Brent crude oil prices have increased by more than 25% since the beginning of January 2011 – when unrest intensified in Tunisia – and have spiked in particular in the wake of turmoil in Libya. Political developments in MENA countries tend to increase the geopolitical risk premium in oil prices given the region’s crucial role in global energy supply. The MENA region accounts for more than 40% of global oil production and two-thirds of global oil reserves (see Charts A and B). Furthermore, spare capacity in global oil production is concentrated in the region, with Saudi Arabia alone accounting for almost 80% of OPEC’s effective spare capacity in February 2011, according to International Energy Agency estimates.<sup>1</sup> The region also plays an important role in global gas supply, as it accounts for around one-fifth of global gas production and holds almost half of global gas reserves.

<sup>1</sup> See also the article entitled “Oil prices – their determinants and impact on euro area inflation and the macroeconomy”, and in particular the box entitled “Saudi Arabia’s oil production capacity – recent developments and prospects”, *Monthly Bulletin*, ECB, August 2010. As regards Saudi Arabia’s capacity to offset supply disruptions in other countries such as Libya, it has to be taken into account that Saudi oil is of a different quality to Libya’s, for example, which may limit short-term substitutability in refining.

**Chart A Oil production**

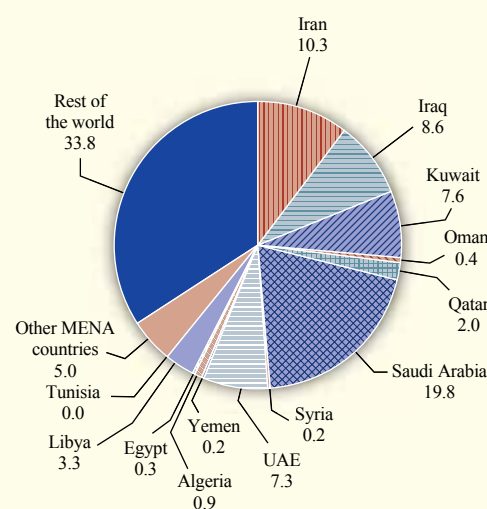
(percentage of global production, end-2009)



Sources: BP Statistical Review 2010 and ECB calculations.

**Chart B Proved oil reserves**

(percentage of global reserves, end-2009)

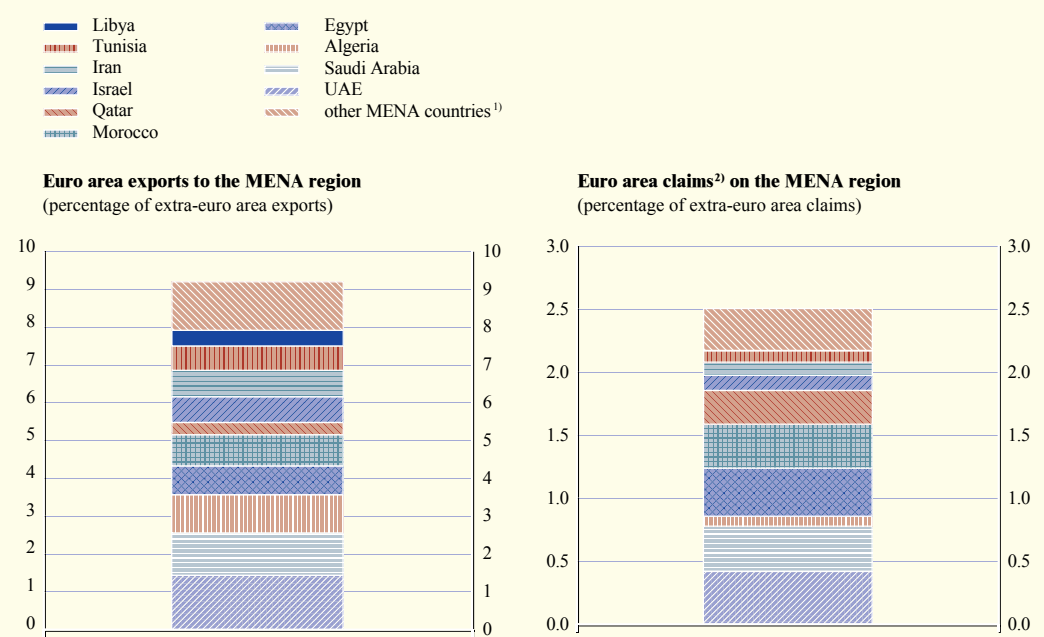


Sources: BP Statistical Review 2010 and ECB calculations.

The MENA region is also an important trading partner for the euro area. It is the recipient of around 9% of the euro area's exports. By contrast, the exposure of euro area banks to MENA countries is relatively small, with the region accounting for only 2.5% of euro area bank claims outside the euro area (see Chart C). The holdings of euro area assets by entities from MENA countries, including those by sovereign wealth funds of the region's oil exporters, represent a further financial link to the region. Potential spillovers from the turmoil in the MENA region to the euro area could also originate from a possible rise in global risk aversion, and from an increase in uncontrolled immigration. As a result of turmoil in MENA countries – some of which are important destinations for European tourists – some tourism may be redirected to southern European countries, for example. The impact of developments in the MENA region on the euro area may differ across countries, given that the trade and financial links of euro area countries with the region vary, depending mainly on geographical proximity.

What is the likely impact on economic activity and inflation in the euro area of higher oil prices? The empirical evidence from model simulations suggests that the overall effect on euro area economic activity of a 10% increase in oil prices is approximately -0.25% after three years, but exhibiting considerable variation across countries, ranging from close to zero to -0.4%. The pass-through of oil prices to consumer prices is complex and depends on many factors, including the level of oil prices, the rate of indirect taxation, sector composition of the economy, wage and price-setting institutions and the response of monetary policy. On average, a 10% increase in oil prices increases HICP in the euro area by roughly 0.2% in the first year, and

**Chart C Euro area trade and bank exposure to the MENA region**



Sources: BIS (consolidated banking statistics), IMF, Haver Analytics and ECB calculations.  
 Notes: Intra-euro area exports/foreign claims are excluded. Claims data as of the third quarter of 2010. Export data refer to 2009.  
 1) Other MENA countries: Bahrain, Iraq, Jordan, Kuwait, Lebanon, Mauritania, Oman and Syria.  
 2) Consolidated foreign claims of BIS reporting banks headquartered in the euro area, immediate borrower basis.

by 0.45% after three years.<sup>2</sup> It is important to remember that all model-based estimates depend on a number of simplifying assumptions. Thus, the reported estimates should be regarded as indicative rather than precise results.

In sum, political turmoil in the MENA region presents a downside risk for economic activity and an upside risk to price developments in the euro area in the short run. In the medium term, political transition in the region accompanied by economic reforms could have the potential to lift growth and enhance stability in the euro area's southern neighbourhood.

<sup>2</sup> See Task Force of the Monetary Policy Committee of the ESCB, "Energy markets and the euro area macroeconomy", *Occasional Paper Series*, No 113, ECB, June 2010.