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Oil surge considered key threat to global economy

CanWest News Service

Wednesday, July 26, 2006

OTTAWA -- The major risk to the global economy is that oil prices, and then in turn interest rates, will be driven higher by geopolitical uncertainties, according to an otherwise upbeat forecast Tuesday.

The global economy will slow to 3.4 per cent this year from 3.5 per cent last year and then slow further to 3.0 per cent in 2007, which will keep a lid on non-oil commodity prices, the Conference Board of Canada forecast Tuesday.

Globally, there are powerful forces controlling inflation, especially intense competition resulting from globalization, which suggest central banks will not have to increase interest rates to levels which would damage economic activity, it said.

But geopolitical issues could push oil prices to surge higher than \$75 US a barrel. "Such a development could force interest rates well above current levels, possibly resulting in a severe downturn in global economic activity."

The report was released in the wake of rising geopolitical uncertainties stemming from the outbreak of war in the Mideast, which recently helped to push oil prices to record highs of nearly \$80 US barrel.

Oil prices have since slipped back to less than \$75 US a barrel, closing Tuesday at \$73.75 in New York, down \$1.30 for the day. The board is forecasting they will ease further to an average of \$70 US a barrel over the rest of this year.

The Conference Board of Canada, meanwhile, sees the Canadian economy continuing to be supported by its strong domestic economy, and mostly unaffected by a modest U.S. economic slowdown.

"Weaker economic growth in the United States will not have a significant impact on overall growth in North America this year," the think-tank said, forecasting growth in the NAFTA region will ease marginally to a still relatively robust 3.4 per cent.

"However, overall economic growth in North America will weaken to 2.7 per cent in 2007 as higher interest rates and soaring energy prices hamper economic growth in the U.S.," it said. "This will not have a significant impact on Canada's economic prospects for next year, but it will affect Mexico's"

The latest Canadian forecast is for growth of 3.1 per cent this year and again next year, up from 2.9 per cent in 2005.

Not all analysts agree with the conference board the global economy will not be weighed down by rising interest rates.

John Johnston, analyst with RBC's The Harbour Group, sees the increase in interest rates by central banks as the biggest threat to growth.

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