

# ["got those opec blues again” and "rational exuberance” 1631](https://assignbuster.com/got-those-opec-blues-again-and-rational-exuberance-1631/)

" Got those OPEC Blues Again" and " Rational Exuberance"

SUMMARY

Since March of 1999, when the price of West Texas Intermediate crude oil was at $13 a barrel, we have seen a steady increase in prices in all phases of the economy. OPEC, the organization that is largely responsible for setting production goals in the Middle East, was under fire to find ways to increase prices. OPEC members at this time " pledged to cut back the supply of crude and push oil prices higher." (Business Week, 48) The results were better than most expected: crude oil prices were almost $27 a barrel on November 23, 1999, the highest price since the 1991 Gulf War. (Business Week, 48) The demand for oil is outpacing current supply by 2. 8 million barrels, causing some in Congress to push for relief by tapping into the Strategic Petroleum Reserves. (Business Week, 49) The rapid increases in prices have had a welcome effect on " Big Oil", however. Companies such as BP Amoco, Chevron and Royal/Dutch Shell Group have posted 15% increases in earnings (Business Week, 49) This trend is expected to continue, with L Bruce Lanni, an analyst at CIBC World Markets Inc. noting, " I see clear sailing ahead for the next two to three years." (Business Week, 49)

" Happy days are here again!" This quote, noted by Jodie Allen of U. S. News and World Report, refers to the booming U. S. economy. (Allen, 71) The stock market, as of November 8, 1999 was flying high, posting strong gains, prompting inflationary fears and a hard once-over of the situation by Federal Reserve Chairman Alan Greenspan. However, the numbers are extraordinary. The Gross Domestic product surged at an annual rate of 4. 8% in the third quarter of 1999. The employment cost index, which measures total compensation paid to workers in a broad sampling of jobs, rose by 3. 1 percent over the past 12 months. (Allen, 71) But, cautions Princeton economist Alan blinder, " this is a change in the measurement system, not in the reality." (Allen, 71) Still, he concedes, " the underlying reality was looking good even in the older data." (Allen, 71) Even in this seemingly booming economy, Greenspan warns " It is not clear" whether interest rate hikes the Federal Reserve has already made will suffice to prevent overheating of the economy (Allen, 71)

APPLICATION

In the case of OPEC" s decision to cut supply to raise prices, it is clear that all sectors of the economy will be affected in some way. This decision causes a shift of the Aggregate Supply curve, because of the resulting increase of energy prices. Looking at Oil on a simple Supply/Demand curve, we see that the resulting decrease in supply and saying demand is equal, or ceteris paribus, results in the increase in prices that OPEC was looking for. See the following graph:

Notice how the shift of the AS curve from AS1 to AS2 results in a price level adjustment from P1 to P2.

The economy as a whole as suffered from this increase in oil prices, however, there is little reflection in the stock market. As unemployment stays low, we are in a " help wanted" economyaˆ” firms are looking for " warm bodies" to fill needed positions. We also have seen a tremendous rise in GDP and in personal spending. The combination of low unemployment and higher than normal GDP has Fed Chairman Alan Greenspan worrying about how to cool off the economy a bit to control inflation. Unfortunately for some of us, his " big stick" is raising interest rates, increasing the cost for both firms and individuals to borrow money. This will have the desired effect, as the shift in monetary policy will cause aggregate output to fall. But Greenspan will have achieved his goal: keeping inflation low.

VIEWPOINT

In my humble opinion, as a student, the gas prices do affect me, as the do everyone. There seems to be relief in the future, as OPEC may decide this week to increase production, helping lower costs to a more " reasonable" level. The one thing I find interesting, however, is that there has not be as much complaining about these gas price increases. This can be attributed to how the economy is performing as a whole. Also, although I may not like it, Alan Greenspan" s monetary policy has been very sound and the resulting increases in interest rates will have the desired effect. It will be interesting to see how the upcoming Presidential elections help or hinder the economy.

BIBLIOGRAPHY

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Allen, Jodie T., " Rational Exuberance," U. S. News and World Report, November 8,

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