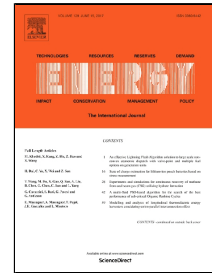


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# Crude oil price: demand, supply, economic activity, economic policy uncertainty and wars – from the perspective of Structural Equation Modelling (SEM)

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## Abstract

We studied the relationship between the change in the price of oil and some of its determinants, using a structural equation model. The demand for oil is confirmed to be inelastic to the change in oil price during our sampling period. Economic activity is found to be the most significant factor in explaining the dynamics of oil price. Wars and political tension, among the largest oil producers and their neighbouring countries, can drive the crude oil price sharply higher, but no significant direct effect was confirmed by the SEM. The significant effects of wars and political tension on the price of oil lies in their ability to disrupt oil supplies.

Keywords: crude oil price, wars, economic policy uncertainty, Kilian economic index, structural equation modelling

## 1. Introduction

A dramatic change in oil price was reported between 2003 and 2008, and during the most recent global financial crisis and the European debt crises. As crude oil is considered to be strategically important to the global economic system [1], to understand how the evolution of the real oil price is important to both traders and policy makers. In addition to the supply and demand, the price of oil is determined by many factors, such as the global economic outlook, economic policy and regulatory uncertainty in countries with high levels of oil consumption, political stability in oil exporting countries and their neighbours. Historically, the price of oil

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