Commodities Research: Crude Oil

OCBC Bank

The Winners in Asia

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Highlights

- The crude oil oversupply glut is still expected to rebalance into 2016, led by the fall in non-OPEC oil production, while oil demand is expected to pick up on better economic fundamentals.
- Still, the low oil prices have already benefited many oil importers across Asia. Through our investigation, we identify five key economies namely India, China, Japan, South Korea and Indonesia, which were undeniably beneficiaries from lower oil prices.
- On the other hand, oil producers especially in the US, Middle East and Russia had been adversely affected by lower oil prices.

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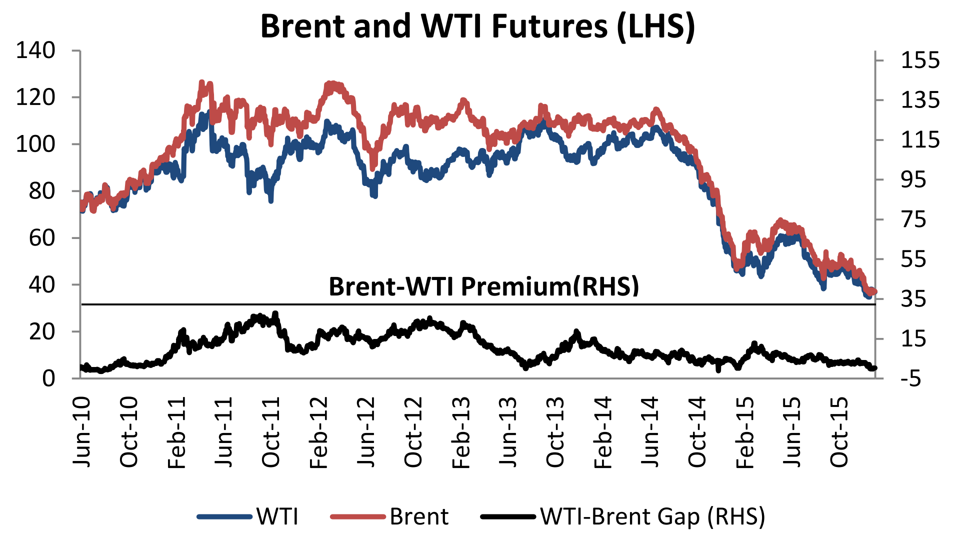
Whither the oil prices?

It may be said that the implications of low oil prices to the global economy is as hazy as one of which how oil prices may trend in the coming year. Since June 2014, oil prices have lost roughly 70% of its initial levels. Still, the future direction of oil prices is arguably uncertain, given the oversupply climate and questionable crude oil demand into the year. Elsewhere, the view is heavily obscured with geopolitical tensions looming at the horizon, now with Libyan's oil assets increasingly threatened by the Islamic State amid political friction between Saudi Arabia and Iran.



Source: Bloomberg, OCBC Bank

On this, we note that the risk of lower oil prices, even at where oil prices are printing, remains tangible at least in the first half of 2016 – the US has lifted its 40-year crude oil export ban, signifying their intention to play a greater role in contributing (and determining) to global crude supply. Elsewhere, Iran has repeatedly announced its intention to lift production by as much as 1 million barrels per day (mbpd) this year, in the aim to recover lost market share. Collectively, the Organization of the Petroleum Exporting Countries (OPEC) has refused to pinpoint a production quota in its last 168th

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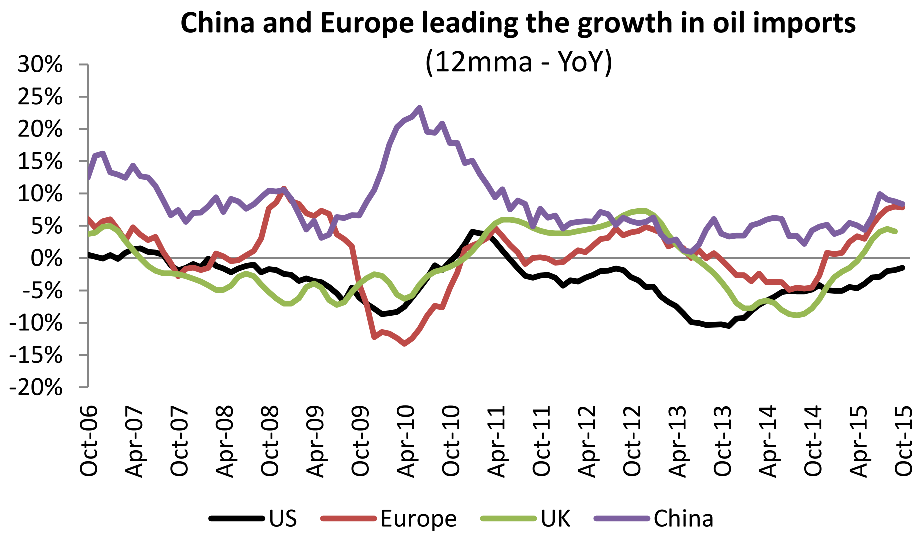
OPEC meeting, exacerbating market-watchers' concerns for a prolonged supply glut.

Still, the saving grace for oil bulls would be the demand side of the equation. Crude oil is by far, still widely considered as a growth-related commodity, and does offer an argument for oil to inch higher should global economic winds blow favorably. Even as the year 2015 presented us with a mix-bag of economic performance across Europe and Asia, we note that crude oil imports in these regions are encouragingly healthy. Elsewhere, we remain positive that the US economic growth would remain on an optimistic footing on the back of the recovery already seen in its labor, manufacturing and housing market.



Source: Bloomberg, OCBC Bank

For the year ahead, although there exists considerable uncertainty (and volatility) in the crude oil space, we remain firm on our expectation for crude oil supply glut to 'rebalance' itself on improving demand over the second half of this year.

We thought we were winners

This is where reality hits hard; a fall in crude oil prices this severe should have boosted global growth prints significantly. According to the IMF back in 2014, a 10% change in oil price is associated with a 0.2% change in global GDP. However, global growth in 2015 decelerated to an estimated print of 2.49% on-year basis, from 2014's print of 2.66%.[1]

The expectation for positive implications to the global economy is not unfounded: a lower oil price spells great savings for both producers and consumers alike. Elsewhere, lower oil prices would benefit many developing economies (especially those with energy subsidies) in lowering public deficit levels.

Last but not least, the savings by energy importers would severely outweigh those of energy exporters, given that energy exporters only make up only about 14% of the world GDP, whereas importers account for the rest of the 86%.[2] Needless to say, the complexity of the global economy, the unique structural make-up of individual economies, and the many woes surrounding last year had likely limited the potential gains from low oil prices.

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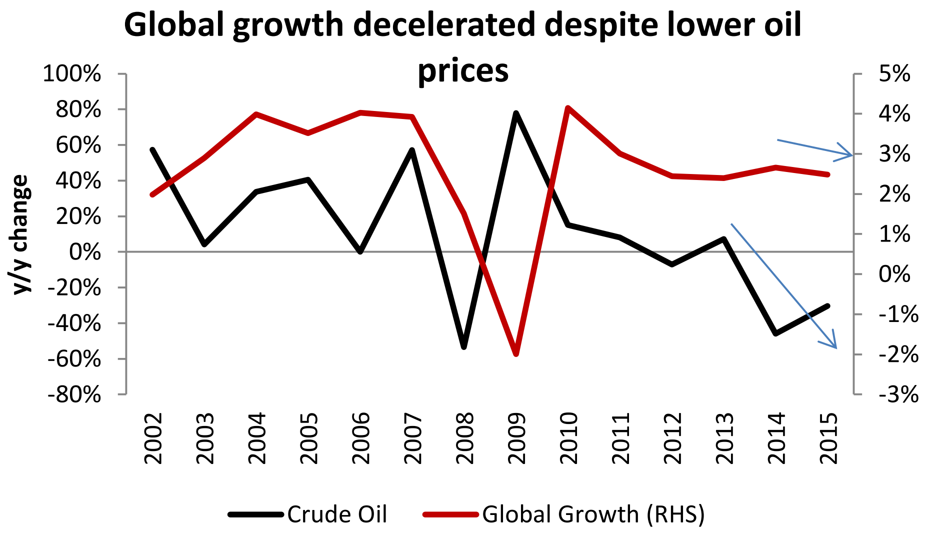
[1] The International Monetary Fund, World GDP Constant Prices

[2] CME Group, *The Geopolitical and Economic Consequences of Lower Oil Prices*, March 2015

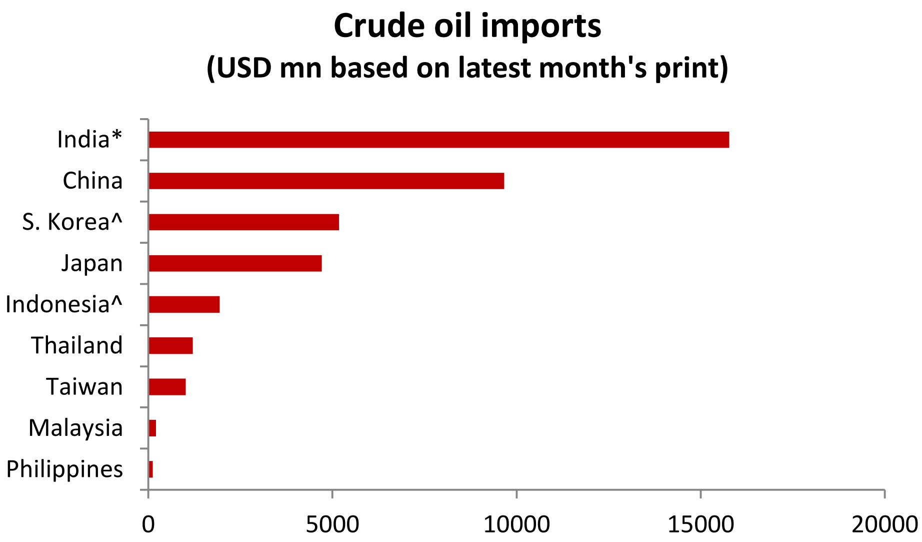


Source: IMF, Bloomberg, OCBC Bank

Despite the absence of higher global growth in the last year, there are still arguably unambiguous winners from the free-fall behavior in oil prices, and they will likely continue to be beneficiaries if oil prices stay weak in the year ahead. Holistically, the biggest beneficiaries are those countries with no significant oil resources, especially seen in Asia including India, South Korea, Japan and China, while lower oil prices in the indebted Eurozone countries especially Italy, Spain and Greece spells much required savings and overall improvement in macroeconomic stability. However in our discussion, we concentrate on five economies in Asia (ranked according to the extent of gains from low oil prices) that are clear winners from low oil prices.

Clear winners from low oil prices

Our five key beneficiaries in Asia enjoy one key trait – they are ranked in the top five economies that import the most crude oil.



Source: CEIC, OCBC Bank
* Data up to March 2014
^ Data includes imports of petroleum products

The top of our list is unambiguously, India. The home to the world's largest population of Hindus and a third to the world's population is a clear beneficiary of lower oil prices based on three-fold factors. Firstly, India imports 75% of its oil consumption, accounting for a third of its imports, while its exports are diverse amongst mostly non-oil related products, thus benefiting its current account standing. Secondly, unlike some of its Asian peers, lower oil prices brings relief to its relatively high inflation print of 7.4% in July 2014 to a more comfortable level of 5.4% seen in Nov 2015. On this, low inflation does allow greater room for the Reserve Bank of India (RBI) to inject accommodative measures to stimulate its domestic economy should the need arise. Lastly, cheaper oil would mean lower budget deficits for India given that the state engages significant subsidies ranging from food and energy.

Second on our list would be China, now being the largest net-importer of oil (and second largest absolute oil importer) in the world. Similar to India, China has already enjoyed huge gains in its current account, which rose from a tepid 1.17% of GDP to 2.58% in 3Q15. Elsewhere, the savings from government subsidies on energy prices would be substantial as well. The difference however compared to India, would be China's unique economic structure, limiting the positive spillover effects to overall growth. This includes China's purposed shift of economic growth reliance from its manufacturing sector to its services industry. The overall pessimism over the Chinese equity space is another factor to content with, especially with sell-off seen in the early days of 2016. Lastly, the falling property prices and oversupply of both residential and commercial space is still threatening to drag overall growth further.

The last three economies that had benefited from lower oil prices would then be Japan, South Korea, and Indonesia. Similar to India and China, they rely mostly on oil imports to meet their energy needs, which in turn spell improvements in their current account standing. Specific issues however, are present for each economy, firstly with Japan in-which lower oil prices threaten its battle against deflationary risk, an aim the Japanese policy-makers are trying to achieve ever since Mr Shinzo Abe came into power. On the other hand, South Korea, although relies on oil imports to meet a whopping 97% of its energy needs, has its policy-makers frowning with a warning that low oil prices would restrict the country's nominal economic growth on stagnating consumer prices.

Lastly, Indonesia has more worries than the rest of the group, given its sizable oil exports. Finance Minister Bambang Brodjonegoro had in fact warned that a price below $60 per barrel is detrimental to Indonesia as the loss in state revenue might exceed economic benefits. Still, we are comforted by Indonesia's net oil importer status, as well as stable economic growth seen in 9M15 on the back of accelerating manufacturing growth as a counterweight to the contraction seen in its mining and quarrying sector.

At this juncture, readers may observe the stark absence of any mentioning of the United States, given that it is a significant importer of crude oil as well. While that being true, the US oil industry has suffered immensely from low oil prices given its expensive shale oil sands (estimated at the cost of production of between $50 - $77 per barrel), rendering production unprofitable and stimulating further capital expenditure cuts (estimated of about 20% in 2016). Needless to say, the acute pains felt by the US will also be seen in major oil producing countries including those belonging to the OPEC cartel and Russia.

Back to global growth in 2016

With our discussion to pinpoint the winners and losers, it is vital to relook at our crystal ball to decipher how global growth may print. While the paradigm remains noticeably hazy, we are encouraged by IMF's estimate for global growth to accelerate to about 2.96% on-year basis from 2015's 2.49%.

Thus, with crude oil being a growth-related commodity, we remain firm on our expectation for the supply glut to rebalance itself. Our call then for oil prices, although stands about 45% higher from current levels at $50/bbl for both WTI and Brent at year-end, will then be a trend likely welcomed by many as we usher in the new year.