Falling Crude Oil Prices: The Impact on the Economy of the Asia-Pacific Region

By Nam Foo*

Introduction

The global energy market is an important primary driver of economic activity to sustain a nation's economic growth. Volatility in the global energy market such as changing crude oil prices and availability of oil reserves continue to affect the economic growth prospects of particular nations.

There are several agencies from different sources, such as British Petroleum (BP), International Energy Agency (IEA) and the World Bank who share a common view that the global energy markets are under stressed. The reasons for the declining oil price are echoed in global economic conditions, such as a downward revision of energy demand forecasts following global economic stagnation, emerging differences in global economic performance, geopolitical uncertainty, and ongoing debates about the proper roles of government and markets.

Many factors have affected 2014's steep fall in crude oil prices. Among them are the increase in United States (U.S.) shale oil production, a slowdown in economic growth in China, the European Union (EU) reducing demand for oil, and concerns of political insecurity and uncertainty across the world. Among these factors, geopolitical risk has increasingly concerned most countries. The recent crisis in Ukraine and political collusion between Saudi Arabia and the United States are major contributors to the current uncertainty of the energy market.

The aim of this paper is to discuss some policy recommendations in the Asia-Pacific region. At present there is extremely high uncertainty in the business environment. One way to build business investors' confidence is through appropriate policy decisions. Successful and transparent governance is the key role to ensure economic stability and prosperity in this region.

A decline in crude oil prices can undermine the global economy in many ways. A tumbling in oil prices can undermine global investments, the oil and energy industry, and the economies of the oil-producing countries. Global investment, particularly in the oil and energy sector, has been hit hard by the extreme level of oil prices. The seven major internationally well-known oil companies – Royal Dutch Shell, BP, Exxon Mobil, Chevron, Total, ENI and Statoil have agreed that they need at least the crude oil price of US$125-US$135/barrel to be profitable (Salameh, 2015).

Lower crude oil prices are not all bad news. On the one hand, decreasing oil prices can drain hundreds of dollars from petroleum producers, exporters and oil companies. On the other hand, lower crude oil prices can benefit some economies. For instance, many European countries, the USA and Japan are helped as a result of lower crude oil prices by shifting hundreds of billions of dollars into stimulating their economies because household demand picks up. This paper discusses the costs and benefits of falling oil prices for the Asian-Pacific economies.

Falling Energy Prices and the Asia-Pacific Region

Countries in the Asia-Pacific region have grown phenomenally since World War II, despite the oil price shocks in the 1970s, a sluggish world economy in the early 1980s, a rising protectionism and currency appreciation in the late 1980s, and the Asian financial crisis in 1997.

The 2015 growth projection for this region is 6.2 percent, which is slightly softer than the actual growth as expected (ADB, 2014). However, the growth outlook in this area seems to remain steady and stable despite the significant decline in energy prices in 2014. The Asia Development Bank reports that a steep decline in crude oil prices can offer a golden opportunity for many beneficial reforms in the Asia-Pacific region. For example, lower oil prices can increase purchasing power, lower industries' production costs and lower inflation.

Falling crude oil prices certainly can benefit the nations' economies in many ways as mentioned above. To a certain degree, it can also cause significant tension and uncertainty for global economies, such as the political tension in Ukraine and Iraq. Unlike the situations encountered in the rest of the world, in the Asia-Pacific region, lower oil prices can have a broad impact on the economies, with opportunities arising to address many longstanding macroeconomic issues. Therefore, declining world crude oil prices is not necessarily bad news for oil exporters. The impact of the steep decline in oil prices seems to offer a win-win situation for both oil exporters and importers in this region. For instance, Indonesia, one the major oil importers has taken advantage and benefited by transforming their costly and expensive fuel

* Nam Foo is a Ph.D student at Curtin University, Perth, Western Australia. He may be reached at nam.foo@curtin.edu.au

subsidy program. Lower crude oil prices also offer advantages for major oil importers. By diverting substantial funds for much-needed infrastructure and other growth projects, these nations can avoid stoking inflation.

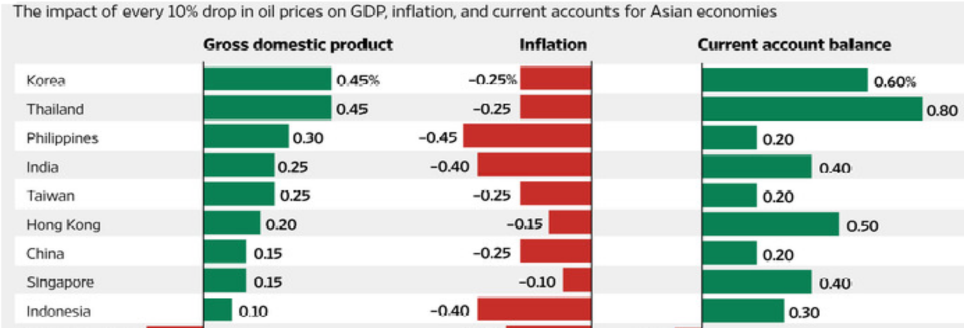

Figure 1: Asia's windfall from oil's collapse
Source: The Wall Street Journal, 2015

Figure 1 shows Asia's windfall as a result of the sharp dive in oil prices. Declines in the oil price should boost these countries' economy by half a percentage point. The figure shows that the slip in oil prices benefited Asian economies, particularly in countries with a lack of natural resources such as the four Asian Tigers: Hong Kong, Korea, Singapore and Taiwan. These Asian economies are net importers of oil and gas, so they have benefited as a result of falling oil prices.

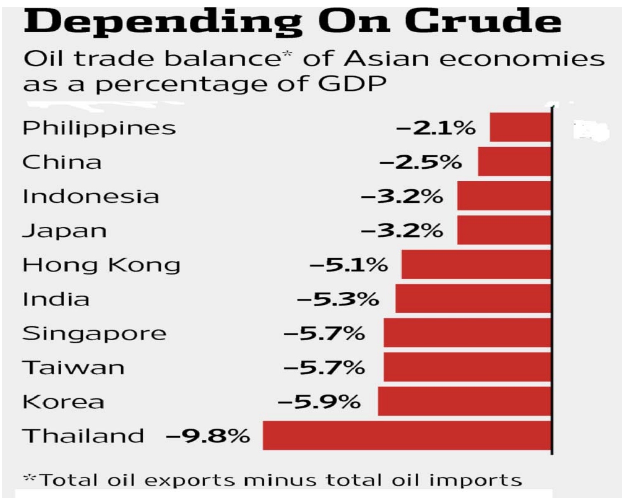

Figure 2: Major oil importers in Asian economies as a percentage of GDP
Source: The Wall Street Journal, 2015

Figure 2 shows the major net oil importers in Asian economies. These Asian economies depend on importing crude oil to sustain their nation's productivity. In Figure 2, Malaysia has been excluded. However, it is worth noting that Malaysia is *the* major net oil exporter among the ASEAN economies. So Malaysia is feeling the pain in the short-run, but if Malaysia's oil production continues to be suppressed in response to the depletion of its oil reserves, Malaysia will turn from net exporter to a net importer of crude oil. Thus, in many respects, this would be good news for the Malaysian economy.

There are opportunities for oil importers to leverage the short-term loss into long-term gain when the oil price falls. The major oil exporters, such as Malaysia, can seize the opportunity of low crude oil prices to focus on other industries, such as manufacturing and assist this through innovative research and development. Oil exporters can develop high-skilled manufacturing industries, such as aviation and aerospace, road haulage and shipping. By taking advantage of low commodity prices with their competitive real exchange rate, these countries tend to make these industries more competitive for global trading.

Manufacturing and services industries in the Asia-Pacific region, which have substantial energy costs are also beneficiaries from the sharp dive in crude oil prices. The transport sector, for instance, is a significant winner because petrol is one of its major input costs. Energy intensive heavy manufacturing industries such as cement, steel and metals refining requiring substantial energy power will also be beneficiaries. Low crude oil prices certainly provide a positive impact in many industries across the region by stimulating consumer spending as a result of lowering inflationary pressures and subsequently boosting economic growth.

Policy Challenges and Opportunities

Falling crude oil prices can impact decision making in monetary, fiscal and structural policies. However, the impetus to shift these policies depends on whether a country is an oil importer or exporter.

Because the crude oil price is expected to continue at a record low over the 2015-16 period, this can ease inflation pressures for central banks, at least in the short-run. For oil importers, in this situation, the low inflation rate could provide the central banks greater flexibility by loosening monetary policy or providing forward guidance. For oil exporters, monetary policymakers will have to balance the need to support growth in order to keep the inflation rate at the comfort zone and stabilise its currency at a level investors will feel confident.

From a fiscal policy perspective, fuel subsidisation is one of the standard schemes introduced in most of the developing Asia-Pacific countries, such as India, Indonesia, and Malaysia. In some cases, this fuel subsidisation comprises more than 5 percent of these countries' subsidies. However, this particular fuel subsidy benefits middle-income households disproportionately. In fact, with the record low oil prices, the government may impose a policy to encourage production that is more fossil fuel or energy intensive. Instead of offsetting the medium-term incentives for increased oil consumption, policymakers may redirect current energy tax policies especially in Asia-Pacific countries with low tax rates (Baffes, *et.al.,* 2015). In general, fuel subsidisation can generate inequality and inefficiency. As a result, many countries have undertaken a structural reform and decided to abolish this subsidy policy in 2013-14.

From a structural policy perspective, the fall in crude oil prices certainly strain the public finances for major oil exporting countries. Asia-Pacific countries that are heavily relying on crude oil as a major export must reshape their policy to redouble efforts to diversify their trade activities. Investing in innovative research and development, and so-called “elaborately transformed manufacturing” such as aircraft parts, medical instruments, and civil engineering and telecommunications equipment is the key to ensuring the long-term prosperity of the nation (Drum & Ghosh, 2015).

In the context of oil importers, lower oil prices can make substantial savings, which will help rebuild these countries’ fiscal position after the global financial turmoil. Therefore, governments in the Asia-Pacific countries can reorient their income distribution towards better-targeted programs to support poor households, rebuild major infrastructure, such as schools, hospitals and better road systems, as well as make human capital investment.

Conclusion

The decline in oil prices certainly has macroeconomic, financial and policy implications. However, falling oil prices present another window of opportunity for both oil importing and exporting countries in the Asia-Pacific region. A sharp decline in oil prices is a benefit to those Asia-Pacific countries without natural resources and relying on fuel imports to sustain their economic growth. By saving substantial money on fuel consumption, these countries can reallocate these funds to invest in the country’s major infrastructure. By contrast, for oil exporting countries experiencing significant revenue loss, the sharp dive in oil prices is not all bad news. These countries, at least can use this opportunity to readjust their policies by transforming the economy into other high-tech sectors, which can sustain their economic growth.

References

Asia Development Bank (ADB) 2015. Cheap Oil Can Benefit Asia - ADB Report [Online]. Manila ADB. Available: http://www.adb.org/news/cheap-oil-can-benefit-asia-adb-report [Accessed 6 April 2015].

Baffes, J., Ayhan Kose, M., Ohnsorge, F. & Stocker, M. 2015. The Great Plunge in Oil Prices: Causes, Consequences, and Policy Responses In: The World Bank. (ed.). Washington: Department of Economics.

Biswas, R. 2015. *Oil slump to fuel Asia-Pacific growth* [Online]. Hong Kong: China Daily Asia. Available: http://epaper.chinadailyasia.com/asia-weekly/article-3826.html [Accessed 8 April 2015].

Drum, M. & Ghosh, V. 2015. Innovation the key to post-boom prosperity. The West Australian, 7/04/2015.

International Energy Agency (IEA). 2014. The World Energy Outlook 2014. Paris.

Kumagai, S. 2015. *Asian economies benefit from falling crude oil prices* [Online]. Tokyo: Japan Research Institute. Available: http://ajw.asahi.com/article/views/opinion/AJ201503060049 [Accessed 8/04/2015 2015].

Olayele F.B. 2015. The Geopolitics of Oil and Gas. *Energy Forum*, 2nd Quarter, 25-27.

OPEC 2014. World Oil Outlook 2014. Vienna.

Salameh, M. G. 2015. What is Behind the Steep Decline in Crude Oil Prices: Glut or Geopolitics? *Energy Forum*, 2nd Quarter, 25-28.