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Falling Oil Price: An Opportunity for Asia?

By Lee Chia-Yi

Synopsis

In the past three months, the price of crude oil has fallen dramatically, from higher than US\$100 per barrel to below US\$60 per barrel. The plunge in oil prices has significant influence on our daily lives, but how will the low price affect Asian countries?

Commentary

THE MAJOR cause of the recent oil price fall is the increasing oil production in the United States as advanced technology enables US oil companies to extract previously untapped shale oil and gas. Although remaining a major oil importer, the US now produces more than half of the oil it consumes. One salient consequence which may have great geopolitical impact is that the US has overtaken Saudi Arabia as the world's largest oil producing country.

On the other hand, Saudi Arabia, the leading member of the Organisation of Petroleum Exporting Countries (OPEC) and the world's largest oil exporter, is unwilling to cut its oil production to reduce global oil supply. At a recent energy forum held in Abu Dhabi, Saudi Arabia's Oil Minister Ali al-Naimi restated Riyadh's policy of not cutting oil output, and blamed the non-cooperation of non-OPEC member oil producers for the drop of oil prices.

Will oil remain cheap?

The reason why the OPEC members refused to cut oil production is two-fold. First, they would like to see low prices drive American competitors out of the market. The cost of conventional oil extraction is much lower than the cost of extracting shale oil, which can be up to US\$90 per barrel. If the oil price remains lower than the cost, the American producers may not be able to afford it and will stop drilling shale oil.

Second, as Saudi Arabia claimed, cheap oil is good for the global economy, and reviving economic growth will increase the oil demand, which eventually will lead to higher prices. In the words of the Saudi oil minister Ali al-Naimi, "[c]urrent prices...stimulate global economic growth, leading ultimately to an increase in global demand and a slowdown in the growth of supplies".

OPEC's efforts to curb shale oil production through market forces, however, may not be successful. While the costs of producing shale oil and gas are high, most of them are sunk costs that were already made. So far, only two US shale companies have stopped drilling shale oil due to low prices, but other companies still continue their production. In the long term, there is little reason that the American oil companies will exit the global oil market.

The second wish that increasing global economic activity caused by cheap oil will heighten demand on oil is even harder to achieve in the short term. While emerging-market countries can take advantage of low oil prices and accelerate economic development and growth, the increasing demand for oil will be offset by growing oil production. So, does this mean that an era of low oil prices is coming?

The answer is yes, at least for the short term. As Saudi Arabia reiterated its reluctance to cut oil supply, we do not see any indication that the oil price will return to its peak. The US Energy Information Administration predicts that oil will remain cheap in 2015, with the monthly average price around US\$63-US\$73 per barrel. But how long the low price will last is hard to predict, because there are other factors that may affect the global oil market including conflicts in Middle East and these are still unclear.

Low oil prices good for Asia?

Low oil prices seem to benefit most countries, even including oil producers. As long as the price does not fall below the level that OPEC members can withstand, they still profit. For other countries, low energy costs should be beneficial to consumers and to most of the industries, especially the transport and refining industries. After all, research has shown that what is harmful is not oil prices per se, but the instability of oil prices.

Asian countries are mostly oil importers, so the Asian economy should take this advantage and benefit from low oil prices. China, for example, should be one of the winners. China's growing reliance on imported energy is a big concern to the economy and to the national security. As the US domestic supply of oil has been increasing, China is now the world's largest net oil importer. Its demand on energy, despite the slowdown, is expected to continue escalating.

While the oil demand from China will be an important determinant of future oil prices, the current low price is a good opportunity for China to develop the economy, to lower inflation, and to increase strategic oil reserves, which China actually has started to do.

Low oil prices also help Asian governments lower their spending and reallocate the money. Malaysia and Indonesia are oil exporters and potentially can be harmed by the fall of oil prices. But both countries cut their oil subsidies that have long been a major financial burden on the governments. As Indonesian President Joko Widodo pointed out at the recent APEC Summit in Beijing, the money saved from the oil subsidy cut will be channelled to more productive sectors, including infrastructure. This is the correct direction governments should pursue when the oil price is low.

So, it may not be clear for how long we can enjoy the cheap oil, but it will be hard to see US\$100 per barrel again in the near future. Low oil prices should not just benefit individual car owners. They should provide a good opportunity for governments to carry out policy adjustments or reform.

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