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China's Economic Slowdown and the Challenges for its State-run Oil Companies

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From March 22 to 25, I attended an international conference in Hong Kong and exchanged views with local experts on a wide range of topics involving international energy and Asian economic situations, including recent crude oil price drops and geopolitical issues in the Middle East and Russia. The most impressive issue for me in the discussion with them was a growing concern about the future course of the Chinese economy.

At its annual session from March 5 to 15, the National People's Congress, or the Chinese parliament, adopted the government's basic policy for 2015 which sets the economic growth target at around 7.0% for the year. The target was thus lowered by 0.5 percentage points from the previous year. China had recorded double-digit economic growth before the 2008 Lehman Shock and its growth gradually decelerated to 7.4% in 2014, below the government's target of 7.5%. Though being above 7%, the growth was the lowest in 24 years. It slipped below a government target for the first time in 16 years. The Chinese government has positioned the even lower growth of 7.0% as representing the so-called “New Normal” and given priority to the quality and efficiency of economic growth.

Nevertheless, the Chinese economy's growth deceleration has a significant impact on the world economy as it has served as the driver of global economic growth since 2000. Behind the loosening international oil supply-demand balance represented by the recent crude oil price plunge and a general slump in international commodity markets is slack demand in China after its sharp expansion in the 2000s. The slackness has become a key factor to shake the global energy situation.

Interestingly, the discussion with experts in Hong Kong led me to find that many of them are concerned about the Chinese economy's further deceleration. They voiced concern about China's failure to accomplish the 2015 growth target. Matters of concern to market players there include delays in economic restructuring and reform, real estate price falls, nonperforming loans and general oversupply. Even if the 7% growth target is achieved, they may feel that economic sentiment may be less robust than indicated by such growth rate. Given railway transportation and electricity

consumption data that better reflect real economic fundamentals, many experts felt that recent growth may be limited to 3-4%.

At the PNC session, the government, while giving priority to the quality of economic growth, indicated that the 7% growth target should be achieved to stabilize society through employment security and that it would take flexible monetary and fiscal policies to attain the target. Given that the massive economic stimuli worth as much as 4 trillion yuan after the Lehman Shock have caused the current overcapacity and real estate bubbles, many Hong Kong experts pointed out that it would not be easy for the Chinese government to expand fiscal spending to boost the economy again.

When the present Chinese leadership was inaugurated, it vowed to promote structural economic reform to achieve sustainable economic growth, trumpeting the so-called “Likonomics” policy named after Premier Li Keqiang. But many Hong Kong experts noted that the Chinese government might have become less serious about economic reform as greater priority has been given to the maintenance of the growth target and employment security. They admitted various ongoing reform efforts while doubting their quality and effects. It was interesting that some experts indicated that the Chinese government might give priority to economic management through economic and investment operations of leading state-run companies.

In this respect, Hong Kong experts made various arguments about the roles and challenges for Chinese state-run oil companies. The 2014 Fortune Top 10 Companies (in turnover) included Chinese state-run oil companies CNPC (ranked fourth) and SINOPEC (third), which are among the biggest, strongest companies in China. Naturally, they are expected to make great contributions to Chinese economic growth. But Hong Kong experts noted that the crude oil price plunge and the loosening oil supply-demand balance have exerted grave pressure on these Chinese state-run oil companies.

As upstream revenues are important for Chinese state-run oil companies as well as oil multinationals, crude oil price drops have become a great burden on them. Hong Kong experts also indicated that crude oil price falls might have caused great challenges for the maintenance of production at major Chinese oilfields (including Daqing) that are maturing and aging. They also noted that if the Chinese government’s natural gas market reform were designed to lower gas prices in line with international market trends, it would also greatly affect Chinese state-run oil companies. Some were concerned that these Chinese companies that fail to promote streamlining and cost-cutting efforts while being expected to make some contributions to economic growth could become less competitive than foreign oil firms that are substantially reducing costs. The discussion with Hong Kong experts provided an opportunity for me to feel that Chinese state-run oil companies

face various challenges.

China must maintain economic growth while giving priority to the quality and efficiency of growth. Whether or not the economic growth target of 7% can be achieved in 2015 is a great challenge for the Chinese government and will become a key factor that could greatly influence the world economy and the international oil situation. We may have to closely watch what measures the Chinese government will take to achieve the growth target and what role Chinese state-run oil companies will play in this respect.

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