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China's "New Normal" and Its Energy Demand

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As a matter of course, the biggest topic regarding the international energy situation since late last year is a plunge in crude oil prices. In this context, discussions have focused on eye-catching supply-side issues such as the impact and future outlook of sharp U.S. shale oil production growth and Saudi Arabia's oil price strategy. In fact, these issues are undoubtedly very important as factors that have caused the oil price plunge and would influence future oil price trends.

But there is an issue that is not a major matter of interest at present for ordinary people other than experts but that deserves close attention. The issue is the demand trend, particularly in China and other emerging countries. The global oil demand increase in 2014 was limited to 640,000 barrels per day, the slowest since 2010. The slow oil demand growth was combined with a substantial increase in non-OPEC oil output including U.S. shale oil, as well as Saudi Arabia's price strategy to cause the easing supply-demand relationship and the oil price plunge. If the oil demand growth was substantial enough, it should have absorbed the supply growth to prevent the supply-demand relationship from easing so much.

Of the weak oil demand increase in 2014, Asian developing countries accounted for 560,000 bpd or 90%, including 280,000 bpd in China. It was remarkable that the weak growth was driven by China and other Asian emerging countries. Recently, China's second- and third-phase oil reserve expansion has been attracting attention. Since last December, China has reportedly enhanced efforts to take advantage of the cheap crude oil prices for purchasing crude oil for reserves.

It is extremely difficult to grasp the additional demand for crude oil for reserves or inventories including national reserves in the absence of any relevant statistics. But the additional demand is estimated at a substantial level, preventing crude oil prices from plunging further since the second half of January. Under the recent crude oil futures price structure including higher prices for forward-month contracts (so called “contango”), market players purchase crude oil at cheap prices to earn profit margins even at the cost of inventory fees. Such investment tactic has also produced additional oil demand, supporting crude oil prices. In this sense, special demand factors emerging from low prices have exerted some impact on the market.

At the same time, however, few people feel any real oil demand recovery even despite the low crude oil prices. One reason for this is that petroleum product prices have failed to fall with the crude oil price plunge, prompting governments to cut oil subsidies to ease their financial burdens in many developing countries that have driven overall oil demand growth. The dollar’s appreciation against other currencies leads to a situation in which the fall in dollar-denominated crude oil prices does not necessarily bring about drops in petroleum product prices denominated in other currencies. This means that the oil price plunge can fall short of stimulating real demand in some cases.

But more important is economic growth deceleration as a fundamental factor behind the oil price plunge. In this sense, China attracts attention again. When crude oil price hikes gained momentum in the early 2000s, China’s explosive oil demand accompanying its sustained double-digit economic growth was viewed as a key factor behind the hikes. The assumption that China’s giant oil demand would continue rapid growth led to market sentiment anticipating long-term resources price hikes. The sentiment grew dominant. China’s rapid economic growth actually continued later, endorsing the market sentiment. But the Chinese economy’s recent slowdown has caused a global resources demand decline and lower resources prices. In a sense, oil prices remained high far longer than other resources and commodities.

But the Chinese economy has now entered a phase called “new normal.” China could have failed to achieve the government’s economic growth target of 7.5% for 2014. As a matter of course, the growth above 7% is still high. But some Chinese economy watchers noted that real economic activities could be slacker as indicated by railway transportation and electricity generation that reflects economic realities. The “new normal” features moderate growth and greater efficiency instead of high growth and massive consumption. In this sense, China’s real energy consumption could have been more decent than indicated by economic growth, even if the economic growth target was achieved. If the target failed to be achieved with downside risks emerging, resources and energy demand could be even lower. In this sense, we should pay attention to the future oil and energy demand in China and other emerging countries. The world economy has grown more uncertain due to the resurging Greek debt crisis and economic deterioration in Russia and other oil producing countries amid the oil price plunge. We must take note of various demand-side problems as well as the abovementioned supply-side problems and geopolitical risks involving the Middle East and other regions.

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