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News

Changing China's Oil

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05 Apr 2023

One area of the macro landscape that received intense attention in 2022, but less so in the last few months, is the oil price. From the Covid-driven lows of April 2020, the oil price climbed steadily until the Russian invasion of Ukraine in February 2022, but since June 2022, the benchmark Brent Crude oil price has declined from US$125/barrel to US$77/barrel.

Yet, there appear to be some major changes in the supply/demand balance underway. China’s reopening is driving a recovery in oil consumption, with road transport and aviation contributing significantly to the increase. Leading energy research firm Wood Mackenzie has said this month that China’s reopening will be the single biggest driver of recovering oil demand this year, with 40% of the global demand change coming from China.

Other agencies agree with this perspective. The International Energy Agency (IEA) increased its forecast for global oil demand growth for 2023 to 2 million barrels per day (mbpd), largely on ‘resurgent’ Chinese demand. OPEC forecasts China's oil consumption to rise 600 thousand barrels per day (kbpd) in the first half of 2023 as ground and air travel see strong recoveries as lockdowns end, while the IEA expects China’s oil consumption to be 700kbpd higher for full-year 2023.
At a more immediate level, one of the features of the seaborne fuel transportation sector in February and March 2023 has been huge demand for the largest crude oil tankers for shipments of oil from the US to China. Costs of hiring these vessels have doubled, with reports that 41 tanker bookings occurred during the first ten days of March, compared with 62 for all of February.

How this plays out will be enormously important for the global oil market as well as for incomes in oil producing nations and inflation prospects in oil importing nations. Like many countries, Chinese oil demand has largely been correlated with GDP growth, but the nature of that relationship is changing. From 1980-2004, Chinese oil consumption grew at three times the rate of its USD-denominated GDP growth; from 2004-2016, consumption grew at about 55% of the rate of USD-denominated GDP growth; and since 2016, consumption has grown at 48% of the rate of USD-denominated growth.

In February 2023, Chinese oil imports (using customs data and including imports of refined products) were 10.8mbpd, a level first reached in November 2019. Even with 48% relative growth, the IMF’s forecast for 2027 Chinese USD-denominated GDP to be 49% higher than in 2021 implies 23% growth in Chinese oil consumption, or an extra 3.7mbpd. With Chinese domestic production essentially flat since 2009, that marginal demand will likely need to be met by imports.

In that light, the OPEC decision in October 2022 to reduce their oil production by 2mbpd until the end of 2023, alongside Russia's 0.5mbpd cut in production in retaliation to Western sanctions, suggests that oil prices may experience upward pressure as 2023 progresses.

Two other factors are going to prove critical. The first is the changing relationship in China between growth and oil consumption. An ongoing shift in the drivers of economic growth drivers away from manufacturing, construction, and infrastructure and towards services may see the relationship shift yet lower. Further, China has been aggressively investing in renewable energy sources, including wind and solar (the portfolio has exposure to the Chinese solar power industry), as well as electric vehicles and power storage solutions, which are also likely to reduce demand growth.

The second, which goes the other way, is that the next few years are likely to see an ongoing recovery in India and Indonesia, and eventual recoveries in other sizeable emerging Asian economies. In 2021, the breakdown of emerging Asian oil consumption was 52% in China, 13% in Taiwan and Korea and 35% in the rest. Recoveries in India, Indonesia, Malaysia, Philippines, and Thailand can be significant marginal sources of demand, particularly if tourism and air travel recover with borders reopening.

An economic recovery in China is of global significance, but we feel that the relative lack of focus on the oil market may overlook the challenge it represents for oil importing nations and the opportunity for oil producing countries, including Brazil, Mexico, Indonesia and UAE, all of which we are overweight in the portfolio.

Sources

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