China's slowing economy hangs over oil market

Stimulus measures may yet help the country meet its high growth targets. In the meantime, the data remain distinctly bearish, writes Damon Evans

CHINA'S implied oil demand hit a near two-year low in August, raising worries of a sharp slowdown in the world's second-largest economy.

China, the world's biggest source of oil-demand growth, consumed about 8.92 million barrels per day (b/d) of oil in August. The figure marked its lowest rate since October 2010 and was 0.8% down on the same month last year as industrial activity ebbed. The numbers were 3.7%, or 340,000 b/d, below the July rates and extended a weak trend that began in April, when demand fell for the first time in over three years.

In the same month crude imports fell 12.5% from a year ago to their lowest daily rate in 22 months as refiners cut requirements. Imports were down 15.7%, at 4.33 million b/d, in August from 5.14 million b/d in July, leaving the year-to-date gain at 7.4%.

At first glance the data sound bearish for China's economic health, but a combination of factors was behind the decline, and not all of them will persist.

The dip came after a strong first half in 2012, when China added to strategic and commercial storage amid concerns about possible market disruption from the loss of Iranian supplies due to Western sanctions against Tehran's nuclear programme.

Whether China will continue to build its stockpiles at the same unprecedented rate during the first half, when it imported over 600,000 b/d more than it refined, remains to be seen.

It is estimated that 112 million barrels went into strategic and commercial storage in the first half, 53% more than the International Energy Agency (IEA) forecast the country would stockpile for the whole of 2012.

But judging from the latest data, it appears that the impetus to stash away barrels has slowed down as crude prices climbed and Iranian jitters melted away.

This year the IEA has repeatedly revised down its growth forecast for Chinese demand as economic expansion slowed more than expected. The latest revision in its August report predicted demand growth of 2.6%, or 240,000 b/d, to 9.5 million b/d for 2012, sharply lower than its previous estimated growth rate of 363,000 b/d. The IEA numbers suggest China will make up less than a third of incremental global demand this year. That compares with a share of 45% estimated in the IEA's July report.

The agency is "cautiously optimistic" that demand will pick up and bases its latest assumption on GDP growth of 8% for the year. It is betting that Beijing will step up measures to bolster the economy and restrain the worst of any downside momentum.

But the odds are stacked against the IEA's view. It is likely the stimulus measures will be more modest and take longer to work this time, especially if the external environment remains difficult.

Fears of a slowdown in economic growth are palpable given that virtually all indicators of economic activity are pointing down.

A welter of data released by China's National Bureau of Statistics in early September showed the extent of the problems.

Slowdown

Growth in GDP, industrial production and retail sales have all slowed markedly. Alternative indicators like electricity consumption suggest an even sharper slowdown. Foreign trade has not helped, with export and import growth contracting sharply as well.

With fear in the air, foreign capital is no longer pouring into China and some domestic investors are even taking capital out.

Inflation has eased 2% and some of the froth has come off the property market, but these are seen by many as signs of deeper malaise rather than positive developments.

It is possible that China's crude consumption will rise over the rest of the year, especially if efforts to stimulate growth work.

But the outlook for crude imports may be different, with fewer barrels going into storage but more consumption. A subdued third quarter could be followed by a strong fourth quarter if the economy regains momentum. That is a big if, because the Chinese economy has lost steam faster than the authorities would have expected, or wanted.

The government has moved to counter the slowdown by approving more infrastructure investment and trying to get banks to free up more lending.

The measures have come in dribs and drabs, however, and judging from the weak data, they have so far failed to provide the punch needed for a marked increase.

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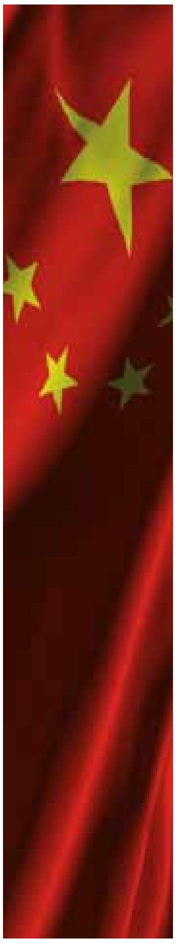

For all the angst about China's growth though, Beijing does have room to stimulate the economy through fiscal and monetary policies. And with a leadership transition looming, the Chinese government appears to be holding some of its fire to be able to respond strongly to external shocks.

Official policy is expected to become more proactive and further support will likely be rolled out this month.

Although many economists say such measures will bolster economic growth later this year, many have cut their forecasts for China.

In September investment bank UBS lowered its outlook for 2012 to 7.5% from a previous projection of 8%.

UBS economist Tao Wang lowered her forecasts for the third quarter to 7.3% and for the fourth quarter to 7% – both figures below the government's target of 7.5% for this year.

Eswar Prasad, a former head of the China Division of the IMF says attaining this year's GDP growth target of 7.5% is likely to be difficult but not insurmountable. And China's Prime Minister Wen Jiabao reminded the world that his nation has the wherewithal to spend its way back to rapid growth.

For now it is a question of timing. Some stimulation is already happening. But there are good reasons to hold back. The biggest restraint, however, is that it is not yet clear things are bad enough. ●