



# PBEC Intelligence Report

A SERVICE OF THE PACIFIC BASIN ECONOMIC COUNCIL

THE INDEPENDENT VOICE OF BUSINESS IN THE PACIFIC

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*(This report is intended only for use by PBEC members and compiled from sources including Asia Intelligence Ltd. and others secured and edited by PBEC Vice President Steve Olson.)*

## ANOTHER OIL SHOCK IN ASIA?

### ISSUE

With war in the Middle East looming, Asia is becoming increasingly concerned about disruption to oil supplies.

### ANALYSIS

Asia has had a bad experience with three previous oil shocks (in late 1973 following the Yom Kippur War, in mid-1979 after the toppling of the Shah of Iran, and in late 1990 following Iraq's invasion of Kuwait), and so its concerns are understandable.

The region has a daily requirement of 21m barrels of crude, and 60% of this is imported from outside Asia, with 10m barrels a day coming from the Middle East - and recently saw South Korea, China, the Philippines, and Thailand all announcing emergency measures, while India and Bangladesh have been steadily increasing their inventories.

The following are the measures announced during January by Asian governments:

- China said on 29 January that it would start this year to build a reserve of 150m barrels of crude.
- The Philippines said on 29 January that refiners must hold a minimum 30-day inventory of crude and oil products by February. Bulk oil suppliers must hold a minimum 15-day inventory, and all relevant parties must have a minimum seven days of supply of liquefied petroleum gas.
- South Korea, which with Japan is one of only two Asian countries to have state emergency reserves exceeding the 90 day minimum standard set by the International Energy Agency, said on 28 January that it would begin to partially release oil stocks if Dubai crude hits \$33 a barrel. It said it would cut import tariffs and local taxes on oil products and limit some business energy use if Dubai crude went into the range \$29-\$33. If Dubai crude rose above \$35, it said it would release more reserve oil, increase tax cuts, put a ceiling

on the price of local oil products, subsidise refiners' oil imports, and cut oil products exports.

- Thailand said on 28 January that it had drawn up a contingency plan to stop oil products exports and for special crude imports from Malaysia, Indonesia, and Brunei. It has had strategic oil stocks amounting to 50 days of consumption since the 11 September 2001 attacks on the United States.
- India said on 7 January that state refiners had increased their oil products inventories to meet demand for 35-40 days and that it had enough crude oil to keep refineries running for a month.

All these measures suggest a reasonably high degree of concern about - and preparedness for - a possible fourth oil shock.

But as usual when the potential for any oil crisis is discussed, there is a wide range of views on the likely impact. At one end of the spectrum, for instance, a recent Goldman Sachs report - "More Perfect Storm than Desert Storm" - argued that war with Iraq could drive prices up to as much as \$46 a barrel.

The report argues that low global oil stocks and reduced exports from Venezuela have pushed prices up by more than 30% since late November, and it argues that if the strike continues for two months and the Iraq war lasts a similar time, the cumulative amount of oil removed from the market would be 600m barrels, more than the 400m barrels removed from the market during the 1973 Arab-Israeli war.

On the other hand, some energy experts are saying that if the war is over quickly without any major damage to oil-production facilities in the Gulf, and if Iraq returns as a major oil exporter unhampered by sanctions, then oil prices could be down below \$15 in 3-4 years.

### CONCLUSION

Our intelligence examined the likely impact of a fourth oil shock on Asia last May, and for a variety of reasons (including less dependence on the Middle East than previously, low levels of inflation, a weak dollar, and the stage of the economic cycle) they believe that the impact of a fourth oil shock on Asia would not be as great as previously.



# PBEC Intelligence Report

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## OUTLOOK FOR ECONOMIC POWERS AS WAR IN IRAQ COMMENCES

### ISSUE

The latest economic numbers and forecasts for the two biggest economies in the region show strength and moves to spur recovery. Will war slow the momentum of China and Japan?

### ANALYSIS

#### CHINA

A series of good data from China last week indicated that its economy is relatively immune to the downturn currently affecting the rest of Asia. Retail sales rose 9.3% year-on-year in the first two months of 2003, according to figures released on March 14, while foreign direct investment rose 53.6% in the same period from a year ago. Actual FDI rose to \$7.54bn in January and February, while contracted FDI rose 59.1% to \$14.22bn. Actual FDI rose 12.5% in 2002 to \$52.7bn.

Data released last week also showed China's imports rising 49.4% year-on-year to \$23.8bn (principally due to higher oil prices) while exports rose 27.8% to \$24.5bn - leaving a trade surplus of \$1.25bn, reversing the January deficit, which was the first in six years.

Perhaps the most encouraging indicator was China's industrial output, which grew 17.5% over January and February year-on-year and 19.8% in February alone - the fastest rate of growth in nearly eight years. The huge rise in output was mainly due to increased domestic demand for electronics and cars: vehicle output rose 62% in the first two months of 2003 from last year to 627,000 vehicles, of which 242,000 were cars - a rise of 140%. Cell phone output rose 86% in the first two months of the year, while computer production was up 92%.

Spurred by robust domestic demand, consumer prices (as measured by the CPI) continued to rise in February, up 0.2% on the year after 0.4% growth in January (when prices broke a 15-month deflationary trend).

#### JAPAN

Japan's government reacted last Thursday to slumping stock prices (at 20-year lows), and to fears that there will be a

financial crisis at the end of the fiscal year on 31 March, by announcing steps to promote market stability. These included an easing of rules allowing firms to buy back their own shares, a tightening of rules on short-selling, and closer market surveillance. But the moves did not have any appreciable effect on Japan's markets, and they were criticized as being short-sighted.

In fact, news on Friday that Sanyo Electric Co would post its biggest ever loss this year (of Y70bn, or \$590m) due to a Y75.5bn drop in the value of its stockholdings illustrated the continuing severity of the problem, especially since Sanyo had earlier forecast it would make a profit.

One particular government suggestion to forestall instability in the banking sector, by postponing for two years the imposition of a limit on the amount of shares banks are allowed to hold on their books, prompted the ratings agency Standard & Poor's to warn such a move could force a downgrade in their ratings.

Japan's banks held shares worth Y25tr (\$210bn) at the end of the last financial year, and they are struggling to eradicate bad loans worth Y50tr and raise funds to boost their capital - so a ratings downgrade could be disastrous. Their situation was not helped by the fact that in February (according to the research firm Teikoku Databank) debts held by firms made bankrupt reached a post-war record for that month of Y1.53tr (\$12.9bn).

Japan's net exports, one of the few bright spots in its economy last year, will be less important as a driver of GDP growth in 2003, principally because worsening political conditions will lessen demand from Japan's key markets. Imports have also grown in value - principally due to higher oil prices from the tension in the Middle East - and a rise in the yen is making Japan's exports more expensive.

Japan's trade surplus fell 22.1% in January to Y265.3bn (\$2.27bn), with exports growing 8.6% year-on-year but falling 3.2% from December. Imports rose 12.1% in January year-on-year. The overall current account showed a surplus of \$427.1bn (\$3.65bn) in January, down 37.6% from the same month in 2002.

### CONCLUSION

While most economic indicators continue to be positive for China and negative for Japan, the impact of the unfolding military conflict in Iraq on both these economies will be depend on a number of factors. We'll explore those factors in upcoming PBEC Intelligence Reports.