By Nareerat Wiriyapong

Oil re-emerges as a wild card in Asian economies

PHOTO: REUTERS

The Khurais megaproject is the largest of several being undertaken by Saudi Aramco to expand the production capacity of oil fields in Saudi Arabia, the world's biggest oil producer.

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• A sharp increase in oil prices, which are now trading at a two-year high above US$60 per barrel for Brent crude, could adversely affect Asian economic growth by stoking inflationary pressure as well as costs in a region where demand has not yet fully recovered.

Oil prices hit their highest since early July 2015 as a political upheaval in top crude exporter Saudi Arabia reverberated through a market where prices were already elevated by signs of tightening supply.

Investors have piled into oil as a shake-up of the ruling elite in the biggest producer of the Organization of Petroleum Exporting Countries (Opec) was seen to consolidate power with Crown Prince Mohammed bin Salman, who backs extending the group's output cuts aimed at clearing a global glut.

Oil has gained more than 20% since the beginning of September on signs that global supplies are tightening and the output deal may be extended past March next year.

Analysts warned that inflation might head up as a result of an oil price spike, but it would be "manageable".

"There's an indication that an oil price increase is brewing," said Frederic Neumann, co-head of Asian economic research with the Hong Kong and Shanghai Banking Corp.

As Brent crude holds above $60, its inflationary effect will remain manageable. "But if growth holds up, presumably, so will demand for the stuff. A further climb in oil to, say, $65-70 would push up price gauges across the region," Mr Neumann noted.

A number of governments in the region have cut back on fuel subsidies and price controls in recent years. This means that a rise in crude costs would punch through to headline inflation much more quickly than in the past.

Malaysia is a case in point. Here, the weight of oil-related products in the consumer price index (CPI) basket is already relatively high, and with the dismantling of subsidies, it's likely that inflation would track up further. The same is true, to differing extent, in India, Indonesia and the Philippines.

The other point relates to demand, said Mr Neumann. Changes in the price of oil are far more inflationary if demand is robust. Since growth should hold up reasonably well, higher crude costs could swiftly stoke second-round effects, even pushing up core readings. And that, surely, would change the narrative.

A separate research paper issued by HSBC late last month noted that governments in Indonesia and Malaysia had slashed spending on energy subsidies when oil prices were low. This explains the current overshoot of consumer prices in Malaysia while in Indonesia, prices do not adjust as frequently as global prices would suggest, hinting at lingering fiscal risks should oil prices rise above $60.

"This may jeopardise infrastructure spending in the future," said the report. "As such, a key reform is for Indonesia to follow through with previous subsidy pledges, and allow a more mechanical formula for pump-price adjustments. However, it may be difficult to fully achieve this during the upcoming election campaigns."

Meanwhile, higher oil prices could push up costs across the supply chain of Asian manufacturing. While most parts of the sector have enjoyed growth in demand for goods, especially from outside the region, producers have already felt the pinch of rising costs stemming from raw material shortages, weaker exchange rates and rising commodity prices.

Data compiled by IHS Markit showed that Myanmar experienced the sharpest rise in production costs among Asean members, followed by the Philippines and Vietnam.

Demand for goods in developed Asian economies, according to the UN Economic and Social Commission for Asia and the Pacific (Escap), has still not fully recovered. As well, economic restructuring in China will have important implications for the rest of the region.

As Beijing seeks to rebalance its economy by boosting domestic consumption rather than export orientation, it is likely that intraregional demand may not be sufficient to bring trade growth back to pre-crisis levels.