China's economic slowdown may hurt global oil market, says expert

August 26 2020, by Avery Ruxer Franklin

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A slowdown in China's demand for oil would profoundly affect the multitrillion-dollar global oil market along with many related industries, according to a new brief from Rice University's Baker Institute for

Public Policy.

"A sustained slowdown in China's oil demand growth is, from the risk perspective, a lurking crocodile," wrote Gabriel Collins, the Baker Botts Fellow in Energy and Environmental Regulatory Affairs at the Baker Institute.

"If the croc bursts onto the riverbank, it could set in motion a complex chain of events that would likely reset the global oil supply/demand picture, cost curve and investment thesis in ways deeply challenging to multiple oil exporters as well as U.S. unconventional liquids plays, even the Permian Basin," he writes.

This adjustment process could have systemic consequences across the oil and gas value chain. "The impacts would be especially pronounced in the Houston area and Texas overall if spending reductions and cost compression force additional layoffs, and squeeze the constellation of business that provide goods and support services to the (exploration and production) and oilfield services sectors," Collins says.

The economic slowdown stems from China's aging and debt-ridden population. One of Chinese President Xi Jinping's major policy priorities has been to dramatically increase domestic consumer consumption. At the same time, there's been a rapid expansion in household debt as a fast path to personal economic fulfillment. China's household ratio of debt-to-gross domestic product is "rapidly approaching that empirical danger threshold," Collins writes. With this magnitude of debt, consumers are less likely to spend their money and an aging population is also less likely to buy "gasoline-thirsty" vehicles, he argues.

History indicates demographic shifts of the scale and speed now underway in China can have momentous economic consequences,

according to Collins.

"As China's population of prime-age workers stagnates, wages generally must rise, and the osmotic pull that low-cost labor exerts on foreign capital thus wanes," he writes.

An older population requires higher wages, Collins says. So wage increases in Chinese manufacturing, along with greater geopolitical tensions, will probably prompt multinational companies to move more of their supply chains outside of China, he argues.

Moving manufacturing out of China and shortening supply lines may help U.S. consumers, Collins asserts. For instance, "goods produced in northern Mexico only require about half as much fuel per shipping container equivalent to reach Midwestern U.S. markets compared to goods sourced from coastal Chinese manufacturing zones," he wrote.

However, Collins warns that a sustained slowdown in China's economic growth would have long-term consequences for global oil markets.

"While a longer-term slowdown in China's economic growth likely empowers the U.S. in relative strategic terms, such a transition will cause—and perhaps already is causing—serious pain and dislocation in key U.S. oil and gas jurisdictions, Texas foremost among them," he wrote.

More information: Gabriel Collins, China's Debt Bubble and Demographic Stagnation Pose Major Risks to Global Oil Prices—and U.S. Shale Prospects. (2020). www.bakerinstitute.org/media/f … 20-ces-chinadebt.pdf