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Riding out the commodities storm

LESSENING VULNERABILITY: *Broader economic reforms necessary to deal with commodities boom-and-bust cycles*

THE era of oil shocks is far from over. In the past two years, oil prices have been in a free-fall, tumbling from US$100 (RM401.5) a barrel to around US$30. Frighteningly, nobody knows for sure where the bottom is. The International Energy Agency optimistically predicts a rebound to US$80 a barrel in 2020. Calculation by the Federal Reserve Bank at St Louis proposes oil prices could drop all the way to zero by mid2019.

This by no means suggests that oil will be offered for free. The conclusion is based on a model that combines inflation expectations with oil prices. What the study does point to is, the contradiction of economic data and the' roller-coaster nature of the oil market.

Low energy prices create winners and losers. Net importers, such as India, Pakistan and China, had enjoyed the sharpest gross domestic product (GDP) growth last year.

Since oil accounts for a third of India's imports, the current supply glut has enabled India to reduce its fiscal deficit to the targeted 3.9 per cent. Similarly with China; every US$1 drop in oil leads to a saving of US$2.1 billion annually.

Oil producers have certainly felt the adverse impacts. With 90 per cent of its income from oil, Saudi Arabia last year suffered a deficit of more than 20 per cent of GDP. In the, event of a prolonged period of low prices, the International Monetary Fund (IMF) predicts that Saudi Arabia could be bankrupt within five years.

Dwindling revenue led other oil ex-· porters such as Russia, Venezuela, and Nigeria to face recession and widespread retrenchment. If gripped by spiralling inflation, the political effect of social unrest or change of government may follow suit.

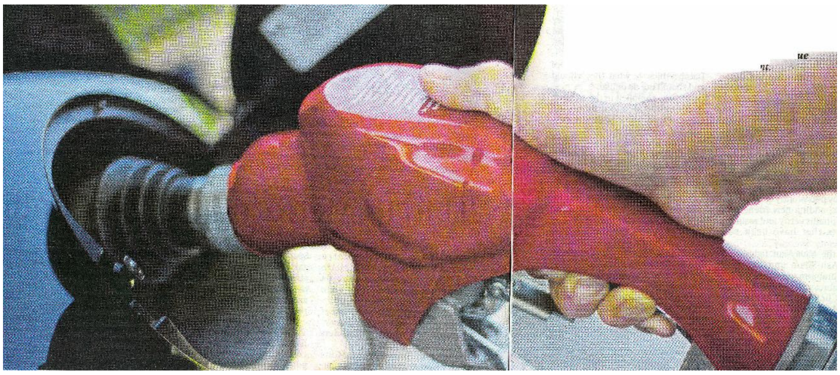
Even a small producer such as Malaysia is feeling the heat. In January, the Malaysian government had to recalibrate its 2016 Budget by slashing spending plans and lowering its growth forecast. Austerity measures are inevitable because every US$1 drop in oil prices is equivalent to RM3 million loss of revenue contribution from Petronas to the government.

Drill a little deeper, and things are more complicated. Crude oil is not the only commodity with plummeting prices. Minerals and other natural resources, too, have shown negative growth in recent years. Analysts have now cautioned that the world has approached the end of the third commodities super-cycle.

Commodity markets have had boom and bust cycles before. Prices of commodities first tended upward during the industrialisation of America in the late 19th and 20th centuries. The rebuilding of Europe and Japan following World War 2 led to the second commodities super cycle.

The upswing of the third super cycle kicked in following the Asian financial crisis of the late 1990s.

It was fuelled by the demand for raw materials to transform China into an urban industrial society whose economy then expanded at a double-digit pace. Indices of commodity prices tripled between 2000 and 2011, backed by a sharp increase in the production of most commodities.



The government has had to recalibrate its 2016 Budget by revising spending plans. Austerity measures are inevitable because every US$$1 drop in oil prices is equivalent to millions of ringgit loss of revenue contribution from Petronas to the government.

Sustained high prices have kept treasury coffers flush in countries exporting commodities. For a number of producers in Africa, the surge of easy money from natural resource wealth sadly led to crippling corruption, decimated governance and chronic underdevelopment.

Some visionary producers used the super-cycle to pursue broader economic reforms to place themselves on a sounder economic footing. Others opted to refill their sovereign-wealth funds or build stockpiles of foreign-exchange reserves.

Malaysia, too, as a producer of all kinds of hard and soft commodities - crude oil, natural gas, bauxite, timber, rubber, palm oil- has mostly benefited throughout the last super-cycle decade. In fact, our economy has been heavily reliant on commodities for more than a hundred years. That is, from rubber and tin as the main export earners in the 1900s, to petroleum and oil palm in recent decades.

For the most part following Independence, Malaysia has strategically treated primary commodities production as a means of supporting an emerging manufacturing sector in what was essentially an agrarian economy.

But the party is now over. There is wide acceptance that the third commodities super-cycle has run its course. By the end of 2014, IMF's commodities index fell by a third without signs of a revival since. Worse, the drop came amidst a slowing global economy.

Now that the good fortune is coming to the apparent end, how do we lessen our vulnerability to the boom-and-bust cycle of crude oil prices and those of other commodities?

Thankfully, we are not short of the right answers to this existential question. Instructions to embrace knowledge economy, diversify the sources of wealth, moving up the economic value chain are all available in numerous Malaysia Plans since the 1990s till the most recent one last year.

In remaking the future, success lies not only in crafting good policies but most importantly, in executing policies well.

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