

Malaysia in the era of low global oil prices

by

SAMIRUL ARIFF OTHMAN

Senior Research Officer

Malaysian Institute of Economic Research (MIER)¹

The fall in crude oil prices have greatly impacted the global economy and exchange rates of most nations. It has also adversely affected Malaysia's trade balance. Ironically, this global phenomenon tested the resilience of Malaysia's economic structure as it demonstrated Malaysia's ability to adjust to Global Oil's new normal of low prices. While at the same time exposing its weaknesses. Balance of trade and external reserves were the most vulnerable and susceptible to external vagaries. Why did this happen and subsequently what steps can be taken to mitigate the aftereffects and repercussions?

Oil and Natural gas are the precursors of petroleum-based products and petrochemicals. Even electricity is generated from fossil fuels. As an upstream product, petroleum has a high commercial value, this not surprisingly it is referred to as 'black gold' that flows.

Role of Oil & Gas in Economic Development

Oil & Gas plays a crucial role in the Malaysian economy as this commodity contributes to approximately 15% of export value and 30% to Federal Government's revenue. Broadly speaking, there are two main categories, which are refined petroleum (downstream) & crude petroleum (upstream). A quarter of Oil & Gas exported is in crude form, the remainder refined. Malaysia is net exporter of crude petroleum, however she is a net importer of petroleum products.

Emerging markets begin to experience a situation of both declining commodity prices & exchange rates, since August 2014. In the case of Malaysia it is important to understand the structure of the market and structure of production to clearly understand how crude oil prices impacts the national economy.

Global Political Economic perspective

Crude Oil is quoted in US Dollars as with other commodities, the implication being that some quarters allege that this benefits the United States, as its own currency (i.e., the US dollar) has become the de facto international reserve currency. One of the major obvious benefits is that

¹ The views and opinions expressed herein are those of the author and do not necessarily reflect the views of MIER.

the US would not face a balance of payments crisis, because it purchased imports in its own currency. This is referred to as “Exorbitant privilege”, the term was first coined in the 1960s by Valéry Giscard d'Estaing, then the French Minister of Finance who served under Charles de Gaulle.

A common question among those in geopolitics is when China's GDP overtakes that of the US, will the US Dollar share the fate of the sterling and Britain's historic economic dominance. There was a time when Britain was the world's largest economic power and her currency the global reserve currency. Some, however, do not think the dollar is about to be vanquished as sterling was, rather, a “multipolar” system of international currencies may emerge. This inspired Barry Eichengreen who teaches at the University of California to write the book “Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System” in 2011.

Impact of crude oil prices on Malaysian Economy

In the case of Malaysia and other emerging economies, Balance of Payment is affected. Falling global crude oil prices will impact our economy, for example we will have to produce more oil if we want to maintain the same output value. The magnitude of the impact on GDP is determined by the structure of the Economy. To be more specific, how is everything technically related to each other and how much value addition will be generated for each unit of output?

We have experienced a somewhat prolonged balance of trade surplus and this was a relief. However of late this surplus is declining and this declining trend will affect Balance of Payment. In addition, remittances of funds by Foreign Workers in Malaysia will also put heavy pressure on Balance of Payment. This is because though they number many, most of the Foreign Workers in Malaysia are actually not very skilled or productive.

Changes in oil prices will exogenously affect the US Dollar and subsequently exchange rates of all currencies including the Malaysian Ringgit. Our external reserves are managed by Bank Negara Malaysia. Because reserves are in dollar-denominated assets, it is subject to exchange rate volatility.

Fortunately, the Strategic reform initiatives (SRI) undertaken as part of the New Economic Model (NEM) have somewhat mitigated the severity. The current global environment exposes whatever weaknesses there are in our economic structure and makes it even more pressing for these weaknesses to be addressed and the production structure enhanced.

In the final analysis, borrowing from the British Arnold Toynbee's observation, the journey to transform our economy is a movement and not a condition, a voyage and not a harbor.

