FALLING PRICE

Oiling our economy

ON Jan 28, the government announced a recalibration to the 2016 Budget due to the drop in global oil price. This was to be expected, as oil price had dropped to US$30 (RM125), while the budget was made based on US$48 for this year.

The revised budget was made under the expectation that oil prices would be from US$30 to US$35.

As the crude oil and natural gas sector is the key driver for the economy, the drop in oil prices would have negative implications for the country, specifically in the government fiscal position, and on economic growth.

Specifically, there will be a reduction in government revenue, economic growth, and employment income and job creation.

How will this impact government revenue? The sector contributed 16.4 per cent, or RM26,956 million, of total tax revenues in 2014. For the average price of US$49.49 last year, the sector is estimated to contribute RM13,766 million to tax revenues.

Our analysis shows that for every US$1 drop in oil prices, the government will lose RM295 million. Thus, if the oil price is expected to average at US$30 this year, government revenue will further drop by RM5,816 million.

If the oil price is averagely at US$35, the government revenue will drop by only RM4,339 million.

How will this impact our economic growth? The sector generated 9.3 per cent of gross domestic product (GDP) in 2014.

In the 11th Malaysia Plan (2016 to 2020), the mining sector is expected to contribute 7.1 per cent to GDP in 2020, with about 90 per cent of the total value added for the mining sector coming from the crude oil and natural gas sector.

Given that the crude oil and natural gas sector is export-driven and, thus, the growth of the sector depends on the fluctuations in world commodity prices, results from our analysis show that value added last year is expected to be lower by RM14,809 million, which is equivalent to 1.4 per cent of GDP in 2014.

Thus, GDP for this year is expected to drop by 0.6 per cent and 0.4 per cent, if the oil prices average US$30 and US$35.

We expect employment income to reduce by RM987 million, which is equivalent to 0.26 per cent of total employment income in 2014.

This is not unexpected, as the number of people looking for jobs has been increasing at double digits since the end of last year.

For instance, the number of unemployed went up by 22 per cent in October last year compared with the previous year.

Given the weakness in the sector, we expect the number to climb further. The unemployment rate this year is expected to increase 0.2 per cent and 0.1 per cent for the average oil price at US$30 and US$35.

What are the policy options to reduce the impact of falling oil prices? These depend on whether the fluctuations in the world prices are temporary, or whether prices will stabilise at around US$50, or will recover in the next several months.

It is important to note that the economic consequences of falling oil prices are minimal if our economy is associated with a higher degree of economic diversification. More seriously, the depreciation of ringgit is correlated with falling oil prices.

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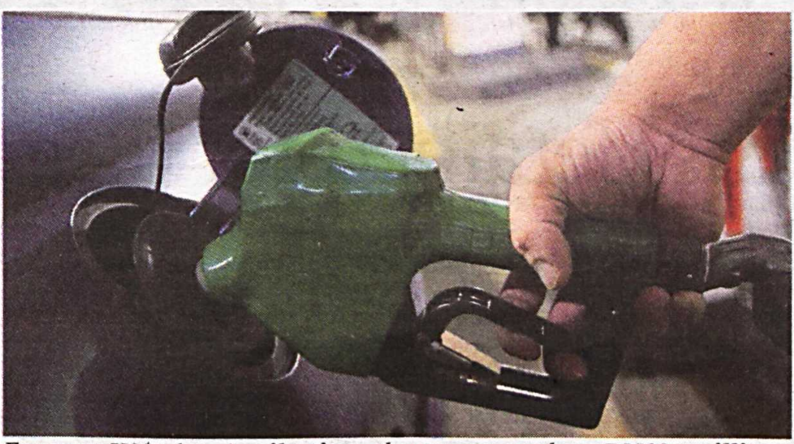

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