

For Information  
On 24 May 2004

**Legislative Council Panel on Economic Services  
ADJUSTMENTS IN OIL PRICES**

**Introduction**

At the request of Members, this paper outlines recent trend movements in oil prices and, the impact of high oil prices on the economy and the general public at large.

**Trend movements in oil prices**

2. In addition to local pump prices, we have been monitoring trend movements in prices for Brent Crude oil and Singapore FOB prices (the generally accepted regional benchmark for pricing in the Asia Pacific Region) for unleaded petrol and ULSD. Data on CIF import prices of unleaded petrol and ULSD compiled by C&SD have also been taken for reference, but there is a time lag of at least four weeks before such data are available. Annexures A and B set out the movements in these prices since March 2003 (when Members were last updated).

A & B

I. *International oil prices*

3. Apart from sporadic dips, international prices of Brent Crude, unleaded petrol and diesel have been very volatile and on the increase since March 2003. The increases are particularly prominent in recent months.

II. *Local pump prices*

4. Since March 2003 -

- (i) pump prices for unleaded petrol at local petrol filling stations (PFS) had been increased four times and lowered twice;
- (ii) pump prices for ULSD at local PFS had been increased three times and lowered twice; and
- (iii) in terms of trend movements and magnitude, changes in

local pump prices were broadly in line with and tailed behind movements of the monthly average Singapore FOB prices.

### **Impact on the local economy**

5. As the Hong Kong economy becomes more service-oriented, fuel cost for all sectors of the economy taken together now takes up less than 5% of the overall business operating cost (excluding labour cost). Hence, compared with industry-based economies, the direct curtailing effect of an oil price hike on overall demand of the economy through the cost push effect should be smaller. The indirect impact on the Hong Kong through our trade link with the rest of the world should also be small.

6. Government Economist's detailed assessment of the global economic impact of recent oil price hike is at Annex C.

C

### **Administration's view**

7. With no indigenous supply, Hong Kong has to rely on import for oil supply, prices of which are influenced by various external factors beyond the control of the local market and the Hong Kong Government. Locally, supply and demand have always been determined by market forces, and pump prices are determined by oil companies, having regard to international oil prices and their operating costs.

8. The role of the Government is to ensure reliable supply, enhance competition and encourage transparency, as far as practicable, in the determination of local pump prices by the oil companies.

9. To enhance competition in the fuel market, we have

- (i) since July 2000, put up existing PFS sites for tender upon lease expiry instead of automatically renewing the tenancy; and
- (ii) since June 2003, tendered PFS sites in batches to facilitate potential new entrants in acquiring a critical mass of PFS sites to achieve economy of scale. Two new players have since won the tenders to enter the market by each securing

all five PFS sites included in the tenders held in October 2003 and February 2004 respectively.

10. On transparency, we have urged and oil companies have included in their announcement of each intended price adjustment, the rationale and basis for the adjustment.

11. We appreciate the impact of the oil prices on the local economy and will continue to monitor closely trends in international prices as well as local pump prices, and maintain close contact with the local oil companies.

Economic Development and Labour Bureau  
Financial Services and the Treasury Bureau  
May 2004

## Movement of Pump Price of Unleaded Petrol vs Other Indicators

<u>Month</u>	Monthly Average Closing Mid Price of Brent Crude (for reference) HK\$/litre	Monthly Average Singapore FOB Unleaded Petrol Price HK\$/litre	Pump Price of Unleaded Petrol (Note 1) HK\$/litre	Weighted Average CIF Import Cost (for reference) HK\$/litre
Mar 2003	1.49	1.88	11.21	2.10
Apr 2003	1.24	1.46	11.03	1.97
May 2003	1.26	1.45	10.88	1.72
Jun 2003	1.35	1.59	10.88	1.80
Jul 2003	1.40	1.73	10.88	2.01
Aug 2003	1.46	1.88	11.16	2.06
Sep 2003	1.33	1.67	11.16	1.94
Oct 2003	1.45	1.79	11.16	2.01
Nov 2003	1.41	1.82	11.16	2.07
Dec 2003	1.47	2.01	11.16	2.17
Jan 2004	1.53	2.27	11.44	2.46
Feb 2004	1.51	2.01	11.44	2.28
Mar 2004	1.66	2.23	11.44	2.48
Apr 2004	1.64	2.27	11.59	Not yet available
May 2004 (up to 18.5.2004)	1.85	2.48	11.79	Not yet available
<b>Net movement since Mar 2003</b>	<b>+0.36</b>	<b>+0.60</b>	<b>+0.58</b>	

Note 1 : The pump prices are those of regular unleaded petrol for Shell, Caltex, CRC and Exxon Mobil, but there are minor variations in the pump prices charged by these companies.

Note 2 : Caltex, ExxonMobil and Shell increased their pump prices by \$0.20/litre while CRC increased its pump price by \$0.21/litre.

## Movement of Pump Price of ULSD vs Other Indicators

Month	Monthly Average Closing Mid Price of Brent Crude (for reference) HK\$/litre	Monthly Average Singapore FOB Diesel Price HK\$/litre	Pump Price of ULSD (Note 1) HK\$/litre	Weighted Average CIF Import Cost (for reference) HK\$/litre
Mar 2003	1.49	1.81	6.32	2.03
Apr 2003	1.24	1.44	6.17	1.69
May 2003	1.26	1.40	6.07	1.56
Jun 2003	1.35	1.41	6.07	1.55
Jul 2003	1.40	1.42	6.07	1.55
Aug 2003	1.46	1.58	6.07	1.70
Sep 2003	1.33	1.53	6.07	1.69
Oct 2003	1.45	1.59	6.07	1.75
Nov 2003	1.41	1.65	6.07	1.79
Dec 2003	1.47	1.72	6.07	1.85
Jan 2004	1.53	1.93	6.32	2.05
Feb 2004	1.51	1.86	6.32	2.03
Mar 2004	1.66	1.84	6.32	2.03
Apr 2004	1.64	1.92	6.47	Not yet available
May 2004 (up to 18.5.2004)	1.85	2.12	6.64	Not yet available
<b>Net movement since Mar 2003</b>	<b>+0.36</b>	<b>+0.31</b>	<b>+0.32</b>	

Note 1 : The pump prices are those for Shell, Caltex, CRC and Exxon Mobil, but there are minor variations in the pump prices charged by these companies.

Note 2 : Caltex, ExxonMobil and Shell increased their pump prices by \$0.17/litre while CRC increased its pump price by \$0.16/litre.

## GLOBAL ECONOMIC IMPACT OF THE RECENT OIL PRICE HIKE

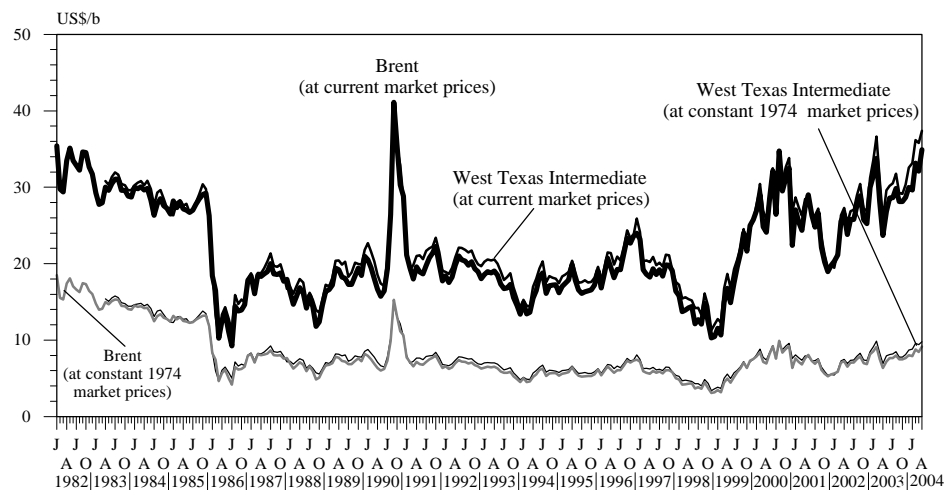
### Issue

It is reckoned that high oil prices will lead to higher inflation and this in turn will dampen global economic growth.

### Current oil price situation

2. The price of Brent crude oil has continued to hike since March 2004, reaching a 13½-year high of around US\$38.80 per barrel on 17 May 2004 (*Chart 1*). The West Texas Intermediate touched US\$41.53 per barrel on the same day. Prices then hovered around this level in the past few days. Compared with the beginning of the year, it is almost 30% higher.

Chart 1 : Crude oil prices

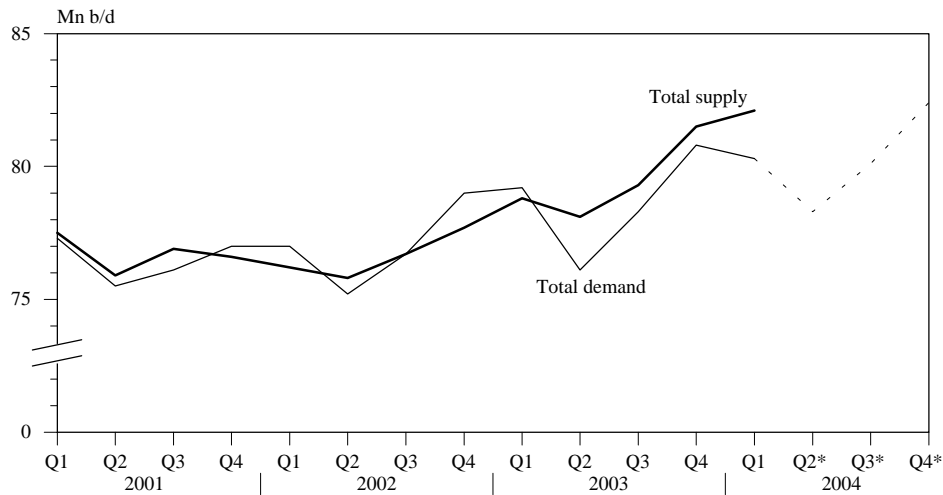


### Causes underlying the recent oil price hike

3. The recent rise in international oil prices to a large extent reflects concern about the escalating geopolitical tension in the Middle East. Nevertheless, market fundamentals should have remained in good balance (*Chart 2*). While the strong global economic growth has raised demand for crude oil, crude oil supply remained abundant. In the first quarter of 2004, oil supply continued to exceed demand generally. Even

production by Iraq has reached 2.3 million barrels per day in April 2004, 16% higher than the average output in 2002 though 9% lower than the peak in 2000 (*Table 1*).

Chart 2 : Crude oil demand and supply



Note : (\*) IEA forecasts.

**Table 1: Crude oil demand and supply**  
(million barrels per day)

		Total demand	Total supply	<i>Of which:</i>			
				<i>Saudi Arabia</i>	<i>United States</i>	<i>Russia</i>	<i>Iraq</i>
2000		76.2	76.7	8.0	8.1	6.5	2.6
2001		76.8	76.9	7.7	8.1	7.0	2.4
2002		77.0	76.6	7.4	8.1	7.7	2.0
2003	Q1	79.2	78.8	8.6	8.1	8.1	2.1
	Q2	76.1	78.1	8.8	7.8	8.3	0.3
	Q3	78.4	79.2	8.3	7.9	8.7	1.1
	Q4	80.9	81.4	8.2	7.8	8.8	1.8
2004	Q1	81.0	81.8	8.2	7.8	8.9	2.1
	Jan		82.0	8.3	7.9	8.9	2.0
	Feb		81.6	8.3	7.8	8.9	1.9
	Mar		81.9	8.2	7.8	9.0	2.4
	Apr		81.5	8.0 (9.8)	7.9 (9.7)	9.1 (11.1)	2.3 (2.9)

Note: ( ) % share of total supply.

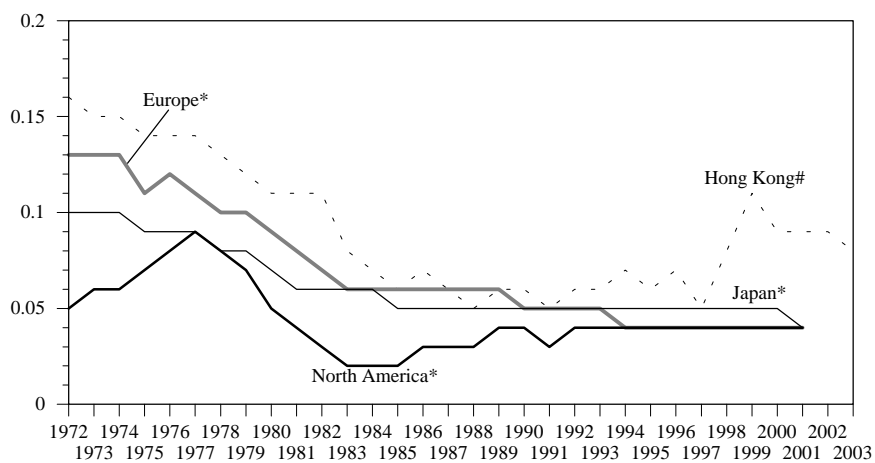
4. According to the estimate by the International Energy Agency (IEA), world oil supply was 1.0% higher than world oil demand in the first quarter of 2004. Also, OPEC will meet on 22 May to discuss the possibility of increasing their oil output quota by 1.5 million barrels per day to 2.5 million barrels per day, which if agreed should help towards building an even better demand/supply balance in the international oil market.

### Impact on the global economy

5. The impact of the oil price hike this time should be smaller than on previous occasions for several reasons. First, discounting for inflation, the current level of crude oil prices is still much lower than the level during the oil shock in the early 1980s (*Chart 1*).

6. Secondly, over the past three decades, oil dependency of the industrial economies has declined with technology improvement and shift to knowledge-based activities. As such, the oil price surge should have less damaging effect on global output now than before (*Chart 3*).

Chart 3 : Oil dependency of North America, Europe, Japan and Hong Kong

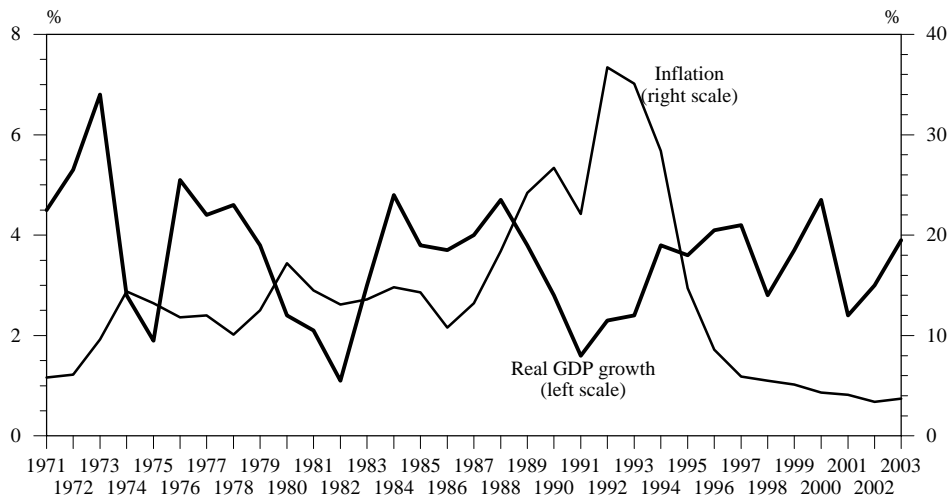


Notes :(\*) Measured by net oil imports in tonnes per US\$1,000 of GDP at constant (1995) prices.  
(#) Measured by net oil imports in tonnes per US\$1,000 of GDP at constant (2000) prices.

7. Thirdly, the global economy is recovering, and inflation is subdued (*Chart 4*).



Chart 4 : Global economic growth and inflation



8. According to IEA, a sustained increase of US\$10 per barrel in crude oil prices will cut GDP growth by 0.4 of a percentage point and raise inflation by about half of a percentage point in the OECD economies in the first and second years of higher prices. The impacts of the oil-importing developing economies in Asia are higher, cutting GDP growth by 0.8 of a percentage point and raising inflation by 1.4 percentage points in the first year.

9. Earlier on, IMF has also done some similar assessment. It indicated that a permanent increase in oil prices by US\$5 per barrel will lower global growth by around 0.3 of a percentage point after one year. Specifically, GDP in the industrialised economies will be curtailed by around 0.3 of a percentage point, while GDP in Asia by around 0.4 of a percentage point after one year.

10. Given that the current economic outlook for both the advanced and developing economies is promising, and their inflation generally at a low level, the negative impact of the oil price hike on growth and on inflation is thus expected to be relatively contained (*Table 2*).

**Table 2: Real GDP growth and inflation of selected economies**

	<u>Real GDP growth</u>			<u>Inflation</u>		
	<u>2003</u>	<u>2004<sup>f</sup></u>	<u>2005<sup>f</sup></u>	<u>2003</u>	<u>2004<sup>f</sup></u>	<u>2005<sup>f</sup></u>
US	3.1	4.6	3.9	2.3	2.3	2.2
EU	0.7	2.0	2.4	2.0	1.7	1.7
Japan	2.5	3.4	1.9	-0.3	-0.4	-0.1
China	9.1	8.5	8.0	1.2	3.5	3.0
South Korea	3.1	5.5	5.3	3.5	3.7	3.4
Singapore	1.1	5.0	4.0	0.5	1.2	1.5
Taiwan	3.2	4.9	4.9	-0.3	0.7	1.5
Thailand	6.7	7.0	6.7	1.8	2.2	1.3
Hong Kong	3.3	5.5	4.5	-2.6	-0.5	0.8
		6 <sup>(0)</sup>			-1 <sup>(0)</sup>	

Notes: (f) IMF forecasts.  
 (0) Official forecasts.

Economic Analysis Division  
 Financial Services and the Treasury Bureau  
 21 May 2004