Heard on the Street

Oil Stays Thick in China Downturn

By Abheek Bhattacharya
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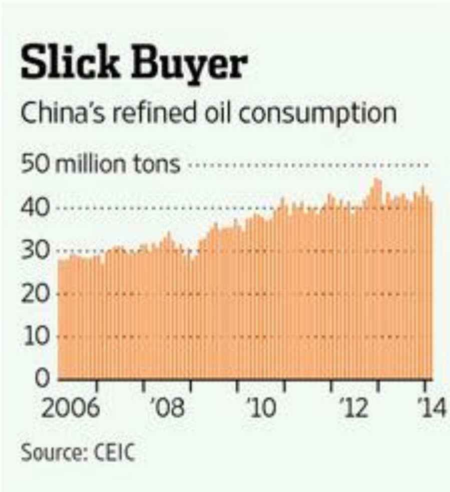
A worker fills a car up with gasoline at a PetroChina station in Shanghai in this Nov. 5, 2013, file photo. Consumers are powering China's petroleum use. *Associated Press*

As China's slowdown becomes clearer, the ground is shaking beneath commodities bulls' feet. Yet there is one corner of the commodities markets that can relax somewhat easier—oil.

Investors in iron ore and copper are on edge after poor Chinese exports and inflation data, not to mention the default of a local bond. Industrial output in January and February was weaker than expected, while fixed-asset investments rose at their slowest since 2002.

That is bad news for metals. China's consumes two-thirds of the world's seaborne iron ore and 40% of its copper. And prices have reacted. Copper slid 8% the past week in London trading to its lowest level since mid-2010.

Oil is a different story. While China accounts for 10% of global petroleum consumption and 40% of its growth, consumption of the black stuff is no longer driven by industrial investment in the way metals rely directly on housing, infrastructure and factories.



Instead, car-adopting consumers power China's petroleum use. Despite an industrial slowdown the past few months, auto sales grew 11% in January and February. The shift has been going on for a while. Transportation now makes up nearly half of the country's oil needs from 30% a decade before, according to Sanford C. Bernstein. Passenger cars account for almost two of every three vehicles running on Chinese roads, say consultants at LMC Automotive.

Some say, as the world's largest net oil importer, a slowdown in China's industrial production will hammer oil. An IMF report fingers Middle Eastern oil exporters such as Kuwait as among the most exposed economically to a China slowdown. But a rival study by Ludovic Gauvin and Cyril Rebillard at the French central bank raises the possibility that even a hard China landing would have a more modest effect on oil than metals, and thus the pain would radiate less to the Middle East and more to metal exporters such as Peru.

So long as China's love affair with autos continues, oil should come out the least banged up in a China slowdown.

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