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EFFECTS OF RISING CRUDE OIL PRICES ON THE INDIAN ECONOMY

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ABSTRACT

Why is everyone so concerned about crude oil prices all of a sudden? That's because the global crude oil prices have been steadily rising over the past few months. For the first time since 2014, the international benchmark for global oil prices crossed the $80/barrel mark in May 2018. Compare this to the $29/barrel price during early 2016. This sudden surge in prices has a great impact on various segments of the Indian economy.
Key Words: - *Crude oil, IEA (International Energy Agency), OPEC*

Research Methodology: -

This paper is based on secondary data which is collected from Books, Journals, News Paper, and Internet Etc.

Objectives of study:-

1. To Study reasons of price rise of crude oil in 2018.
2. To study impact of price rise of crude oil and its impact on India.

INTRODUCTION

The recent rise in the prices of crude oil has drawn everyone's attention towards the crucial role that oil plays in the economy of any nation. Crude oil is one of the most necessitated commodities in the world and India imports around 100 million tons of crude oil and other

petroleum products. This in turn, results in spending huge amounts of foreign exchange. The increasing quantum of imports of petroleum products has a significant impact on the Indian economy, especially when crude oil prices are shooting up globally. Crude oil not only serves as a source of energy but also as a major raw material to various industries. With no major discoveries in the recent years, the increasing costs of production have pushed up crude oil prices globally. Also, the high volatility in the prices of oil breaching the $100/barrel mark and rising to a high of $147/barrel could be attributed to the fact that in the recent years, many index funds have taken positions in commodities considering oil to be an asset stock in their portfolios. It has been usually observed that in India, the pricing scheme is designed in such a way that it offers a system to moderate the soaring international oil prices and thereby study the impact on growth, inflation, etc.

Reasons of price rise of crude oil in 2018

Sanctions on Venezuelan oil industry:

Rumors of US moving closer to putting sanctions on Venezuelan oil industry, the world's largest oil reserves, also aggravate the volatile sector.

As per the latest report from IEA (International Energy Agency), oil output from Venezuela has slid to 1.5 million barrels a day in February, down 60,000 barrels month-on-month and a decline of 540,000 barrels a day against the previous year.

The sharp decline in production is in the wake of the nation's economic crisis. The country suffers world's highest inflation. The agency also hinted that without any compensatory output change from other oil producers, the ongoing Venezuelan supply crisis would deepen that dips the oil market into a deficit.

Tensions between Saudi Arabia and Iran:

Increased instability in the Middle East alarming the global oil market. Tensions between Saudi Arabia and Iran have emerged again recently after the Saudi Crown Prince visiting US President considers ending the Iranian Nuclear deal. Intensifying Libyan conflicts also aided to the sentiment.

The recent hawkish comments from the Saudi Arabian Energy minister raising worries over supply from major global producers.

The Saudi minister stated that the OPEC and Non-OPEC countries including Russia need to cooperate together and extend the production cut till 2019 to reduce the global supply glut.

Global oil producers limiting supply:

With a view to rein global excess supply and lift prices, OPEC and other top oil producers including Russia have been limiting daily crude production by 1.8 million barrels since last year.

US Oil Production:

US oil production has been rising for the last several months. Steadily rising oil prices encouraged US shale oil producers to increase output, driving US oil production to record levels.

Burgeoning US production which surpassed 10 million barrels per day, the first time in nearly 50 years recently had hit global oil prices earlier. Starting the year off, US oil production was at 9.5 million barrels per day which rallied to 10.3 million barrels in early March.

Meanwhile, last week's unexpected drop in US oil inventories raising fears over US production. As per the latest EIA weekly report, crude, gasoline and distillate stocks declined surprisingly as imports dropped and refining rates jumped.

Weak Dollar & Fed:

A weak dollar and reports of higher demand had an impact on oil. Commodity prices weigh on when the dollar strengthens against other currencies.

US Federal Reserve recently hiked their rates and hinted two more cuts in the current year. As per IEA forecast, global oil demand would grow this year. The key consumer US is in transition to summer which kicks gasoline demand into a higher gear in the coming months.

At the same time rising number of US rigs drilling for oil sway prices. The latest report shows that US rig count is at three-year highs, inferring a further increase in production which has already tested 10 million barrels per day.

Looking Ahead:

Looking ahead, the ongoing positive outlook is less likely to prevail unless the looming geopolitical tensions continued. Drop in supply due to restricted production from OPEC and Russia is likely to be balanced by higher US production.

In the meantime, factors like developments on trade war between US and China, intensifying tension in Middle-East and global demand-supply imbalances would set a direction for the oil market later.

On the price side, a choppy trade inside USD 72-55 a barrel is expected in US WTI in the immediate run and breaking either side would suggest a fresh course of action in the commodity.

Impact of Price Rise of Crude Oil On India

Higher Prices: Adverse Impact on Fiscal Deficit:

India imports 1.5 billion barrels of crude oil each year. This comes up to around 86% of its annual crude oil requirement. So, the surge in crude oil prices could increase India's expenditure, thus adversely affecting India's fiscal deficit - the difference between the government's total revenue and total expenditure. Fiscal deficit indicates the amount of money the government has to borrow to meet its expenses. A rise in fiscal deficit could negatively affect the economy as well as markets. The fall in crude oil prices was a major contributing factor in the reduction of India's fiscal deficit between 2014 and 2016, according to a report by live mint. A few years back, we explained the impact of a falling crude oil price on fiscal deficit.

Impact on the Rupee:

The rise in crude oil prices has a clear impact on the Indian rupee. On 24 May 2018, the rupee closed at 68.34 against the US dollar. This is a near 18-month low for the rupee, and only 0.6% away from its all-time low of 68.825, according to a Livemint report . In addition, if crude oil prices remain at these high levels, the rupee is further expected to depreciate by the year end. Rupee depreciation has a reverberating effect on the Indian economy and even the stock market. To arrest the rupee's fall, the RBI often takes a few steps.

Impact on Current Account Deficit (CAD):

India's dependency on crude oil imports has only been increasing over the past few years. The dependency rose from 77.3% in FY2014 to 83.7% in FY2018. The rise in crude oil price has a big impact on the Indian Current Account Deficit (CAD). CAD is a measure of India's trade where the value of goods and services imported exceeds the value of goods and services exported. CAD essentially indicates how much India owes the world in foreign currency. An SBI report suggests that Indian's CAD could cross 2.5% of GDP for FY2019 (providing oil

price continues at $80 per barrel). Currently CAD is estimated at 1.9% for 2017-18. Widening CAD further puts pressure on the rupee's value as well as the rest of the economy.

Impact on Sensex, midcaps:

The Indian stock markets have faced a lot of pressure due to the rise in crude oil prices. Between 1 and 24 May, 2018 alone, the Sensex fell by 2.3%. In comparison, the BSE small cap and mid cap indices have had it worse with a drop of nearly 8%. With crude oil prices touching $80 per barrel, there has been a sell-off in small cap and mid cap stocks. Analysts warn that this could continue if the crude oil price continues to rise.

Impact on stocks:

A lot of Indian companies depend on healthy crude oil prices. This includes tire, lubricants, and footwear, refining and airline companies. The profitability of these companies is adversely affected due to higher input costs. This could negatively impact stock prices in the near term. On the other hand, oil exploration companies in the country could benefit from a rise in oil prices.

Impact on inflation:

Oil is a very important commodity and it is required to meet domestic fuel needs. And in addition to that, it is a necessary raw material used in a number of industries. An increase in the price of crude oil means that would increase the cost of producing goods. This price rise would finally be passed on to consumers resulting in inflation. Experts believe that an increase of $10/barrel in crude oil prices could raise inflation by 10 basis points (0.1%).

CONCLUSION

India imports 3 million barrels of crude oil per day. This is a huge quantity of crude oil import. A rise in crude oil prices by $10 per barrel could lead to an increase of $2.5 billion (or Rs 17,000 Cr) in fuel subsidies, according to a report by live mint. Oil price increases are generally thought to increase inflation and reduce economic growth. In terms of inflation, oil prices directly affect the prices of goods made with petroleum products. Increases in oil prices can depress the supply of other goods because they increase the costs of producing them.

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