The oil risk — on the rise in international prices

As international oil prices head higher, India will have to brace itself for the economic risks of expensive energy. Brent crude oil futures were trading at about $70 a barrel on Friday, marking a four-year high and a price increase of close to 6% since the start of the year. The rise in international prices has been particularly sharp given that oil had been selling at below $45 in June. This is a rally of about 55% in a matter of just months. Oil price dynamics have often been explained by changes in the supply outlook influenced by the decisions of major oil producers. Oil trading at $70 should offer some respite to traditional oil producers like the OPEC members, which have suffered the onslaught of U.S. shale producers. According to the IMF, last year, for instance, Saudi Arabia would break even on its budget with oil at $70. The recent spurt in oil prices, however, seems to be more the result of a weakening of the U.S. dollar than anything else. The dollar has been gradually weakening against major global currencies since the beginning of last year. But the trend was given a new push following comments by U.S. Treasury Secretary Steven Mnuchin in favour of a weak-dollar policy. At Davos this week, Mr. Mnuchin noted that a weaker dollar would be good for American trade. However, given that the U.S. is right in the middle of a monetary tightening cycle, it is unlikely that the dollar will continue to boost oil prices, unless the Federal Reserve slows the projected pace of interest rate increases.

Consumers in India are already beginning to feel the pinch as petrol and diesel prices have hit multi-year highs. The retail selling price of both petrol and diesel in Delhi, for instance, has risen by close to 3 a litre since the beginning of 2018. The rise in domestic fuel prices is on expected lines given the policy of dynamic daily pricing of petrol and diesel adopted by the Centre. But as rising oil prices put pressure on domestic consumers, the government will have to desist from resorting to subsidies to ease the pain. It should work towards rationalising taxes on petrol and diesel to bring down retail prices. This will help consumers without imposing an undue burden on the oil marketing companies. An even bigger risk posed by higher oil prices is to the government’s fiscal management. With the fiscal windfall from low oil prices likely to end for now, the government should think for the long term and make crucial tweaks to its hydrocarbon exploration and licensing policy to expedite oil discovery and production. Simultaneously, it must take a leaf from China’s book and actively support Indian energy firms’ bids for overseas oilfields. Self-reliance is ultimately the best hedge.

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