Slippery oil rally: on the oil-price rise

The price of oil has risen sharply in recent weeks leading to renewed forecasts of a sustained bull market in the price of the commodity. The price of Brent crude, which breached the $60 mark late last month, is currently trading at about $64 per barrel, a two-year high. In fact, in the last one month alone, oil has gained well over 12%. The oil rally has been even sharper from its June low of a little below $45, from where the commodity has rallied more than 40% to reach its current price, with some experts saying the ongoing rally could portend even higher prices in the coming months. The upsurge this week has been driven primarily by political uncertainty in Saudi Arabia, the world’s second largest producer of oil, and the tightening of supply by the Organisation of the Petroleum Exporting Countries, which is expected to extend its supply-cut agreement beyond March. Whether the price gains would sustain and continue over an extended period of time still remains a big question for various reasons, however. Shale oil production is the biggest among them. In the past, North American producers of shale brought a multi-year bull market in oil to an abrupt end. Since then, OPEC has struggled to maintain control over oil prices except for brief spells. The American shale industry has been let free to increase production in response to higher prices, thus imposing a cap on the price of oil. There are no signs yet of a structural change in the oil market to suggest that it could be any different this time.

Shale producers have continued to pump more oil into the market as crude prices have crossed the $50 mark. According to the Energy Information Administration, a body under the U.S. Department of Energy, U.S. shale production is likely to increase by about 81,000 barrels per day in the current month. In addition, in its World Oil Outlook report released this week, OPEC said it expects shale output to grow much faster than it had previously estimated. The cartel’s new estimate is, in fact, more than 50% higher than its projection last year. It also noted that shale output from North America has increased by about 25% over the past one year. All this suggests that shale is likely to remain OPEC’s nemesis for a long time. India has derived huge benefits from lower oil prices since 2014, with the government’s fiscal management and inflation-targeting being rendered a lot easier. There is bound to some economic unease now as the price of oil fluctuates in what looks likely to be a range-bound market. A repeat of the huge damage caused by the last oil bull market, however, seems unlikely. Nonetheless, policymakers in Delhi will surely take a cautious stance given the extensive impact that oil prices have on the Indian economy.

Revving up infrastructure spending is necessary, but not sufficient

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