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# OIL SWINGS AND THE ECONOMY

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Inflation & Monetary Policy

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Global demand for oil, decisions by major producing nations to raise/ cut supplies and the global political environment are key to oil prices.

Prices have swayed from above $160 per barrel in June 2008 to about $35 in January 2016. After breaching $85 a barrel in early October, they plunged 8% last Friday to reach their lowest in more than a year. They have since recovered to above the $60 level. The recent fall has been attributed to two main factors: higher supply and volatility due to uncertainty about the global economy. Fears of the consequences of a full-fledged trade war between the U.S. and China have rattled speculators.

However, oil prices are estimated to regain some lost ground and stabilise above $75 next year, according to an S&P Global Platts survey of top bankers and oil traders. Key support factors for oil price would be anticipated production cuts as well as U.S. sanctions against Iran. Also, automobile demand has risen globally, and as internal combustion engines still rule the roost, demand for oil is not expected to plummet yet.

Media reports cite the International Energy Agency pegging non-OPEC output at 2.3 million barrels per day (bpd) this year, while demand was expected to grow to 1.4 million bpd next year. The OPEC is expected to cut production after a meeting on December 6 in Vienna, Austria. It may push for a cut of as much as 1.4 million bpd.

It is the weighted average of Dubai and Oman (sour) and Brent (sweet) crude. It’s the indicator of the price of crude imports for India and the index has a bearing on price rise in the country, in general. The price of the Indian basket averaged at almost $70 for April this year, and had risen to breach $80 in October.

India imports more than 80% of its crude oil requirements, and it has to pay for these imports in foreign currency, mainly dollars. If international crude prices rise, refiners in the country need to spend more in dollars. If there is volatility and uncertainty about which way prices will sway, refiners tend to buy more oil and stock up. As rupees are exchanged for the U.S. currency in this exercise, it generates a demand for the dollar, thereby weakening the rupee. On October 1 this year, the Indian basket price was $82 and the rupee rate was 72.8 to a dollar. By November 20, the Indian basket had eased to $64.8 and the rupee, almost in tandem, strengthened to 71.3.

Prices of goods are determined as much by their supply as by the cost of transportation. Apples from Himachal Pradesh are eaten in Kerala, for instance. Rise in fuel costs are passed on by truck fleet owners down the chain to consumers. Accelerating inflation influences the central bank to raise rates thereby making it costlier to borrow. Higher interest rates keep supply of money in check and hence control inflation.

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