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A Study of Downturn Trends of Crude Oil Price – An Economic Advantage for Indian Government and Consumers

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Abstract

In this paper, we focus on the positive impact of the fall of crude oil prices on the Indian economy. In this fall trends of oil prices at international level, prices drop throughout an economy, relative purchasing power theoretically increases. We all are aware that Crude oil prices play a significant role in the economy of a country. India's growth hovers around the import of oil as imports 70% of its crude requirements. Any negative change in the crude oil prices has an immediate positive impact on the increment in the GDP and IIP. For instance, a one-dollar fall in the price of oil saves the country about 40 billion rupees. This, in turn has a three-fold effect on the economy. From the limited perspective of India's consumer economy, lower global oil prices undoubtedly augur well. Lower pump prices reduce pressure on the consumer who can spend the savings elsewhere, spurring the demand side of the economy.

Keywords: *PSU, GDP, IIP, OPEC, CAD.*

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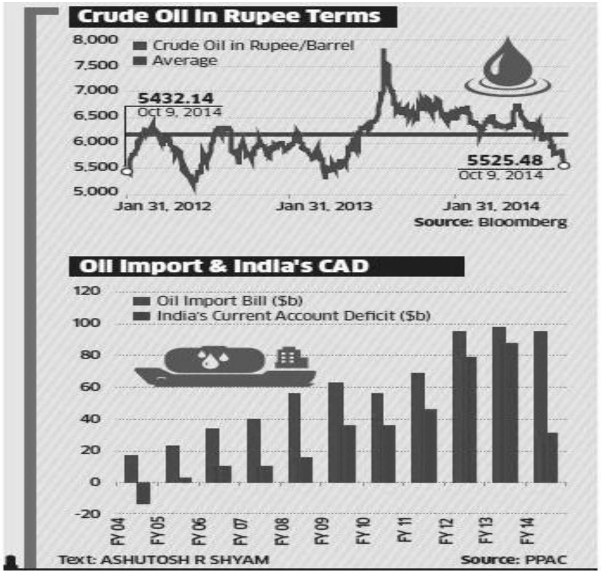
1. INTRODUCTION

In this paper, we focus on the positive impact of the fall of crude oil prices on the Indian economy. In this fall trends of oil prices at international level, prices drop throughout an economy, relative purchasing power theoretically increases. We all are aware that Crude oil prices play a significant role in the economic development of a country. India's growth hovers around the import of oil as imports 70% of its crude requirements. Any negative change in the crude oil prices has an immediate positive impact on the increment in the GDP and IIP. For instance, a one-dollar fall in the price of oil saves the country about 40 billion rupees. This, in turn has a three-fold effect on the economy .To give another example, If the average fall in oil prices is about $4 per barrel in 2014-15, the trade deficit would shrink by about $3 billion. In India in the April-June quarter of the year,the current account deficit had dropped to $7.5 billion mainly due to customs duty that was imposed on the import of gold. the fall in oil prices and the current account deficit should come down further and harden the rupee against the dollar. The fall in international oil prices will reduce subsidies that help sustain the domestic prices of oil products. Petrol prices are already decontrolled. The more commonly used diesel has been subject to staggered deregulation since September 2012.In September this year, the difference between domestic and international prices of diesel will be only 8 paise per litre, which can make diesel eligible for deregulation in about a month. It is kerosene and liquefied petroleum gas (LPG) that is still heavily subsidized. Looking at the mood of the government, kerosene and LPG is unlikely to be market-priced in the near future. The total subsidy on petroleum products in 2013-14 was 854 billion rupees and it would be reduced to the extent the international price of crude declines. The advantage will accrue mainly to the government and oil-producing companies such as ONGC and IOL. Consequently, the fiscal deficit that in 2014-15 was projected at 4.1 percent of GDP may be somewhat reduced. The fall in international prices of oil will have a soothing effect on inflation. But it won't be strong enough because the consumption of oil by industries is not that high except in the industries engaged in the manufacturing of certain products like carbon black. The slide in crude oil prices to four-year lows is a positive change for India as the country depends on imports for more than three fourths of its consumption. It is expected to help improve pivotal macroeconomic indicators such as current account and fiscal deficit besides giving a fillip to energy firms, tyre makers and consumer companies.

India's net imports of crude oil amount to about a billion barrels every year. So, if crude oil prices average about $100 per barrel in the current fiscal (vs about $106 per barrel in the first six months of the financial year), the country's import bill will fall by $10 billion (about Rs 61,000 crore), which is close to one-third of the current account deficit or CAD



Cooling crude prices will also help to bring down fuel under recoveries (cost of selling LPG & kerosene below cost), which would lower the government's share in the total under-recoveries and, result in the narrowing of fiscal deficit.

According to global brokerage CLSA, oil under-recoveries are likely to decline 40% in FY15, compared to the previous fiscal, to Rs 83,500 crore and a further 20% in the next fiscal to Rs 66,600 crore due to the fall in crude oil prices. PSUs such as HPCL, BPCL and IOC are set to gain as cheaper crude will reduce their working capital requirement, thus reducing their dependence on subsidy payout from the government. Makers of Tyres can look forward to an improvement in margin since 25%-35% of their raw material is based on crude oil. Similarly, consumer companies would benefit from lower cost of packaging, which is derived from crude oil. Crude has come under severe pressure in recent weeks amid fears of decreased demand across the globe due to slowing down of growth in places like the euro zone and China. At the same time, supply-and-demand dynamics have also been undergoing a massive change amid the U.S. oil boom, driven by the fraking revolution at home which has resulted in a glut of oil across the globe. India has to wake up fast in implementing the pending reforms to boost its growth. With considerable contraction in twin deficits, we need to strengthen the fiscal consolidation by implementing GST through amicable negotiations with states and find constructive approaches towards skill enhancement to advantage of high demography. Hope we are moving in the right direction with the current stable government. It could help the economy by reduced burden on account of import of crude oil. If one thinks that the ongoing historic decline in crude oil prices would reduce inflation, the oil bill, subsidy on petroleum, the fiscal deficit and interest rates, thereby boosting India's gross domestic product (GDP) growth, then one could be wrong. An analysis of year-wise movements of average global crude oil prices versus India's GDP reveals no inverse correlation, contrary to wide belief. On the contrary, the country's GDP growth has risen every time crude prices have gone up and vice versa.

2. CORRELATION

Average global crude oil prices moved between $10 and $20 a barrel between 1947 and 1972. There was a jump from $15 to $42 a barrel in 1973-74, after the petro exporters' cartel, Opec, imposed an embargo on the US, UK, Japan, Netherlands and Canada for supporting Israel. That year, India's GDP growth also jumped to 4.6 per cent from a 0.3 per cent decline the previous year. Similarly, crude declined 40 per cent to less than $12 a barrel in 1998-99, when Opec announced a 10 per cent quota increase amid slowing Asian economies. India's GDP growth also slumped to an average of 5.5 per cent in 1999 from eight per cent the previous year. Again, crude prices declined 18 per cent in 2002-03 and India's GDP growth also remained a modest four per cent. A year later, in 2004, GDP growth jumped eight per cent when crude prices started rising. In 2004-08, crude oil jumped from $27 a barrel to over $98, due to multiple factors - Iraq war, growth of Asian economies and a weaker dollar. India's annual GDP growth rose from eight per cent to 9.3 per cent in this period. During the financial crisis of 2008-09, crude rates slumped sharply from $98 a barrel to $50 a barrel and India's GDP growth came down to 6.7 per cent in 2009 from 9.3 per cent the year before.

OIL RATE OVER THE YEARS

Year/Period	Change in crude oil price	Change in real GDP growth
1973-74	$15 to $42	-0.3 to 4.6
1998-99	$20 to $12	8 to 5.5
2002-03	$32 to $25	5.4 to 3.9
2004-08	$27 to $98	8 to 9.3
2008-09	$98 to $50	9.3 to 6.7

Crude oil prices in $ per barrel; GDP growth in % over previous year
Source: Economic Survey

But there are indirect gains. The sharp fall in global crude prices has a favourable impact on India’s macro economy, setting off multiple growth boosters. Investment bank Nomura estimates that the $40 fall can potentially boost growth by up to 0.4 percentage points to 6 per cent in the current financial year. “Improvement in macro fundamentals [inflation and the fiscal deficit and the current account balance] will, at the margin, increase the space for macro [monetary and fiscal] policies to boost growth,” it says in a report on the impact of the tumbling international crude prices on India.

“The price fall is fortunate for the new government … it will reduce the balance of payments and if handled well it can be translated into economic growth. The economic advisory councils of five Prime Ministers — Atal Bihari Vajpayee, P.V. Narasimha Rao, V.P. Singh, Chandra Shekhar and Rajiv Gandhi, said the biggest impact on India can be that the government, if it wants, will be able to spend more on development.

The timing of this windfall could not have been better for India’s economy. A new government with a huge mandate is in office and business is on the cups of an upturn.

The most obvious positive fallout is on price rise. Wholesale inflation growth could slow by around 2 percentage points, Nomura estimates. Consumer prices will ease too, though to a much less extent, it says. The spare cash from fuel cost savings, howsoever small, should increase consumer discretionary spending. Higher consumption adds to corporate incomes. Abating input costs too will widen profit margins for businesses. As balance sheets start improving, companies will be better placed to start new projects or revive stalled ones, generate new jobs and growth.

Just as for companies, the government will be able to mend its balance sheet. The fortuitous oil-price situation released substantial savings on the fuel subsidy bill, which Nomura estimates at 0.1 per cent of the GDP. This has made it possible for the Finance Ministry to increase excise duty rates on petrol and diesel for additional revenue up to Rs 15,000 crore this year.

The cushion of extra revenue and subsidy savings will come in very handy for the Centre in keeping its fiscal deficit for this year within the Budget target of 4.1 per cent of the GDP, especially because the Finance Ministry has warned that tax collections will miss the Budget target. More important, the happy oil position has emboldened the NDA government to roll out far-reaching fuel subsidy reforms and clean up the Centre's account books. The Centre has capped the Budget subsidy on cooking gas and eliminated the one on diesel, freeing its pricing from government control. The diesel subsidy that had amounted to 0.3 per cent of the GDP last year stands scrapped.

Besides the government's offers, the public sector oil companies' profitability could benefit too from these measures.

The third channel through which growth impulses can be expected is India's external account or the Current Account Deficit (CAD). Since India imports more than 70 percent of its oil consumption, deflating global crude prices reduces India's import bill. Nomura estimates that India's annual CAD could improve by up to $36 billion from the $40 fall. This gives the Reserve Bank some room to add more dollars to India's forex reserves, allowing the rupee to depreciate, which will make exports more competitive.

3. CONCLUSION

From the limited perspective of India's consumer economy, lower global oil prices undoubtedly augur well. Lower pump prices reduce pressure on the consumer who can spend the savings elsewhere, spurring the demand side of the economy. As petroleum products form a large part of the consumer price indices, lower crude prices result in reduced inflation, which in turn paves the way for lower interest rates and greater buoyancy in investments. Thus, lower oil prices can trigger a virtuous cycle in the Indian economy. After all, with India's imports running at an estimated 3.7 mbpd in 2013, a $30 per barrel decline in oil prices amounts to a $40 billion savings bonanza on annual imports. The impact would be best felt on the petroleum sector where marketers have been groaning under subsidy burden. The transport sector would also be a direct beneficiary. This downturn trend of oil prices increasing purchasing power of Indian consumer positively with build up the confidence of the government without affecting GDP.

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