Cut in Oil Price

Why in News?

Saudi Arabia has cut the oil prices and declared its intention to increase output well beyond what the oil market can absorb currently.

Why did Saudi cut the price?

- The Organisation of the Petroleum Exporting Countries (OPEC) and Russia (the largest non-OPEC producer) failed to reach an agreement to deepen existing production cuts to cope with the falling demand.
- So, the Saudi Arabia has cut the oil price.
- Already teetering from the impact of the corona virus, global markets received a shake with the fall in price.
- This is so as oil prices crashed overnight consequent to the price fall.

What will happen now?

- The oil market is now set to witness the rare conjunction of a demand and supply shock which is bad news for prices.
- Fears of a fall in demand following the outbreak of COVID-19 had already depressed oil prices.
- The possibility of the market being flooded with excess production from Saudi Arabia and Russia will unfortunately lead to a supply shock.
- There is still a downside to prices from current levels especially if Russia joins the battle with Saudi Arabia and decides to hike its own output.

How this news is perceived?

- A fall in prices is good news for major consumers such as India and China which depend on imports for a major part of their oil needs.
- But, it may be bad news for the big oil companies and the smaller shale oil players who are highly leveraged.
- A collapse of these shale oil producers may set off defaults in the bond markets, setting off its own non-virtuous spiral.
- With stock and bond markets already in turmoil, the price war now set off in oil is only going to make the markets more volatile and murkier.

How will India be impacted positively?

- For India, the sharp dip in oil prices is good news, for now.
- This will reduce the oil import bill at a time when merchandise exports are likely to suffer due to the freeze in the developed economies.
- This will keep the current account deficit balanced.
- The fall in fuel prices will also drag down headline inflation giving the Reserve Bank of India elbow room to cut rates.

How will India be impacted negatively?

- The Centre's disinvestment programme to sell the Bharat Petroleum Corporation Limited (BPCL) could run into headwinds.
- The company's valuation may drop.
- So, the big oil companies, which are expected to bid for BPCL, may either shy away from it or their bids may be much lower than expected.
- Eventually, the government may increase the excise duties to compensate for the loss from disinvestment proceeds.
- Any such decision is unlikely to go down well with India's consumer middle class.

Source: The Hindu

Quick Facts

Organisation of the Petroleum Exporting Countries (OPEC)

- OPEC is a permanent intergovernmental organization of 13 **oil-exporting developing nations**.
- It was founded in 1960 by five countries namely Islamic Republic of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela.
- In accordance with its Statute, the mission of the OPEC is to coordinate and unify the **petroleum policies** of its Member Countries.
- It should ensure the **stabilization of oil markets** in order to secure an efficient, economic and regular supply of petroleum to consumers.

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