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Dealing with Falling Crude Price

What is the issue?

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- There is a sudden and sharp fall in the global price of crude oil.
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- Despite the timely benefits, the inherent economic and monetary risks demand well thought out measures from the Indian policy makers.
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How does it benefit India?

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- The price of the Indian basket of crude oil has averaged around $74 a barrel so far this financial year.
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- But there is some hope that it will stay in the $55-60 range for some time.
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- A reduction in the price of oil is always a benefit for India, which imports over 80% of its crude oil.
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- So the full-year import bill may be considerably lower than the revised estimate of $125 billion.
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- This could create favourable cost conditions for the economy.
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- It could also hopefully stimulate the RBI into cutting interest rates and giving investment and growth a boost.
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What is the concern?

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- With fall in global oil price, it is possible that, once again, foreign portfolio investors (FPIs) will put money into the Indian economy.
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- Notably, in November, net inflows turned positive after almost $400 billion outflows in the previous month.
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- This is perhaps good news for the stock markets but from the point of view of the larger economy, it is a mixed blessing at this point.
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- The fear is that the effect of higher inflows would be renewed rupee volatility.
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- As, a surge in FPI flows would have a disproportionate effect on the rupee-dollar exchange rate.
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- This could possibly hurt the incipient revival in Indian exports (as a weaker domestic currency (depreciation) stimulates exports and vice versa).
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- Notably, exports, till recently had been flat for years even amid a revival of global growth.
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What is to be done?

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- **RBI** - The RBI has to be on guard against the above possibility as this is a good moment for it to build up its reserves.
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- If the rupee is too over-valued for Indian exports to experience sustained growth, then its value must eventually fall, in spite of a transitory spike in FPI inflows.
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- So the RBI should logically use its ability to build dollar reserves to manage the rupee's long-term fall.
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- **Centre** - The government should also consider what the impact of the fall is on its own fiscal conditions.
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- If it is having trouble meeting its fiscal deficit targets, it may be able to reverse its recent reductions in fuel taxes.
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- However, given all these, any assumption that oil has found a permanent,

lower level is not warranted.
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- This price fall, which may last into the medium term, is due to a fortuitous combination of circumstances. Click here to know more.
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- Such geopolitical considerations cannot be counted on to continue forever.
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- So freeing the Indian economy from its long-term dependence on global price needs fresh attention.
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Source: Business Standard

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