Impact of Oil Price Rise

What is the issue?

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The rising oil price trend is likely to have repercussions on the overall economy, which calls for concerted government actions.

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How has oil price been?

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- Brent crude oil is the international benchmark price for oil.
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- Brent crude was ruling near $120 per barrel in the mid-2014.
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- The prices fell to a low point of $29 in January 2016, before climbing back up.
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- A year ago, the price had crossed $50, and by December was over $60.
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- In May, 2018 it crossed $70, and is now past $80.
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- It is highly expected to cross $100 once the U.S. sanctions on Iran kick in, and reach as high as $120 in 2019.
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How have past oil price shocks been?

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- Oil price shocks in the past have mostly derailed the Indian economy, usually in conjunction with other factors.
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- It happened in 1973-74, when the international crude oil price doubled in a year of poor harvests.
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- India’s inflation rate rose sharply as growth tumbled.
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- The second oil shock, of 1979-80, saw oil at $111, which along with another bad harvest caused GDP to shrink by a high 5%.
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- The third was during the first Iraq war when average price for 1990 was only $43.
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- But it tipped the country into the foreign exchange crisis of 1990-91.
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- The oil shock of 2008 (average price of $104) came with the financial crisis of the same year, the combined effect causing a sharp dip in GDP growth.
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- Oil prices stayed high through 2011-14, at over $90, causing the country’s current account gap to leap to 4.8% of GDP in 2012-13.
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- Also, growth plunged to the lowest levels in a decade, and the rupee crashed down.
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What could now be the implications?

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- Along with oil price rise, the rupee has fallen against the dollar in the interim, and taxes increased.
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- The petrol and even diesel prices could thus likely be headed for the three-figure mark.
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- If the prices keep increasing as predicted, India will be back where it was years back.
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- The trade gap, inflation, rupee’s external value and economic growth could all come under pressure.
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- The current account deficit, already projected in danger zone at close to 3% of GDP, could further worsen and make rupee the same.
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What is the way ahead?

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- If the government eases consumer pressure by lowering taxes on petroleum products, revenue loss will affect fiscal numbers.
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- If inflation climbs and RBI sticks to its inflation target, higher interest rates will constrict both investment and consumption, affecting growth.
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- Keeping Iranian oil exports going will moderate price spikes, and therefore the size of the oil shock.
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- So the policy choice is whether to continue buying oil from Iran as it is the Iran sanctions that are expected to send oil prices higher.
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- But the challenge is that it could invite US sanctions.
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Source: Business Standard

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