Reduction in global oil prices – II

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Why is there a massive fall in oil price?

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- Investors until a few weeks ago were worried about the lack of sufficient supply in the market due to disruptions in arrivals from major producers such as Iran and Venezuela.
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- But the possible oversupply in the U.S. with the boom in shale production and softening its stance against Iran increased the possibility of global supply and the resultant fall in prices.
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- Also, a drop in global demand due to faltering growth in major economies like China might also be the reason.
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- As a result, Brent Crude dropped by 30% since early October, when a barrel cost around $86 to around $60 today.
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- Imported oil meets about 80% of total demand in India.
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- The fortunes of the rupee have been tightly linked to the price of crude oil in the global markets.
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- Hence, the rupee has recently appreciated almost 5%, after falling consistently against the U.S. dollar for most of this year.
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What does India gain?

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- The fall in global crude oil prices comes as a big relief to the Central government, which has faced increasing macroeconomic and political

pressure due to rising prices.
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- A drop of $10 in the price of oil can improve India’s current account and fiscal deficits by 0.5% and 0.1% of GDP, respectively.
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- Fuel prices across major Indian cities have fallen significantly in the last few weeks.
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- The Reserve Bank of India will be relieved as it will have to worry less about the rupee exchange rate and oil-induced inflation.
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- FPI investments have also considerably improved which points to an increase in investor confidence in the economy as the fundamentals improve.
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What should be done?

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- The forthcoming OPEC meeting will make clear the response of oil producers to the sharp fall in prices.
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- Shale companies are also likely to respond to falling prices by cutting its production.
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- Thus, India should capitalise on the relief offered by the fall in oil prices to improve its preparedness for any future jump in oil prices.
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Source: The Hindu

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