Spike in Crude Oil Prices - Impacts

What is the issue?

The recent spike in global crude oil prices above the $80-per-barrel mark led to a dip in key indices in the stock market.

Why are oil prices rising?

- The oil prices hit a low of $16 per barrel on April 22 last year.
- It has risen nearly 58% from about $51.8 per barrel to about $81 at close on Wednesday.
- Recovery in global demand as the world economy recovers from the pandemic is a major reason for increase in prices.
- Supply restrictions maintained by the OPEC+ grouping have kept international oil prices high.
- A shortage of gas in Europe and Asia has boosted demand for oil for power generation.
- High taxes by the central and state governments too have contributed to retail prices being far higher.

What will be the impact of rising oil prices?

- **Impact on stocks -** A sharp surge in oil prices can create short-term panic in the equity markets.
- Equities often deliver more than the expected inflation that the oil surge may lead to.
- **Impact on bonds** - Sustained high inflation can result in rising yields and falling bond prices.
- For bonds, central bank policies will play a far greater role than the direct impact of rising oil prices.
- In sectors where oil is a major cost component, a negative reaction on returns can be expected.
- **Impact on currency -** Rising crude prices tend to depress the rupee as India being a major importer of oil.
- It will lead to expansion in the import bill as it is expected that Brent crude can test the $ 90/barrel mark.

Crude import accounts for nearly 20% of India's import bill.

- **Impact on inflation** - Rise in prices could lead to a surge in inflation, forcing the RBI to go for liquidity tightening measures followed by rate hikes.
- An increase in crude prices means an increase in the cost of producing and transporting goods thus adding to inflation.
- **Impact on government finances** - A surge in crude prices tends to increase India's expenditure and adversely affects the fiscal deficit.

  It also impacts the current account deficit — a measure of value of imported goods and services exceeding the value of those exported.

- **Impact on market -** Sectors including refining, lubricants, aviation and tyres are sensitive to oil price movement.
- Rise in crude oil prices impact their input raw material cost and profitability thereby hurting their share prices.

Source - The Indian Express

