Drivers of Oil prices in India

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Introduction

- The oil and gas sector is among the six core industries in India .
- In 1997–98, the New Exploration Licensing Policy (NELP) was envisaged to fill the ever–increasing gap between India’s gas– demand and supply.
- The Indian oil and gas is a $ 140 billion industry
- India’s economic growth is closely related to energy demand.
- Therefore, the need for oil and gas is projected to grow more, making the sector quite conducive for investment.

Introduction

- The Government of India has adopted several policies to fulfill the increasing demand.
- The government has allowed 100 per cent foreign direct investment (FDI) in many segments of the sector, including natural gas, petroleum products, and refineries, among others.
- Today, it attracts both domestic and foreign investment, as attested by the presence of Reliance Industries Ltd (RIL) and Cairn India.

Drivers of Oil Prices Globally

There are many factors that influence the global crude oil prices including:

- Technology to increase production, storage of crude oil by richer nations;
- Changes in tax policy,
- Political issues etc.

Drivers of Oil Prices Globally

- Fluctuations in the crude oil prices have both direct and indirect impact on the global economy.
- The price variation in crude oil impacts the sentiments and hence volatility in stock markets all over the world.
- Higher crude oil prices may mean higher energy prices, which can cause a ripple effect on virtually all business aspects that are dependent on energy directly or indirectly.

Drivers of Oil Prices Globally

According to the U.S. Energy Information Administration, there are seven key factors which have an influence on the spot prices of crude oil globally:

- Production,
- Supply,
- Natural causes,
- Inventory, demand,
- Non-OECD demand
- Financial markets and
- Spot market

Drivers of Oil Prices Globally

Production:

- A large part of the world's crude oil share is produced by OPEC (Organization of Petroleum Exporting Counties) nations.
- The Consortium is responsible for 40 percent of the world's oil production.
- The oil that OPEC exports represents 60 percent of all of the oil traded on international markets.
- Any decision made by OPEC countries to raise the prices or reduce production, immediately impacts the prices of crude oil in the global commodity markets.

Drivers of Oil Prices Globally

Supply:

- The non-OPEC suppliers represent 60 percent of the world's oil supply and as a group they're 50 percent larger than OPEC.
- They're referred to as "Price Takers" and they respond to market prices
- As a result, non-OPEC suppliers generally produce at or near full capacity.
- Any production lapse generally has the effect on oil supplies.
- It also gives OPEC the ability to further manipulate the world supplies.

Drivers of Oil Prices Globally

Natural Causes:

- In the recent past, we have seen many events driving volatility in the crude oil prices.
- Events like a hurricane hitting the oil producing areas in the U.S have driven the crude oil prices in the global markets.

Financial markets:

- Oil brokers don’t just sell physical oil.
- They also trade contracts for its future delivery, commonly known as “futures.”
- Some customers, like airlines, purchase futures to hedge against future oil price increases that could have adverse effects on their ability to operate profitably.
- Oil producers often sell oil futures contracts in order to lock in a price for a specific period of time.

Drivers of Oil Prices Globally

Global Oil Inventories:

- Oil producers and consumers build a storage capacity to store crude oil for immediate future needs.
- They also build storage capacity to speculate on the price expectations and sale/arbitrage opportunities in case of any unexpected changes in supply and demand equations.
- Any change in these inventory levels triggers volatility in the crude oil prices which, in turn, creates ripples in the spot market.

Drivers of Oil Prices Globally

- However, Global oil inventories balance supply and demand.
- If production exceeds demand, excess supplies can be stored.
- When consumption exceeds demand, inventories can be tapped to meet the incremental demand.
- If market makers notice an inventory build, spot oil prices will likely to drop in response to balance demand with supply.
- Conversely, if oil futures rise in relation to the current spot price for oil, the impetus to store oil will increase.

Drivers of Oil Prices Globally

Demand:

- During winter, the cold temperatures increases the use of energy for heating in many cold countries.
- During summer months, supply generally exceeds demand and petroleum inventories build up.
- Hence the crude oil prices drop.
- The OECD which is made up of the United States, most of Europe, Japan and other advanced countries is responsible for 53 percent of the world's demand for oil.
- While they consume more oil than non-OECD countries, their rate of growth is much slower.
- During 2000 to 2010, OECD demand actually went down, while non-OECD demand exploded by 40 percent.

Drivers of Oil Prices Globally

Non-OECD demand:

- China, Saudi Arabia and India together had the largest growth in crude consumption among non-OECD countries for the last decade.
- The rate at which oil consumption rises in any given country has a direct relationship to its rate of economic growth.
- So it comes as no surprise that for China and India, at least, their use of crude is skyrocketing compared to the United States.
- Developing countries also typically have more manufacturing-related industries, which tends to support higher crude consumption rates.

Drivers of Oil Prices Globally

Spot Market:

- Crude oil is traded globally, and the many different “streams” of crude oil tend to move in lockstep with each other regarding prices.
- At the refinery, these streams are processed to make the products we use: gasoline, diesel fuel, heating oil, lubricants, jet fuel and various other petroleum products.
- The price of both crude and the finished products are affected by events like hurricanes, geopolitical events, massive oil leaks, terrorist acts, that disrupt the flow of both crude and finished products.
- Since both supply and demand are relatively elastic, any of the above events, or the perceived risk of them, can lead to higher price volatility, especially in the futures market.

Behavior of Oil Prices in India

- India imports more than 80% of crude requirements from oil producing countries.
- Therefore, fluctuations in oil prices are being tracked more closely in the domestic markets.
- Prices of essential commodities like crude are also one of the prime drivers of inflation in the Indian economy.
- Shri **Pranab Mukherjee, the President of India** while addressing the National Energy Conservation Day in New Delhi said
- “Huge dependence on imports for energy needs will have an impact on the fiscal balance of an economy”

Factors Affecting Oil Prices in India

- The price of crude oil is set by the “fundamentals” of supply and demand and the “non-fundamentals” of geo-politics, exchange rates and financial speculation.
- Had the fundamentals being the singular and decisive determinant, the price of crude in financial year 2011-12 would have been in double digits.
- The demand was constrained by the recession in the West and the slowdown in China, and the supply was robust because Saudi Arabia was producing to near capacity and the US and European Governments were ready to draw down their strategic reserves.
- The price averaged $ 115 per barrel manly because of the non-fundamentals of geo- politics (the Israel-Iran imbroglio, the civil strife in Syria etc), currency depreciation and Wall Street traders.

Factors Affecting Oil Prices in India

The Geo-Political Factors affecting Oil Prices:

- After the Yom Kippur War in 1973, when OPEC Arab members turned off the taps on roughly 8% of the world's oil supplies by cutting shipments to the US and other Israeli allies, Crude prices spiked, and by 1974, real GDP in the US had shrunk by 2.5%.
- The second OPEC oil shock happened during Iran's revolution and the subsequent war with Iraq.
- Disruptions to Iranian production during the revolution sent crude prices higher, pushing the North American economy into a recession for the first half of 1980.

Factors Affecting Oil Prices in India

- A few months later, Iran's war with Iraq shut off 6% of world oil production, sending North America into a double-dip recession that began in the spring of 1981.
- When Saddam Hussein invaded Kuwait a decade later, oil process doubled to $40 a barrel, an unheard of level at that time.
- The first Gulf War disrupted almost 10% of the world's oil supply, sending major oil producing countries into a recession in the fall of 1990.

Factors Affecting Oil Prices in India

Economic Factors affecting Oil Prices:

- In 2008, when the world fell into the deepest recession since the 1930's, the oil prices: from trading around $30 a barrel in 2004 marched steadily higher before hitting a peak of $147 a barrel in the summer of 2008.
- Unlike past oil shocks, this time there wasn't even a supply disruption to blame.
- Paying more for the oil means we have little cash to spend on food, shelter, furniture, clothes, travel etc.
- Expensive oil coupled with the average American's refusal to drive less, leaves a lot less money for the rest of the economy.

Factors Affecting Oil Prices in India

- When oil prices go up, so does inflation. When inflation goes up.
- Central Banks respond by raising interest rates to keep prices in check.
- Rising interest rates in China and India are a clear signal that these economies are growing at unsustainable pace.
- Triple digit oil prices will end the lofty economic hopes of India and China which are looking to achieve the same sort of sustained growth that North America and Europe enjoyed in the post-war era.
- There is an unavoidable obstacle that puts such ambitions out of reach.