Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: Escalating tensions in West Asia and its impact on Indian economy

News: As oil prices surged after the killing of Iranian commander, General Qassem Soleimani, in a US drone strike in Baghdad, senior officials of the Finance Ministry and the Ministry of Petroleum and Natural Gas held a high-level meeting Friday to assess the impact and review contingency measures.

Why?

- There’s a possibility of a disruption to oil supplies impacting India’s external debt situation and restricting the headroom to counter the slowdown.

Why is it a worrying issue?

- The concerns stem from the fact that the quartet of Iraq, Saudi Arabia, Iran and the UAE are the top crude suppliers to India, all of which are in the geographical zone likely to be impacted. It is estimated that a $10-per-barrel increase in the price of oil would negatively impact India’s growth by 0.2-0.3 percentage points and worsen the Current Account Deficit (CAD) by $9-10 billion dollars.

- While Indian refineries import crude oil from diverse sources, depending on their technical and commercial considerations and keeping in view the domestic requirement, imports from the OPEC bloc has progressively been brought down from 85.4 per cent in FY’17 to 75.4 per cent in the April-September period of FY’20.

- A rise in global crude prices leads to an increase in the domestic price of crude products, thereby fuelling higher domestic inflation.

- A surge has both a direct and indirect impact on the consumer price index.
(CPI) — firstly, with crude products themselves figuring as constituents in the CPI and seeing a price impact and then, indirectly, a rise in retail prices of all other commodities manufactured using crude as an input reflecting as a cascading impact, which pushes up the CPI again.

- Crude oil import is denominated in the US Dollar and higher import prices raise the country’s import bill, leading to a worsening of the CAD — a measurement of a country’s trade balance when the value of the imported goods and services exceeds the value of the products it exports.

- CAD, however, is only a part of the country’s Balance of Payments accounting, which is dependent on various factors that include supply and demand of Rupee versus US Dollars, interest rate differentials and capital flows.

- India’s current account and fiscal deficits could worsen if oil prices remain at the elevated level, the RBI has warned it its last review. Experts said a sustained level above $70 a barrel could dent the country’s import bill and hence, fiscal math for the current fiscal.

- The RBI, in its latest Monetary Policy Committee review, had flagged crude oil prices as among six factors that could influence inflation outlook, with the rider that “crude oil prices are expected to remain range bound, barring any supply disruptions due to geo-political tensions” even as it revised the CPI inflation projection upwards to 5.1-4.7 per cent for the second half of FY’20.

- A further escalation of the crisis could potentially force the RBI to extended the pause in its rate-cutting cycle.

What was discussed in the meeting?

- Both short-term and long-term diversification measures to reduce dependence on the West Asian region, especially in the wake of a protracted escalation of the crisis, were discussed.
- They included alternative import options, including a status update on an
agreement entered into with the US and ongoing talks with Russia for crude supplies.

- Indian refineries are being progressively encouraged to import crude from sources such as the US, Canada and Mexico, apart from the discussions with Russia. An emphasis on expediting these negotiations has also been done.