

Crude Awakening

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Industry Research

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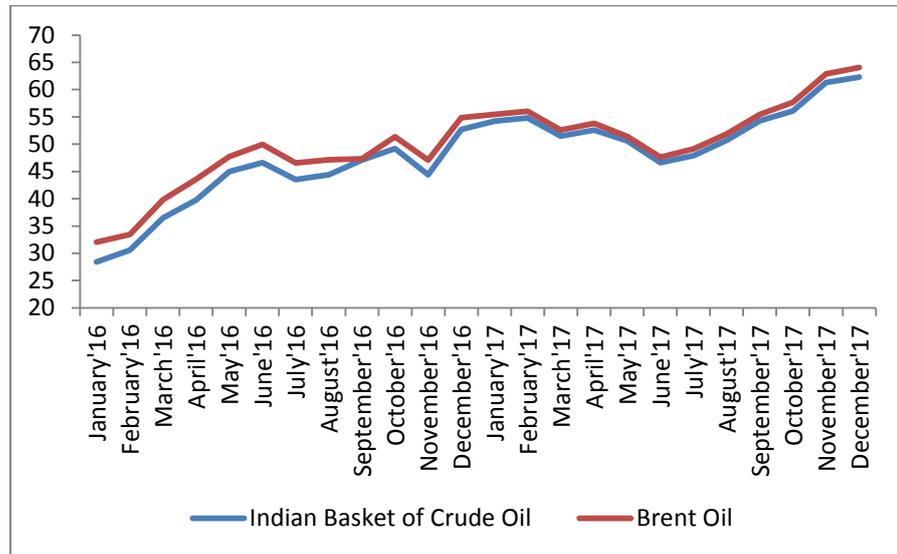
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Overview

The price of crude oil has touched the \$70/bbl mark, the highest since December 2014. Brent Oil has doubled in the last year. **Brent was \$32.1/bbl in January 2016 and \$64.1/bbl in December 2017.**

Chart 1: Brent Oil and Indian Basket of crude price movements since the past 2 years (\$/bbl)



Source: Bloomberg, PPAC

Since the start of this financial year particularly from June 2017 onwards, prices of Brent have been on a rise. The reasons were Geopolitical tension within OPEC countries and disruption in production caused by the cyclonic activity in the USA. Since Mid- July, Saudi Arabia, pledged to lower crude oil exports. In October prices of global crude oil started to increase sharply as a reflection of export cuts undertaken by Saudi Arabia and the production cuts undertaken by OPEC and non OPEC countries to rebalance the global supply glut which was undertaken since November 30th, 2016. Oil prices were also impacted by the rising tension between the Iraqi and Kurdish forces as the Kurdistan region of Iraq (KRI) pressed to hold a referendum on independence.

Post the November 30th 2017 meeting of the OPEC and non OPEC countries it was concluded to cut production by 1.8 million barrels per day, till the end of 2018. In December, 2017 the North Sea's Forties Pipeline System, one of the world's most important crude oil conduits, was shut due to the discovery of a hairline crack. About 450,000 barrels of oil a day flow through the pipeline when it is operating normally.

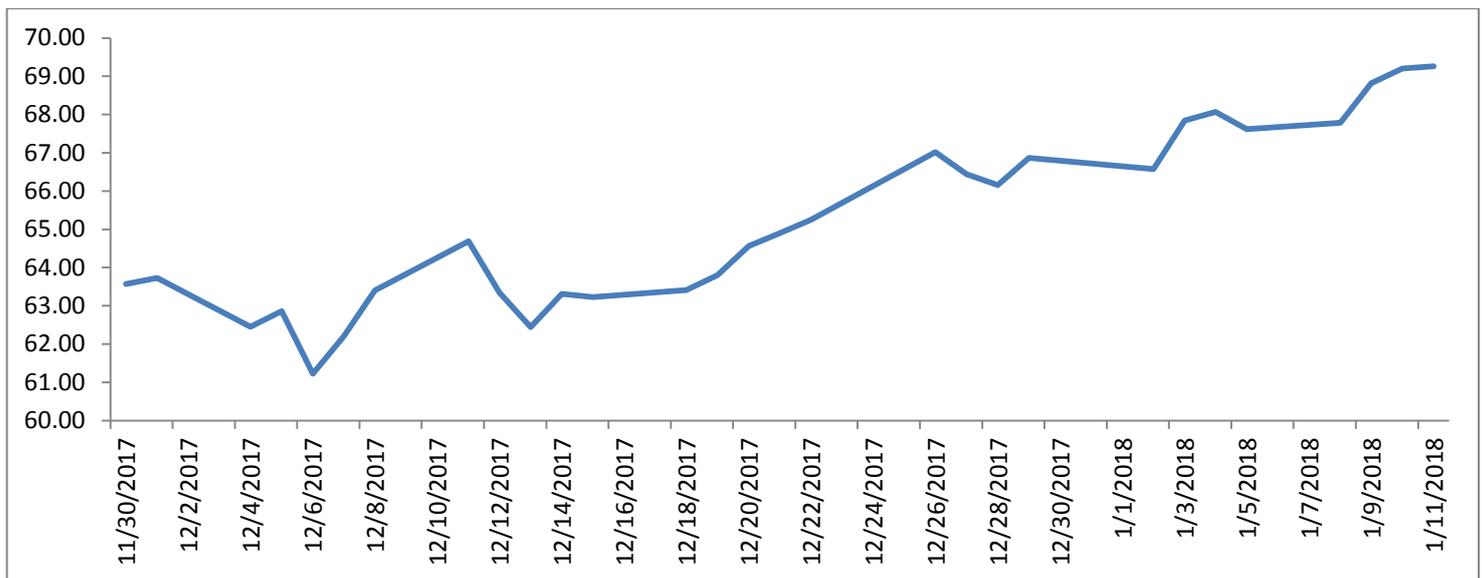
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Fortis plays an important role in the global market as it is the biggest of the five North Sea crude streams underpinning the Brent.

Further, greater than expected fall in the US crude inventories, increase in demand of oil due to the recovery of world markets coupled with the supply disruptions by the OPEC and Non OPEC oil producing countries has caused the prices of oil to rise significantly. Energy Information Administration said crude inventories fell almost 5 million barrels to 419.5 million barrels last week.

Oil prices can be pushed higher in future on account of supply disruptions from Iran (facing threat of U.S. sanctions) and Venezuela.

Chart 2: Brent Oil price movements since the 30th November, 2017 meeting (\$/bbl)



Source: Bloomberg

How does the rise in Crude Oil prices affect India?

1. According IEA worldwide consumption of crude oil is 96million/ bbl per day. India is world's third-largest consumer of crude oil. India imports around 4.2 million bbl/per day. At the macro-level, with imports of 1,568 million barrels of crude oil on an annualised basis, a dollar increase in prices on a permanent basis would increase the bill by roughly Rs 10,000 crore on an annual basis (156.8*64)assuming no change in exchange rate.
2. Import bill would increase by approx. \$ 1.5 bn for every dollar increase in crude oil price.
3. WPI inflation would be directly impacted as the pass through of price increase would be automatic for most products. We estimate that the WPI could increase by 0.5-0.7% on account of 10% increase in crude oil price. CPI impact would be less pronounced given the lower weight of oil related products and could be in the region of 0.3-0.35%.
4. Challenge for the government would be on the fiscal side and the assumption made for the year. In the face of higher inflation, the options would be to either increase subsidy on the expenditure side or lower taxes (along with states) on revenue side.

Concluding remarks

- We believe that the oil price rally is likely to continue till March for certain until the winter demand subsides and clarity reached on the production plans in the USA. OPEC and Non OPEC countries are committed in cutting down crude oil supplies and we are witnessing sharp increase in prices daily. The only relief in the foreseeable future could be if US production picks up even more than its current level. Since the past two years, US have been increasing its production and exports to other nations. As per EIA's latest realise US crude production has been 9.6 million bpd.
- Brent Oil will remain range bound in the \$ 65 region until there is more clarity on the US counter-move.
- Crude oil price will put pressure on inflation, balance of payments and fiscal policy.
- Rise in crude oil will increase the price of natural gas which in turn will increase the input cost for fertilizer and petrochemical companies which use fertilizers as a feedstock and increase the price of CGD entities and power companies which use natural gas as a fuel.

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