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December 1, 2016 | Economics

# The OPEC Impact


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The 14 member-OPEC (Organization of the Petroleum Exporting Countries) group which supplies 34% of global crude oil has agreed for its first oil output cut in the last 8 years. The cartel has agreed to cut production by about 1.2 million barrels per day or about 4.5% of current production, to 32.5 million bpd. OPEC estimates show that overall production is around $ 96/mbd with the balance coming from the non-OPEC countries.

Based on the discussions at the OPEC meeting and the expectations of the reaction of other non-OPEC nations on the quotas to be adhered, the following is the proposed cuts by different countries which will come into operation in January 2018.

**Table 1:Country-wise Production cuts (Barrels per day)**

| Country | Production Cut |
|---|---:|
| Saudi Arabia | 486,000 |
| United Arab Emirates | 139,000 |
| Kuwait | 131,000 |
| Qatar | 30,000 |
| Iraq | 210,000 |
| Iran | 90,000 |
| Venezuela | 95,000 |
| Angola | 80,000 |
| Libya | Exempt |
| Nigeria | Exempt |

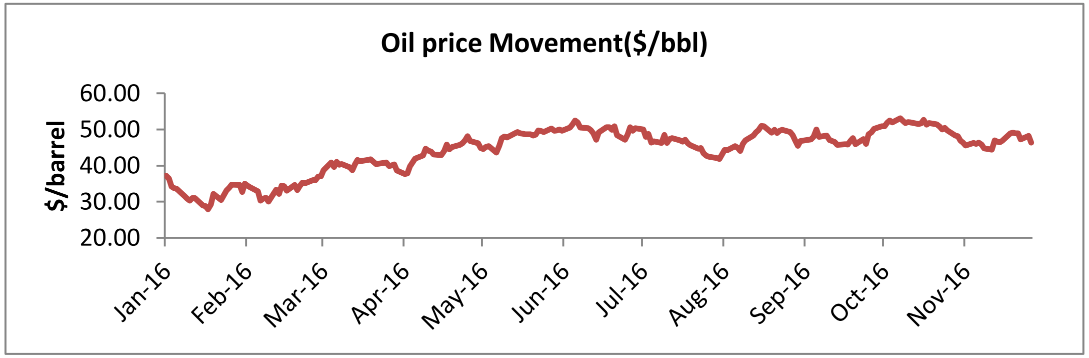
There will also be held a meeting with Non-OPEC members on December 9, 2016 regarding their production cut backs. The motivation for lowering output is that the oil producers have been impacted by the trend of low crude oil prices which was partly brought about by the low global demand conditions as well as oversupply tendencies among the OPEC nations. This in turn affected the growth of these economies which are driven primarily by oil exports.

These nations had continued to drive the price low so that this move could counter the commercial viability of the shale operations in the USA, which ultimately did not make a serious dent to their existence. The damage to some of the OPEC nations has however, been severe with forex reserves drying up prompting cuts in expenditure by the government, especially on social programmes.

**Movement in Prices:**

Global oil prices reacted immediately to this decision and rose nearly 9% after the announcement was made with Brent crude rising from $46 per barrel up to $51 per barrel. There are estimates put out by different agencies for the future price of crude oil price, which indicate a movement towards the $ 55 mark or even $ 60/b. The factors driving the price would be:

- The extent to which the OPEC nations stick to their output cuts. There are chances that some countries would still continue to produce more.
- The non-OPEC nations which have agreed to cut down on production also need to reduce their output for the OPEC deal to work. OPEC is expecting at least 600,000 bpd cut from these nations, which includes cooperation from Russia, which can spring a surprise.
- The demand conditions in the west - where the winter months normally brings in greater need to use oil for heating purposes.
- The reaction from USA is critical which has in the past used its own resources from shale to increase supply and hence stabilize prices. Investment in shale production that had come to a halt in the last 2 years when there was a glut, would resume once prices start to rise, which in turn will affect the global crude oil price as supplies increase. It has been estimated that US production could increase from between 300,000-900,000 bpd which can upset OPEC's calculations. US had increased its production to 8.7 million bpd last week.



It is expected that the announcement of production cut is definitely going to increase global oil prices by 5% or 10% according to Bloomberg. This would also tend to imapct India's procument price sharply. The imapct can be evaluated on the import bill and inflation.

**Impact on India**

In the Indian context, the price of crude oil basket (which is different from Brent and WTI) has risen by around 35% for the period January to November'16 from $ 33 to $ 45/barrel during this period. The import bill has been somewhat stable as oil prices were favourable to India.This announcement is definitely going to hurt India's Import bill and Inflation. The tables below estimates the implications on Imports :

**Table 2 : Imported crude oil Quantity (Barrels)**

| Particulars | Quantity(Barrels) |
|---|---|
| 2016-17(April-Oct) | 1,145,937,331 |
| Per month consumption in FY16 | 163,705,333 |
| ***Expected imports in the period Jan-March*** | |
| Jan 2017- March 2017 | 491,115,999 |

Based on the trends in imports of crude oil in the first 7 months, it has been estimated that the total imports for Jan-March, when the output cuts are invoked, would be around 491 mn barrels. Hence, for every dollar increase in the price of crude oil, the overall import bill will increase by around $ 500 mn or half a billion. If the price increases by $ 5 per barrel, then the additional import cost would be around $ 2.5 bn for the last quarter of the year.

**Impact on WPI**

The increase in price of crude oil would have an impact on inflation in the country. The weight of crude oil, petroleum, ATF and diesel is around 7% in the WPI. Intuitively it can be inferred that 5% increase in crude oil prices (based on the basket of Indian imports) would push up the direct cost by around 0.35% points. Products like LPG and kerosene are partly protected through subsidies and would also entail a cost for the government in the budget. There would also be an indirect impact through prices of other goods increasing which can be between 30-40% of the direct impact.