OPEC+ December meeting
Supply cuts extension

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Overview

Since the last meeting convened by OPEC and its allies there has been certain changes in the dynamics of crude oil prices and demand-supply considering the novel coronavirus is showing no signs of abating.

Crude oil prices have been subject to fluctuations with respect to the total demand annihilation of petro-products caused due to government induced lockdowns all over the world and the resumption of oil production and exports by Libya. But lately due to positive strides in the development and approval of a safe and effective COVID-19 vaccine by various pharmaceutical companies, oil prices have been rallying.

Originally (as per the agreement drawn on during the 10th (Extraordinary) and 11th OPEC and non-OPEC Ministerial meeting) the cartel was to cut production by,

Time Period	Quantum of Production Cuts
May '20-July '20	9.7 mb/d
August '20-December '20	7.7 mb/d
January '21- April '22	5.8 mb/d

*mb/d million barrels per day

The aforementioned production cuts announced by the cartel have been the largest/deepest ever production adjustment in the history of the oil industry.

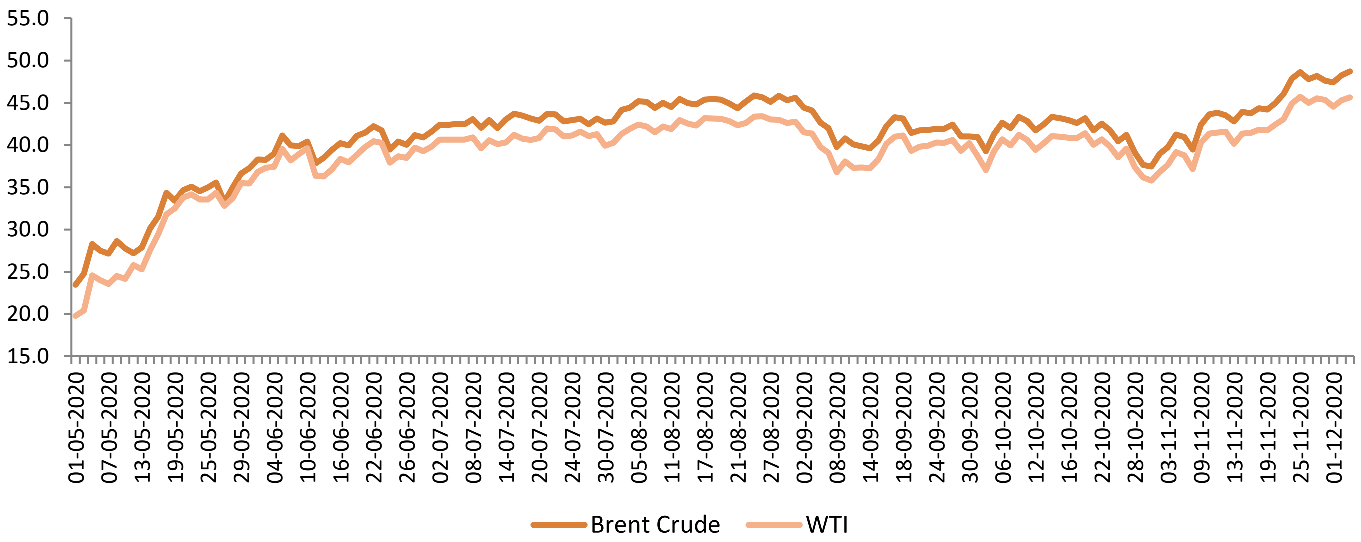
Verdict: During the 12th Ministerial Meeting, OPEC+ members have decided to increase production by 500,000 barrels per day beginning in January 2021. This will bring the total production cuts at the start of 2021 to 7.2 mb/d. In addition to the agreement for adding 500,000 bpd of production back in, OPEC+ members that are laggards in sticking to their production quotas will have to make up the difference between now and March.

Furthermore, participating counties have agreed to hold monthly OPEC and non-OPEC ministerial meetings starting January 2021 to assess market conditions and decide on further production adjustments for the following month, with further monthly adjustments being no more than 0.5 mb/d.

It was speculated the cartel would continue to curb production by 7.7 mb/d for the next 3 months but due to certain apprehensions expressed by some of the members, it was decided to modestly increase it by 0.5 mb/d.

Between May and October 2020, the OPEC+ group has managed to reduce the global supply by approximately 1.6 billion barrels, including voluntary adjustments, which has been the key to the rebalancing of the market. Member nations have compensated a total of 768 tb/d (thousand barrels per day) to make-up for the previously overproduced volumes. This has led the cartel in achieving a level of 99.5% of the production adjustment commitments since May 2020.

Chart 1: Movement in Crude oil prices since the implementation of OPEC+ production cut (Unit: USD/bbl)



Source: Bloomberg

Oil prices have been recovering with the compliance of the production cuts and with the global economies opening up in a phased manner. The gap between both the benchmark crude oil prices has also decreased considerably ever since the OPEC+ group's mega production cuts have come into play as even the US is consciously monitoring its oil production post WTI going into a negative zone in April 2020. Positive strides made towards the development of an effective COVID-19 vaccine has also led to Brent oil to rally to USD 48/bbl and reach its highest level since April 2020.

Concluding Remarks

Even though the oil markets have reacted positively in recent days in the development and approval of a safe and effective COVID-19 vaccine, the global deployment of vaccines will take time, and its effect will likely begin to be significantly apparent in the second half of CY21. OPEC and its allies have agreed to collaborate and support the oil economy, but it will be crucial to see the reaction of the markets towards the on-going supply cuts considering global oil demand for CY20 is expected to decline by around 9.8 mb/d and as the second wave of the pandemic and related lockdowns can put a damper on demand.

Price call

Price of crude oil will be elevated and range between USD 48-53/bbl for a while till the strict adherence of the production cuts is met and if US production and inventory data too is within limits. Further positive news regarding the COVID-19 vaccine trails is also to support the oil prices going forward. Announcement of further lockdowns in Europe and the US with the second wave hitting the regions could act as a detriment to oil demand and could implicate to oil prices falling again.

CARE Ratings Outlook

Impact on the Indian economy

The current oil prices prevalent at the moment are quite favourable for the Indian economy considering how the country imports more than 80%-85% of its oil requirements.

- ***Trade:*** Depending on the oil price prevalent, on a macro level, with imports of million (3.6*365) barrels of crude oil during FY21, a dollar increase/decrease in prices on a permanent basis would increase/decrease the bill by roughly USD 1.3 billion per annum. India's crude oil import bill had come down by 8.7% during FY20 to USD 102.2 billion and is currently value of crude oil imported has fallen by 55.9% during April-October 2020-21 to USD 26.9 billion.

- ***Inflation:*** Crude oil and its products have a weight of 10.36% in the WPI. Of this crude oil and natural gas have a weight of 2.41% and mineral oils around 7.95%. With the exception of LPG and kerosene (with combined weight of 0.83%), the rest would be driven by market forces. Therefore, any increase/decrease in the price of crude oil would tend to impact the WPI inflation number commensurately. In case of the CPI the impact of crude oil prices is directly related to the pass through to transportation fuels which has weightage of 2.39%. Thus increase/decrease in the crude oil prices will impact the WPI more than the CPI.

- ***Government Revenues:*** Currently as of 1st December 2020, the government, centre plus states are able to collect around 195% taxes, (Excise Duty and VAT) on the base price of petrol and 155% in the case of diesel (as on 1st December 2020). Taxes now make up around 63% of the retail price of petrol 59% of the retail price of diesel (as on 1st December 2020). With the fall in crude oil prices the government is relying on the recovery of fuel demand (as the economy is opening up in a calibrated manner) to aid in increasing government's revenue. The government has never passed on the full benefit of the soft crude prices to the consumers and in the last few months even with the sharp fall in price of crude oil, prices of petrol and diesel have not been revised downwards but instead has been kept static .

Note: Retail fuel (petrol and diesel) prices are linked to the price of these fuels in global markets, not that of crude oil per se. As such, the demand-supply situation of finished products in global markets has some effect on the retail price of auto fuel here. Despite that, crude oil, which accounts for about 90% of the cost of these refinery products, is the biggest determinant of retail fuel price.