Falling Oil Prices and Global Economic Landscape

The unprecedented fall in crude oil prices from an all time high of $145 to $45 per barrel would bring a sea change in the economic landscape of the country as well as the world. The price of Brent crude which was hovering around $115 per barrel on June 23, 2014, is now just at $ 52 per barrel as on February 9, 2015. This fall is on account of an over-supply of oil, triggered by the rising US shale oil exploration, inflating US oil output levels to their highest in last 30 years, which is almost 70% above their 2008 levels. This has elevated the US dollar to its highest level of exchange rate of last 12 years vis-à-vis six major currencies of the world. Moreover, if the present level of output is retained by all the oil producing countries, the prices may even plummet to $25-30 per barrel and push shivers down the spine of major oil exporting nations. This would also be the genuine and true-value of oil today, if the pre-1973 price of $3 per barrel is extrapolated, which prevailed before the oil embargo by the Arab countries, aiming to blackmail the US and other major powers against Israel, struggling for its survival in the wake of concerted aggression of the Arab Nations to rout the Jewish homeland from the Arab region.

However, for India, the falling oil prices are a boon for containing the wide deficits, burgeoning in the current account as well as in the fiscal balance of the country. Additionally, it is also going to aid the government in taming inflation, baffling it till the last fiscal, since last four and a half years. India imports more than three fourths of its annual oil requirements, constituting almost one third of the total import bill of the country. A fall of every single dollar in the price of oil helps the country to save $ 40 billion a year. A fall of 10 US dollars per barrel can help the country to bring down the current account deficit by 0.5 percent of the GDP and the fiscal deficit by 0.1 to 0.12 percent of the GDP. A 10 percent decline in oil prices can help us bring down inflation by around 0.2 to 0.25% and push up growth by 0.3 to 0.32 percent per annum.

Unlike India, the falling oil prices have led the economies of most of the oil exporting countries like Russia, the OPEC, the Latin American as well as African countries into severe crisis. These countries are largely dependent on oil revenues to the extent that many of them are likely to face a rapid surge in economic meltdowns, corporate bankruptcies in the oil sector and sovereign defaults. Quite a many of such countries, including Russia, Venezuela, Argentina, Ecuador etc. have been banking upon China as the lender of the last resort. It is going to alter the total geo-political balance of strategic relations worldwide, besides, triggering long-range changes in the global financial architecture to the tune of even making the IMF, the World Bank and the G-7 largely irrelevant in their role in shaping the economic scenario with respect to global trade, investments and finances across the globe, as these Chinese loans are not without strings. But, all these countries do not have any other option.

Russia incurs a loss of around $2.0 to $2.2 billion in revenues, for every dollar's fall in the oil prices. Therefore, the World Bank has already warned that Russian economy might shrink by 0.7 percent in the current year i.e. in 2015, if the oil prices stay low. China, while seeing it as a unique opportunity to reshuffle and barter global balance of power in its favour, has been stumping up billions of dollars of loans to these countries whose economies are crumbling from falling oil prices. China has a clear and unambiguous goal to internationalise its currency Yuan on the one hand, and to expand and strengthen its global clout on the other, by extending such loans to all these crisis ridden countries. The Bank of England's endeavor to pose as a lender of last resort in the Overend Gurney panic of 1866, in the manner China has now been lending, had then elevated the pound sterling as the international reserve currency. Similarly, the swaps by the American Federal Reserve (the Central Bank of the US, like the RBI) with foreign banks, after the financial crisis of 2007 had also bolstered the dollar. So, if China has been emulating the U.S and UK, especially when it is over-flush with export earnings, it should be no surprise. But, the terms at which China has been lending, as

an alternate banker, rendering all the global agencies like the IMF and the World Bank redundant, are not publicly known, and may be too harsh to scuttle any immediate recovery in these countries or in the global economy, due to tough collaterals of China, as is being apprehended by experts. One thing is clear beyond doubt that, China has procured firm commitments from all the borrower countries to reciprocate with ample projects and contracts to Chinese companies for years to come. Sensing the severity of the crisis in several countries, China has scaled up its loan book over the past 5 years, with a clear assertion that the borrower countries give more than reciprocal access to Chinese companies and project executors. China has also committed USD 500 billion plus in currency swaps with 30 countries from Canada to Venezuela and Nigeria to Pakistan, which has all been rendering the counterparties dependent upon Chinese Yuan in a big way.

India, however, should not remain as a spectator in the global arena, when China is loosening its purse strings to strengthen its clout in financial diplomacy. India should rather intervene even more actively in all global moves aimed at reshaping the financial architecture and even independent of the Chinese moves, to promptly save the turf from growing Chinese influence. India needs to tread its path very cautiously with fine tuned calibration. It should also rethink on the UPA's decision of allowing Indian corporates to raise loans up to $ 500 million through Yuan denominated bonds or of availing cheap credit lines offered by the Chinese for setting up power plants in India. Even the MOUs signed by India with China for railway modernisation or for setting up intergrated industrial parks for easy Chinese money needs to be revisited.

Since, India is heavily dependent upon Foreign Portfolio Investments (FPI) coming from the Foreign Institutional Investors (FIIs) and the Foreign Direct Investment (FDI) inflows, to bridge its Current Account Deficit (CAD), there is an urgent need to curb growing imports, at every cost to bring down the CAD to zero, which is possible with the plummeting oil prices. Though, the likely bankruptcies erupting in the oil sector abroad, imminent sovereign defaults and economic slowdown in the OPEC might affect our export revenues as well and might also scuttle the private as well as corporate remittances from abroad which may bring our trade and current account balances under pressure. Therefore, the flip side of this phenomenon also needs to be taken care-of. Yet, and in spite of all the odds, the falling oil prices decisively offer an opportunity to India to relinquish its over dependence on foreign investments, with the declining oil import bill. However, domestic investments too need to be triggered and sustained to meet our growing investment needs for the industry and commerce; including infrastructure, railways, smart cities and so on. Without availing this opportunity to curb the CAD with declining oil prices, we would never be again in such a position of advantage to relieve ourselves from growing dependence upon foreign investments to bridge the CAD. Indeed, domestic investments alone can lead to desired ancillarisation and development of a components sector, capable to raise production, employment and incomes manifold, necessary to promote products and brands 'Made by India'. If we take the case of the US, which has opted for and resorted heavily to Quantitative Easing (QE) leading to monetary expansion to the tune of $2 trillion in the post-meltdown era, for generating domestic resources to be invested, instead of soliciting any foreign investments or loans to secure faster recovery in the post meltdown era. Europe too had resorted to it (QE) and has been continuing with it. Japan has been doing the same now. Since, India has a much vast market in numerical terms it can therefore afford to opt for internal monetary expansion. But, it should be via a Special Purpose Vehicle (SPV) route to circulate fresh monetary resources for domestic investments, and growth, to avoid demand-pull inflation in consumables.

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