OIL&GAS

Stoking inflation; choking growth

Rising crude prices pose a serious challenge to curb inflation and may impact economic growth adversely. Sunil Fernandes reports

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he last few months have been characterised by unprecedented developments in the oil and gas markets. First, it was the unrest in the Middle East and North Africa region, followed by the tsunami in Japan. Crude prices (WTI) have been gaining ground steadily and have risen by as much as 50 per cent since February 2011. Brent Crude has hit a recent high of almost $126, breaching the highest levels achieved in the last 30-months.

The sharp rise in crude prices is now a big worry. The global economy would clearly be impacted by rising crude prices on inflation, particularly in China and India, which have emerged as giant economies. China is doing its utmost to dampen inflation and has raised key interest rates earlier this month –   
doing so for the fourth time since October 2010.

India is already feeling the pinch of rising crude prices. “Current oil prices will spur global inflation and retard economic growth. India feels that this is a concern that needs to be addressed on priority,” minister of state for petroleum and natural gas R P N Singh said at the recently concluded fourth Asian Energy Ministerial Round Table in Kuwait.

His concerns can well be understood, since India faces a precarious position. Should it continue to subsidise oil prices, the country loses heavily, adding to the budgetary deficit which is already running high. On the other hand, should it increase fuel prices to factor in rising crude prices, the country stokes up inflation, which is running at near 9 per cent levels. The country has already raised rates in January this year, and it was for the seventh time it did so, since raising rates in March 2010.

The International Energy Agency (EIA) sees the impact of rising crude running across economies. “Oil is harming global economic growth and is a mounting concern for consuming nations,” Richard Jones, deputy executive director of the International Energy Agency said recently.

“Oil at $120 or more has an effect on economic activity. We have seen similar levels during times of economic slowdown if not recession,” he observed.

The moot question now is: Would crude prices dip? In the short term, it looks unlikely that there would be a sharp reversal in trend. There seems to be a sustained economic recovery around the globe and a recent government report in the US showed that gasoline inventories plunged the most in 12 years. Also, there seems to be no end in sight to the present crisis in Libya, with production having dwindled to a few thousand barrels per day.

Having said that, it is also pertinent to point out that th ere has been an element of speculation which led to a sharp rise in prices. With some signs of stability, it is likely that speculative unwinding may see prices retracing from the current levels.