IMPACT OF OIL PRICES ON FX - SPOT MARKET IN INDIA

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ABSTRACT

Oil is one of the most important commodities in the world. Oil is greatest in importance because of its significance of being a far easier to use than any alternative fossil fuel. Oil price has the capability to move the whole spectrum of the market because of its demand and supply and we as a county heavily count on oil, as it is used in our day to day life. After the World War II, oil consumption in India has increased drastically. On other hand there have been great efforts to reduce the consumption of oil, by using other form of energy. India more than 60 % of import payments goes in paying oil bills.

In today's scenario the oil prices are determined by an association, the OPEC (Oil Producing and Exporting Countries), it was established on 1960 to coordinate oil production among the leading exporters. About 65% - 70% of the world's oil reserves are in the Middle East and the Arab Countries.

INTRODUCTION

The price of crude oil experiences broad price swings, same as prices of other commodities, during period when there is shortage or oversupply of particular commodities.

The crude oil price cycle may extend over several years responding to changes in demand as well as OPEC and non-OPEC supply. We will discuss the impact of oil pricing in forex spot market in India. Until March 28, 2000 when OPEC adopted the $22-$28 price band for the OPEC basket of crude, real oil prices only exceeded $30.00 per barrel in response to war or conflict in the Middle East.

In the crude oil industry, there are oil names such as Brent Light Crude Oil and Bonny Light. Futures contracts for crude oil are traded at the New York Mercantile Exchange (NYMEX), Intercontinental Exchange (ICE), Dubai Mercantile Exchange (DME), Multi Commodity Exchange (MCX), India's National Commodity and Derivatives Exchange (NCDEX) and the Tokyo Commodity Exchange (TOCOM).

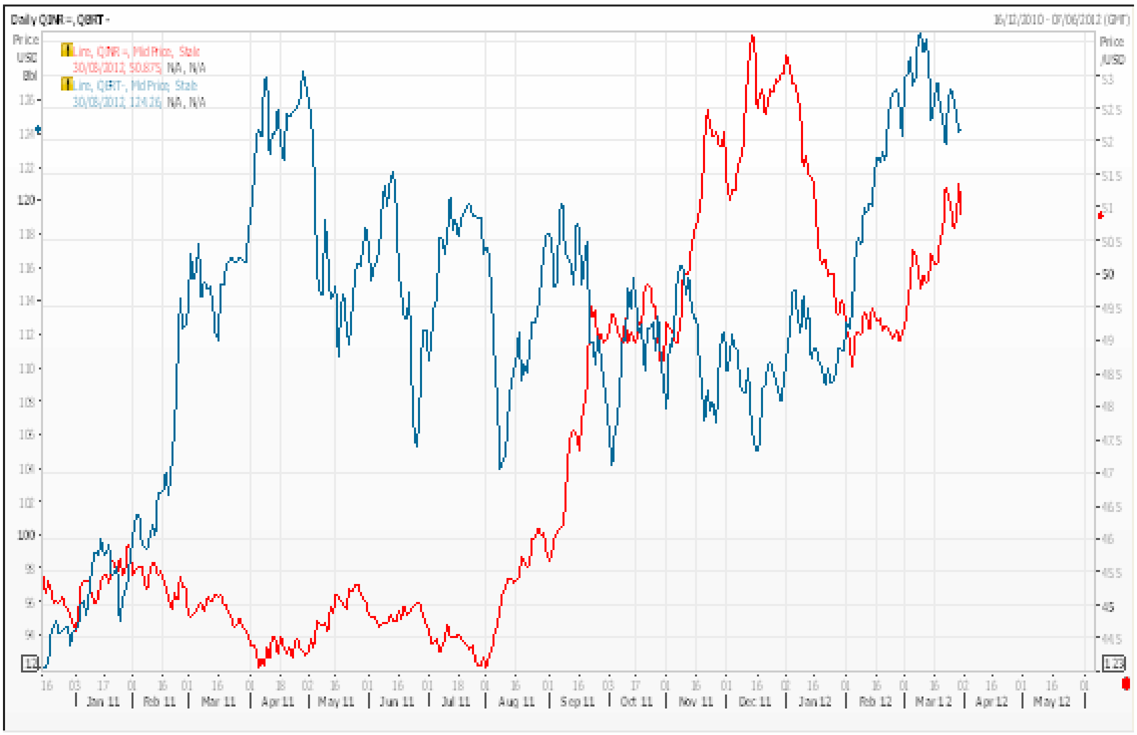
Brent Crude is a major exchange traded crude oil in the world; oil is priced in two ways, in spot market and in futures market across the global.

Impact of Oil on Fx Spot Market

Crude oil accounts for almost a quarter of all Indian import. According to the Reserve Bank of India, crude and other oil products accounted for more than 30 per cent of the country's total imports in the year 2010-11. Rising crude prices poses a serious concern, since it has a cascading effect on India's economy, including its fiscal deficit, current account deficit and inflation. If the crude price continues to strengthen, it will lead to higher inflation, which will attract monetary tightening by Reserve Bank of India.

When oil price is increased by OPEC countries, the ideal senior is the price of a currency should depreciate, i.e for example, if on a particular day, the price of oil is \$100 per barrel and if the price of the per barrel is increase to \$110 that means, we need to buy more USD by given rupee for paying oil bill. Generally the Oil bills are to be paid in USD, so as and when the price of the oil increases the Rupee value should decrease against USD.

But in really scenario, when the Oil prices go up it does not, assure that the Spot Rupee will depreciate or vice versa which is highlighted in the graph given below



Source: Thomson Reuters

The blue line in the graphs indicates Brent crude price and the red line in the graph indicates Spot USD / INR. As per the graph most of the time it shows that when the price of Brent crude has increase the Spot Rupee has strengthen and vice versa. This is mainly because of two reasons. Firstly because the Indian Rupee is partially convertible, so it never gives market based price discovery, it will only work when Indian Rupee is made fully convertible based on market forces who will think alike. Secondly Indian Spot Rupee movement is not only based on one factor but is based on numerous factor like Political, Social, Geographical, and other related commodity price like gold and silver which also plays a great role for the spot Rupee movement

The increase in Crude price will defiantly effect India inflation, as the impact of oil prices on inflation would probably be greater in the emerging economies like India. India would then require employing expansionary fiscal and monetary policies to offset the impact of higher oil prices on growth.

CONCLUSION

In the following article, we have discussed about crude price and its effect on USD/INR Spot FX Market. OPEC is the largest producer of oil in the world. Oil being one of the most important commodities in the world, even its importance and significance for India is high. India's major portion of the import bill payment goes in paying oil bill. This article show how important role an oil pricing in international market play to control the inflation of the country. The central bank like India needs to alter its fiscal policy if there is vast change in oil price. But Indian Currency being a partially convertible currency and there being more than just one factor which effects the currency movement some time even if the Oil price in the international market increase, we may not experience a Rupee deprecation.

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