

# Crude Oil Price Crash - Black Gold Loses its Glitter

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RBSA  
Research Initiative

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40  
Years of  
Leadership

- Valuation
- Investment Banking
- Advisory Services



## Historical Rise in Crude Prices

The plummeting crude oil price is bringing cheap oil to net importing countries like the United States and India while wreaking havoc on oil-producing countries like Russia and Venezuela.

Back in June 2014, the price of Brent crude was up around \$115- \$ 120 per barrel. As of January 23, 2015, it had fallen by more than half, down to \$49 per barrel.

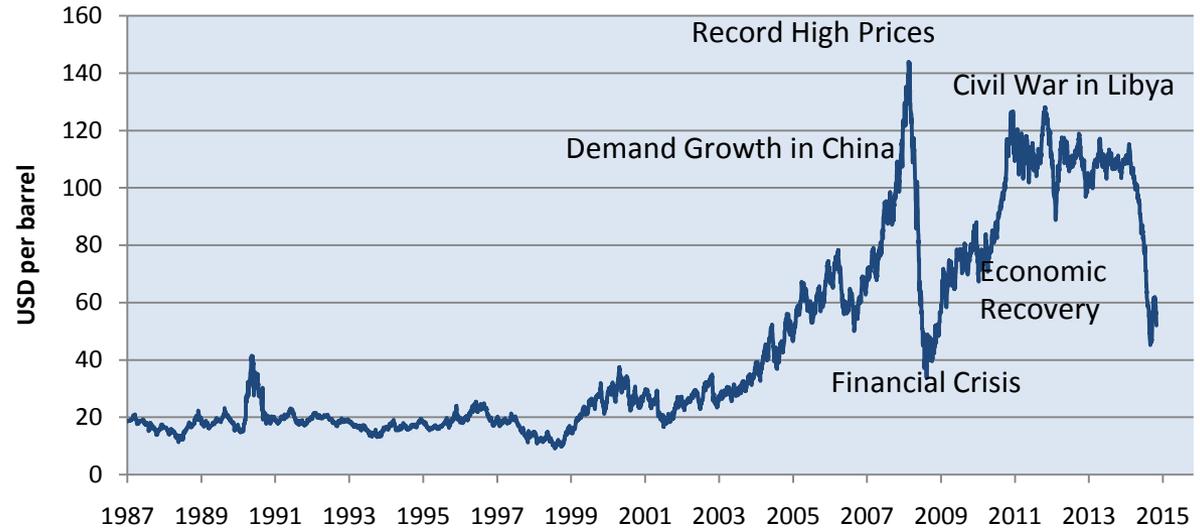
### Time Lines:

**2004-2008** : Non OPEC production decreased and demand increased. Hence the price rise was due to market fundamentals.

**The Unprecedented rise in 2008 was due to decrease in supply:**

- **February 2008:** Venezuela cuts off oil sales to ExxonMobil due to nationalization of the company's properties
- **March 2008:** Iraqi production was low due to wartime damage and saboteurs blew up the two main oil export pipelines.
- **April 2008:** Scottish oil workers strike led to closure of the North Forties pipeline in the UK.
- **April–May 2008:** Nigerian production was shut down due to militant attacks, sabotage, and labour strife.
- **May 2008:** Mexican oil exports (tenth largest in the world then) fell sharply

## Brent Spot Price (\$ per Barrel)



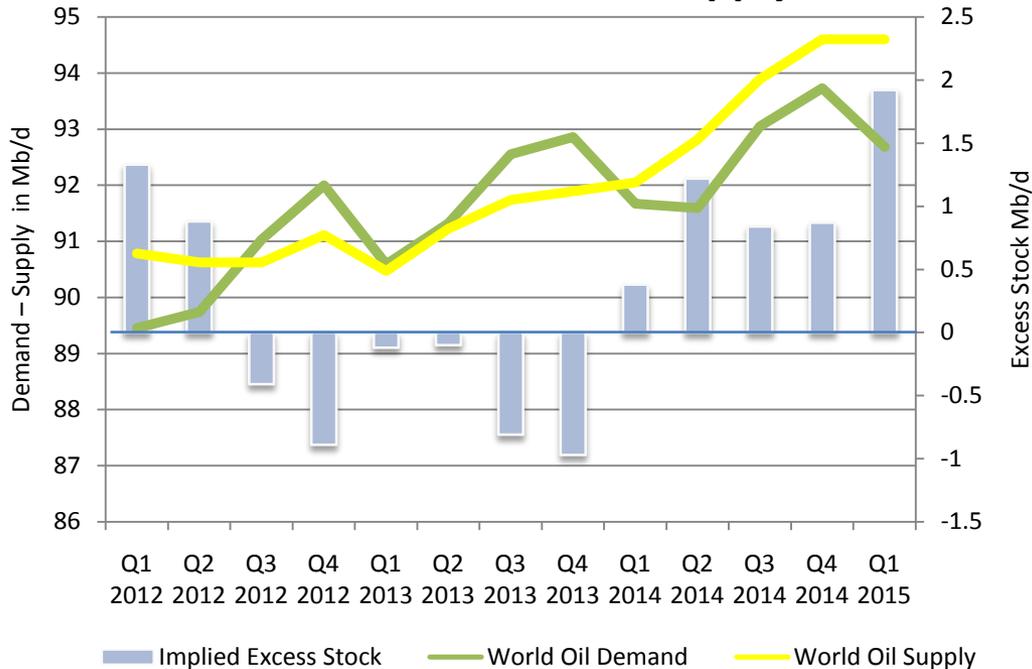
### *The short version of the story:*

*Oil prices had been high because of:*

1. *Soaring oil consumption in countries like China.*
2. *Conflicts in key oil nations like Iraq.*
3. *Oil production in conventional fields couldn't keep up with demand, so prices spiked.*

# Current Crude Prices

## World Oil Demand Supply



Source: International Energy Agency

BY 2014, OIL SUPPLY WAS  
MUCH HIGHER THAN  
DEMAND

### Why is the price of oil falling?

The dynamics of Oil exploration was rapidly shifting. High prices spurred companies in the US and Canada to start drilling for new, hard-to-extract crude.

- In the United States, companies began using techniques like fracking and horizontal drilling to extract oil from shale formations in North Dakota and Texas.
- In Canada, companies were heating Alberta's goeey oil sands with steam to extract usable crude
- Demand for oil in places like Europe, Asia began tapering off, thanks to slowdown in countries like China and Germany.
- By late 2014, world oil supply was on track to rise much higher than actual demand as shown in the adjacent chart. A lot of unused oil was simply being stockpiled away for later. So, in September, prices started falling sharply.
- OPEC, the world's largest oil cartel, decided not to cut back on production to push prices back up.

# Current Crude Prices

## Why is the price of oil falling?

- Due to high oil prices production of oil using expensive methods like fracking and horizontal drilling became economical in USA.
- In 2014 the USA production increased from about 4-4.5 million barrel per day to about 8.5 million barrel per day. If USA would have been in OPEC it would have been amongst the top two producers.
- The total production of Oil today in USA is larger than Saudi Arabia. Although USA is still a net importer of Oil.
- Until 2010 USA was net importer of the gas however now it is exporting more gas than Abu Dhabi and Qatar put together.
- In USA, the production of Oil is not regulated. Hence as long as it is economical, the exploration companies will produce oil.

## Why is OPEC not reducing the production?

- In OPEC meeting in Vienna on November 27, 2014, countries like Venezuela and Iran wanted the cartel (mainly Saudi Arabia) to cut back on production in order to prop up the price.
- Saudi Arabia believes that low oil prices would make it unprofitable for USA companies to produce

oil, and will eventually go out of business.

- For all intents and purposes, OPEC is now engaged in a "price war" with the US.
- **Political Reason:** The Iran sanction reduced its oil export by 60 percent, and finally Iran became politically irrelevant in OPEC and the world. The Saudi Arabia wants to protect its Political relevance in the world economy.

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*IN GULF THE ABILITY TO  
MANAGE THE BUDGET  
WITH OIL PRICES OF \$50-  
\$60 IS HIGH.*

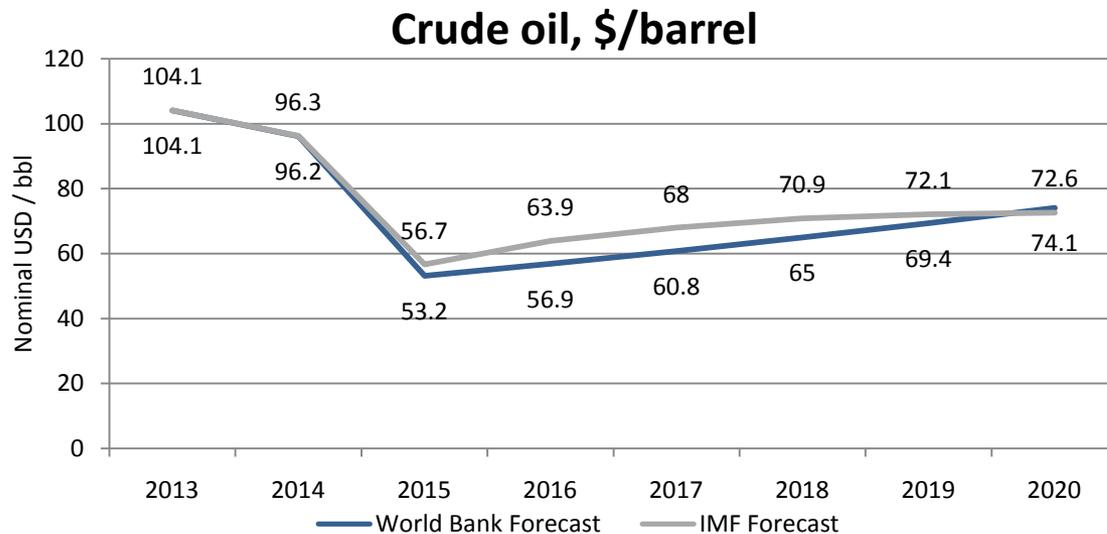
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## Future Oil Price Forecast

### Will global oil prices stay low?

- If oil demand remains weak and oil production stays high, prices might not bounce back for some time.
- In January 2015, the World Bank released its commodity forecast which predicts that world crude oil price shall fall from \$96/barrel in 2013 to \$53/barrel in 2015.
- According to commodity price forecast by IMF released in January 2015, spot average price for crude oil will fall from \$96.3/barrel in 2014 to \$56.7/barrel in 2015.



\* Average of (Brent, Dubai & WTI)

Source: World Bank & IMF

*IN JANUARY 2015, BOTH  
IRAQ AND RUSSIA  
ANNOUNCED THAT THEY  
WERE EXPORTING MORE  
OIL THAN EVER, AND  
PRICES SLUMPED EVEN  
FURTHER*

#### The world is full of potential surprises.

- Conflict could break out again in Libya or Iraq, which would hamper oil production.
- China's economy could come roaring back. Europe could suddenly rebound out of its malaise.
- Saudi Arabia could decide that enough is enough, and cut back on production all of a sudden. Any of these things could increase prices.

# Impact of falling Oil Prices on Global Economy

The plunge in oil prices is having significant economic consequences around the world:

## Russia:

- Oil revenues make up 45 percent of the government budget.
- Economists now estimate that Russia's GDP will shrink by at least 4.5 percent in 2015 if oil stays below \$60 per barrel.
- The plunging price of oil has also caused the Ruble's value to collapse and a rise in inflation.
- On December 15, 2014, Russia suddenly hiked interest rates from 10.5 percent to 17 percent in an attempt to stop people from selling off Rubles. But those rate hikes are likely to slow the country's economy down even further.




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*RUSSIA'S ECONOMY IS  
EXPECTED TO SHRINK 4.5%  
NEXT YEAR IF OIL STAYS AT \$60  
PER BARREL*

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## Iran:

- As per IMF Iran's economy had recently started to rebound after years of recession. But that was all before oil prices started to plunge — a potentially precarious situation for the country.
- One big problem for Iran is that it also needs oil prices well north of \$100 per barrel to balance its budget, especially since Western sanctions have made it much harder to export crude

## Venezuela:

- The oil crash could cause Venezuela, a major oil producer, to default. The nation's economy which is heavily dependent on oil revenue, is set to shrink some 3 percent this year and inflation is rampant.

## Saudi Arabia:

- The world's second-largest crude producer (after Russia), will suffer financially from cheap oil. If oil stays at around \$60 per barrel next year, the government will run a deficit equal to 14 percent of GDP.
- The Saudis are toughing this out. The kingdom has built up a stockpile of foreign currency worth some \$750 billion, which it will use to finance its deficits.
- If low oil prices persist, Saudi Arabia may have to cut back on some of the social programs it had instituted after the Arab Spring.

*"It is not in the interest of OPEC producers to cut their production, whatever the price is,"*  
- Ali al-Naimi,  
*Oil Minister of Saudi Arabia.*

# Impact of falling Oil Prices on Global Economy

The plunge in oil prices is having significant economic consequences around the world. A few examples:

## The United States:

- In the US, a fall in crude prices will have both positive and negative impacts. For many people, it will offer an excellent economic boost: cheaper oil means lower gasoline prices
- The EIA projects that US drivers will spend less on gasoline in 2015 than they did in 2014, assuming prices stay low. That will give consumers more money to spend on other things.
- But it's not all good news. Oil-producing states like Texas, Alaska and North Dakota are likely to see a drop in revenues and economic activity.



## Europe:

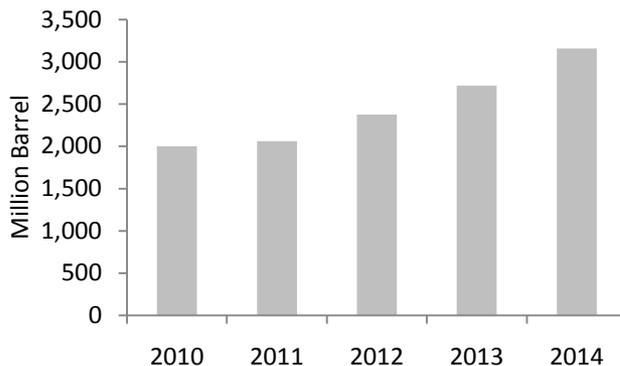
Growth in the European Union remains weak

- With Europe's flagging economies and weak growth, any benefits of lower prices would be welcomed by beleaguered governments.
- A 10% fall in oil prices should lead to a 0.1% increase in economic output. In general consumers benefit through lower energy prices.

## Asia:

- China, which is set to become the largest net importer of oil, should gain from falling prices. However, lower oil prices won't fully offset the far wider effects of a slowing economy.
- Japan imports nearly all of the oil it uses. But lower prices are a mixed blessing because high energy prices had helped to push inflation higher, which has been a key part of Japanese Prime Minister Shinzo Abe's growth strategy to combat deflation.

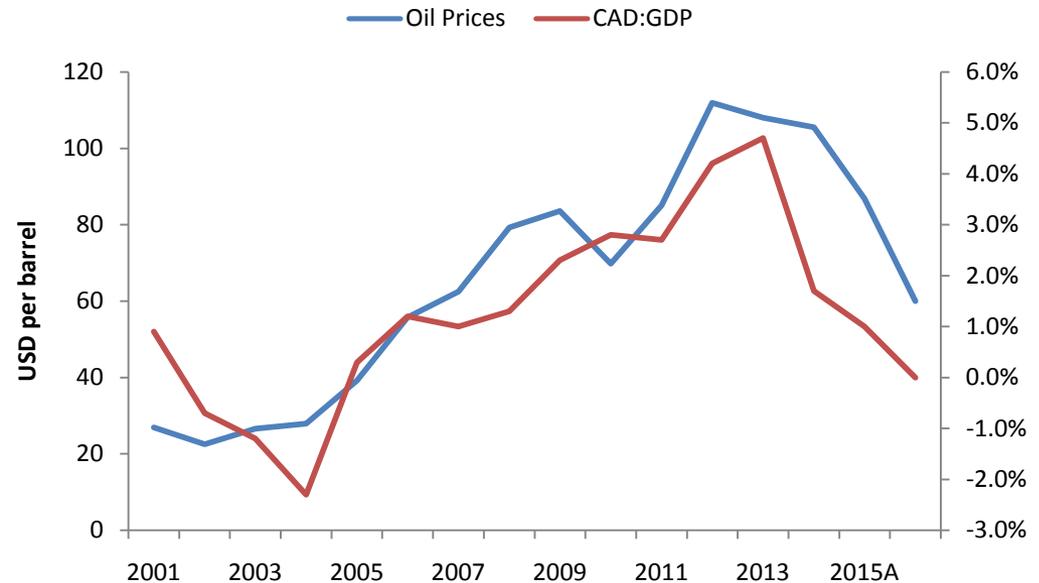
USA Annual Oil Production



# Impact of falling Oil Prices on India – An Analysis

India, which is the fourth largest consumer of oil, is a big beneficiary of falling oil prices.

- At nearly 37%, Oil Products constituted a lion's share of our total imports in FY13-14. Lower oil prices would help reduce the Current Account Deficit (CAD)
- Escalating oil prices in the last few years resulted in a rise in the CAD to a high of 4.7% of the GDP during 2012-13
- India reported a CAD of 1.7% of the GDP at the end of FY2014. With crude oil prices falling sharply, we might even report a current account surplus in the near future.
- The reduced prices will not only lower the import bill but also help save on foreign exchange.
- This allows the Reserve Bank some room to add more dollars to India's forex reserves, allowing the rupee to depreciate to make exports more competitive.



However, a low oil price has marginal negative effects as well.

- India's exports to oil producing economies could get impacted when the growth rates of those economies take a dip due to low oil prices. Oil Products constituted 20% of our exports in FY13-14.
- Any slowdown in oil producing countries can affect the inward remittances by the large Indian diaspora working in those countries.

**A \$10 FALL IN CRUDE COULD REDUCE THE CURRENT ACCOUNT DEFICIT BY APPROXIMATELY 0.5% OF GDP AND THE FISCAL DEFICIT BY AROUND 0.1% OF GDP**

# Impact of falling Oil Prices on India – An Analysis

## India's Trade Deficit is heavily affected by Oil Prices

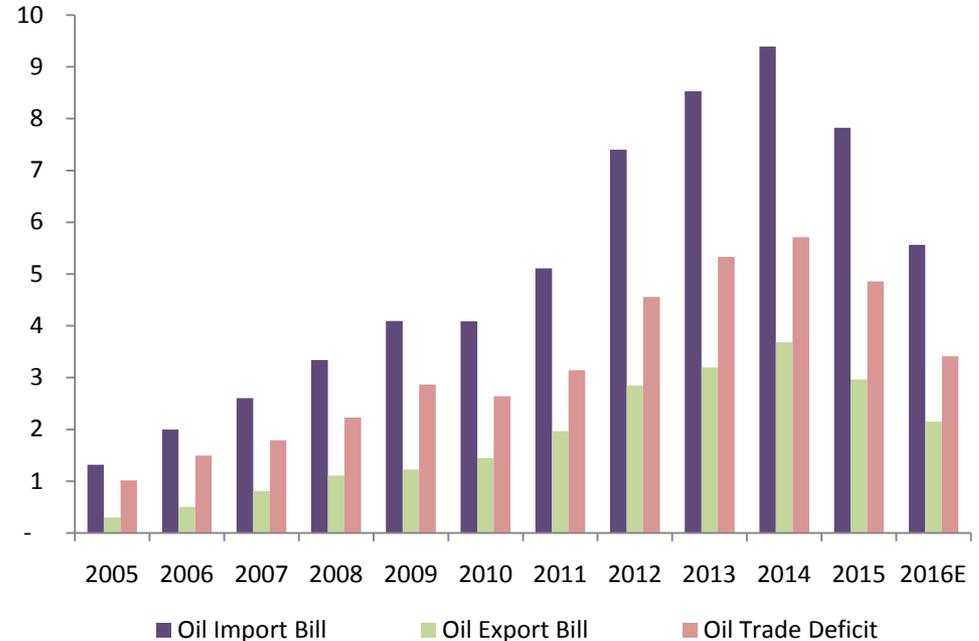
- Crude Oil consists of more than 90% of India's total Oil Import Bill
- Petrol and Diesel consists of more than 65% of India's total Oil Export Bill

## In the decade between 2005-14:

- India's annual imports of crude oil doubled from 96 million metric tons (MMT) to 190 MMT.
- However, the Oil Import Bill amplified more than 7 times from INR 130,000 Crores to INR 940,000 Crores
- India's annual exports of Petrol and Diesel quadrupled from 10 MMT to 42 MMT
- However, the Oil Export Revenue grew more than 12 times from INR 30,000 Crores to INR 370,000 Crores

In FY 2014-16, India can save an estimated  
**INR 333,000 Crores**  
*in the Net Import Bill due to falling oil prices*

## India's Oil Products Trade (INR Lakh Crores)



## Forecast for FY2015-16

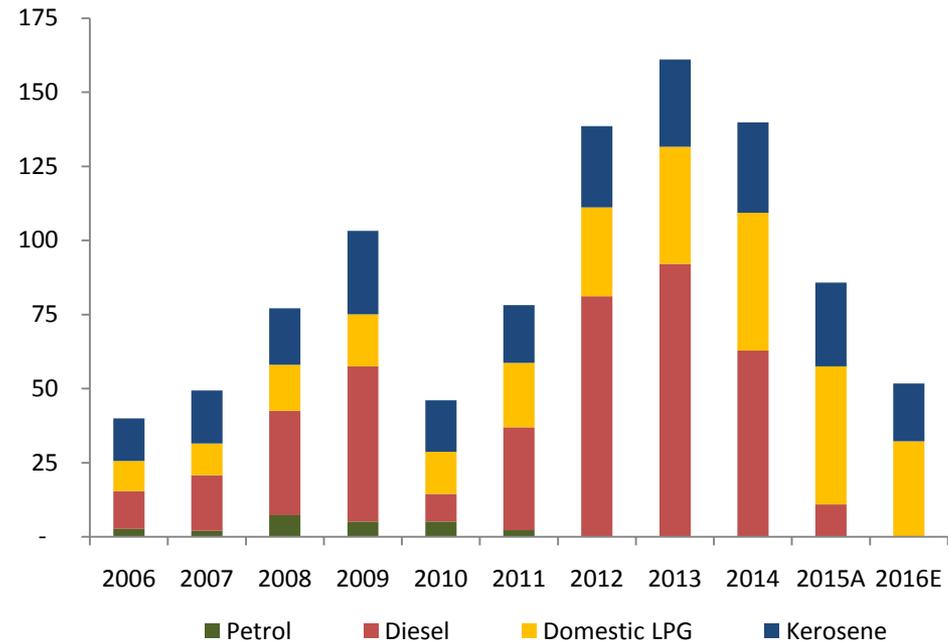
- With global economists predicting average oil prices stabilizing around US\$60 in FY15-16, India's crude oil bill would nearly halve to INR 560,000 Crores. The crude oil bill has already fallen 17% in FY14-15 over the previous year.
- India's Oil Trade Deficit could reduce by over 40% from the record high of INR 570,000 Crores in FY13-14.

# Impact of falling Oil Prices on India – An Analysis

## India's Fuel Subsidies account for a third of the total Subsidy Bill

- Under Recoveries happen when Oil Marketing Companies (OMCs) sell petrol, diesel, LPG and kerosene at prices less than the cost of production. The Under Recovery Losses are compensated by the Indian Government.
- Owing to surge in oil prices in FY12-13, the Under Recoveries of OMCs touched a record high of INR 1.6 Lakh Crores (1.7% of GDP)
- Diesel formed over 57% of the total subsidy bill in FY12-13 and was eventually deregulated in FY14-15, owing to drastic fall in oil prices. Similarly, Petrol prices were deregulated in FY10-11.

Under Recoveries of Oil Marketing Companies  
(INR Thousand Crores)



In FY 2014-16, India can save an estimated

# INR 88,000 Crores

*in the Fuel Subsidies due to falling oil prices*

## Forecast for FY2015-16

- With global economists predicting average oil prices stabilizing around US\$60 in FY15-16, India's fuel subsidy bill would fall nearly 60% to INR 52,000 Crores. The fuel subsidy bill has already fallen 40% in FY14-15 over the previous year.

# Impact of falling Oil Prices on India – An Analysis

## Effect on end user consumers and companies

- The sectors that will have a positive impact due to falling oil prices directly as well as indirectly will be:
  - Automobiles
  - Chemical
  - Plastic
  - Paints
  - Transportation & Logistics
- The sectors negatively impacted will be Oil and Gas Exploration companies.
- The prices of both Petrol and Diesel have come down by more than 10% in the last 12 months. This has helped curb food and commodity inflation tremendously.
- Crude Oil prices account for approximately 50% of the cost component in the production of Petrol and Diesel, while taxes account for nearly 33%.

In FY 2014-16, consumers can save an estimated

# INR 80,000 Crores

*in Fuel costs due to falling oil prices*

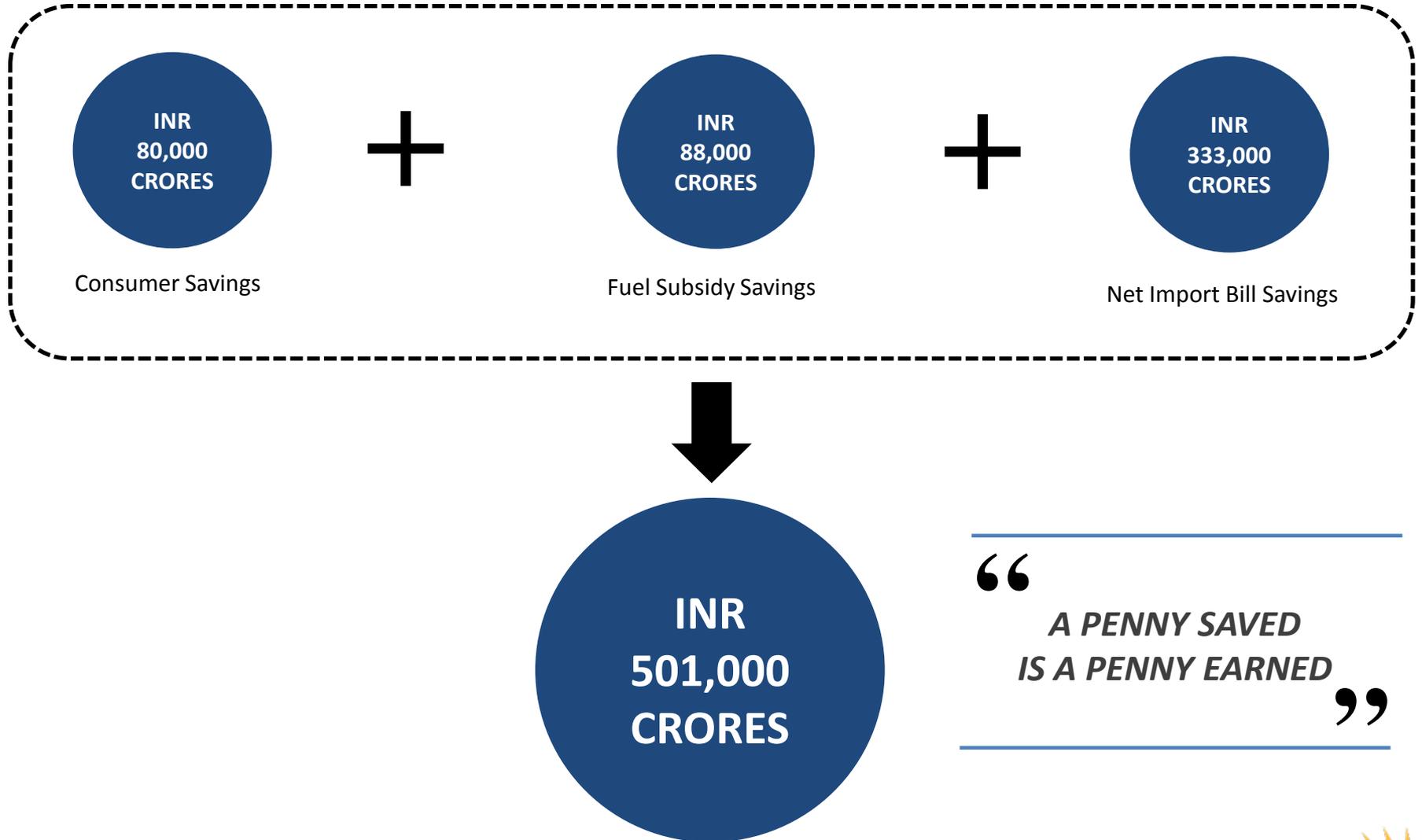
Financial Year	India's Total Petrol + Diesel Consumption (Crore Litres)	Total Fuel Costs (INR Crores)
2011-12	9,979	487,376
2012-13	10,611	568,208
2013-14	10,716	640,415
2014-15A	11,086	671,387
2015-16E	11,485	635,997

## Forecast for FY2015-16

- With global economists predicting average oil prices stabilizing around US\$60 in FY15-16, consumers will benefit greatly due to the corresponding fall in petrol and diesel prices. The net sales of the Oil Marketing Companies are also expected to fall slightly.
- However, the entire benefit of falling oil prices has not been passed on to the consumers. The Indian government hiked the excise rates to partially negate the total benefits, raking in an additional INR 87,000 Crores, thereby reducing the fiscal deficit further.

# Impact of falling Oil Prices on India – An Analysis

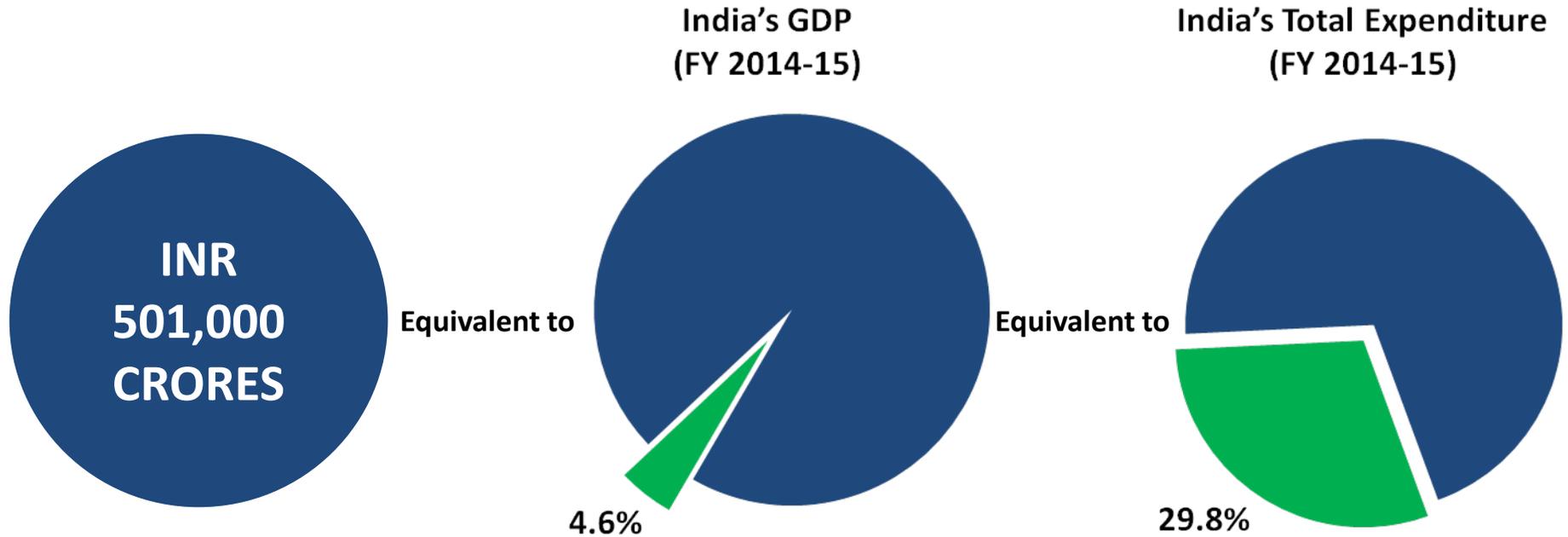
Estimated aggregated savings by the Indian Government and Consumers in FY2014-16, due to oil prices falling from US\$110 to US\$60



# Impact of falling Oil Prices on India – An Analysis

Just how much is INR 501,000 Crores?

To put things into a better perspective, here are some comparisons...



Particular	Value (INR Crores)
Total Corporate & Income Tax Revenues for FY14-15	705,000
2G Scam + Coal Scam Loss, as per CAG	362,000
Gross NPAs of PSU Banks as on December 2014	260,000
Quarterly Revenues of Apple Inc., USA (Q1-2015)	460,000

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