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CRUDE & NATURAL GAS FUELING INFLATION IN INDIA

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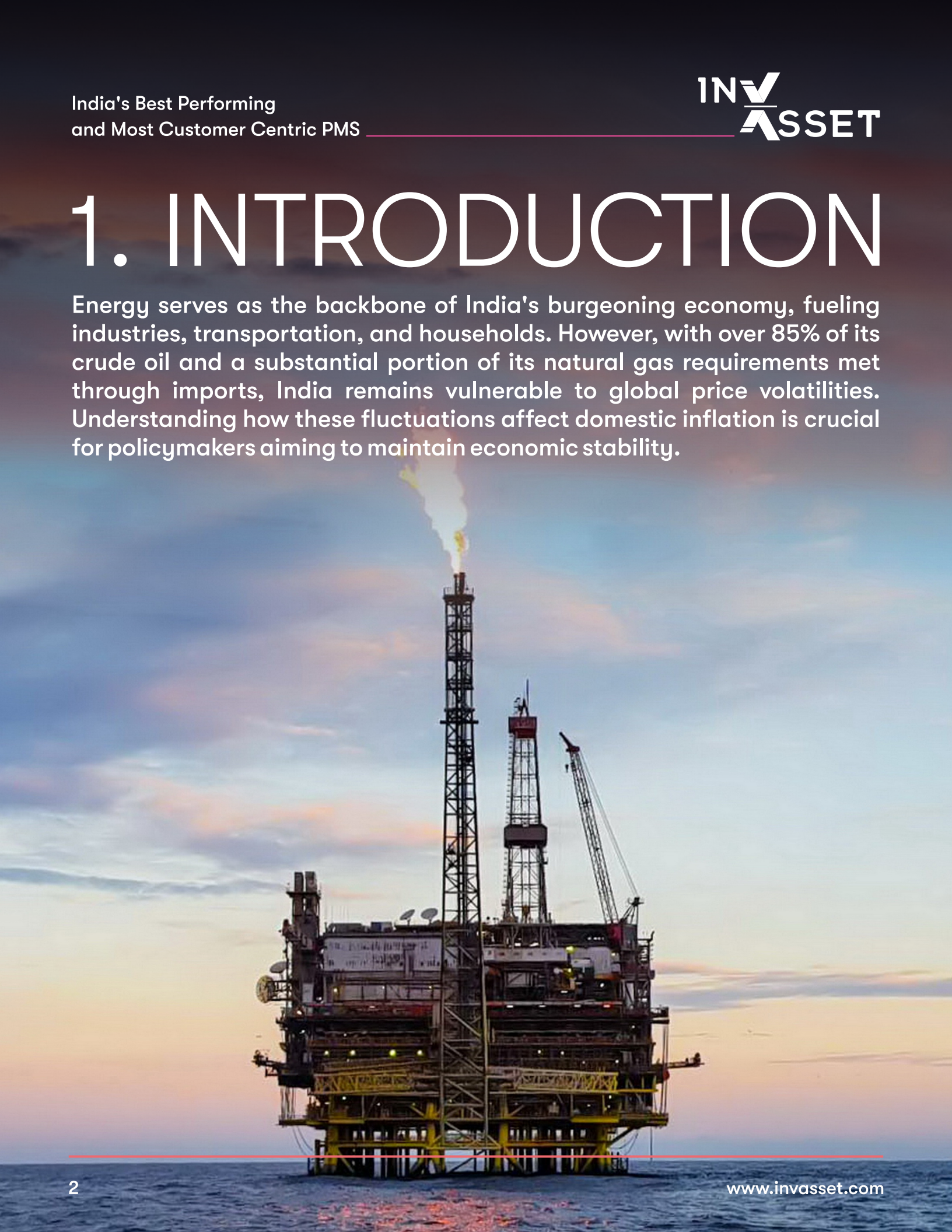


IMPACT OF **CRUDE OIL** AND **NATURAL GAS** ON **INDIAN INFLATION**

India's economic landscape is intricately tied to the dynamics of crude oil and natural gas prices. As a nation heavily reliant on energy imports, fluctuations in global oil and gas markets significantly influence domestic inflation rates. This article delves into the multifaceted relationship between crude oil and natural gas prices and their impact on India's inflation, exploring the transmission mechanisms, historical trends, policy responses, and future implications.

1. INTRODUCTION

Energy serves as the backbone of India's burgeoning economy, fueling industries, transportation, and households. However, with over 85% of its crude oil and a substantial portion of its natural gas requirements met through imports, India remains vulnerable to global price volatilities. Understanding how these fluctuations affect domestic inflation is crucial for policymakers aiming to maintain economic stability.



2. TRANSMISSION MECHANISMS FROM GLOBAL PRICES TO DOMESTIC INFLATION

The pathway through which international crude oil and natural gas prices influence India's inflation is multifaceted:

- **Direct Impact on Fuel Prices:** Elevated global crude oil prices lead to higher domestic prices for petrol, diesel, and liquefied petroleum gas (LPG). Given that these fuels constitute a significant portion of the Consumer Price Index (CPI), any increase directly propels retail inflation.

- **Indirect Impact via Production Costs:** Industries reliant on petroleum products, such as transportation and manufacturing, face escalated production costs during periods of high oil prices. These increased costs often cascade down to consumers in the form of higher prices for goods and services, thereby exerting upward pressure on inflation.

- **Exchange Rate Fluctuations:** A surge in oil import bills can deteriorate India's trade balance, leading to depreciation of the Indian rupee. A weaker rupee amplifies the cost of all imports, further stoking inflationary tendencies.

3. HISTORICAL PERSPECTIVE OIL PRICE SHOCKS AND INFLATION TRENDS



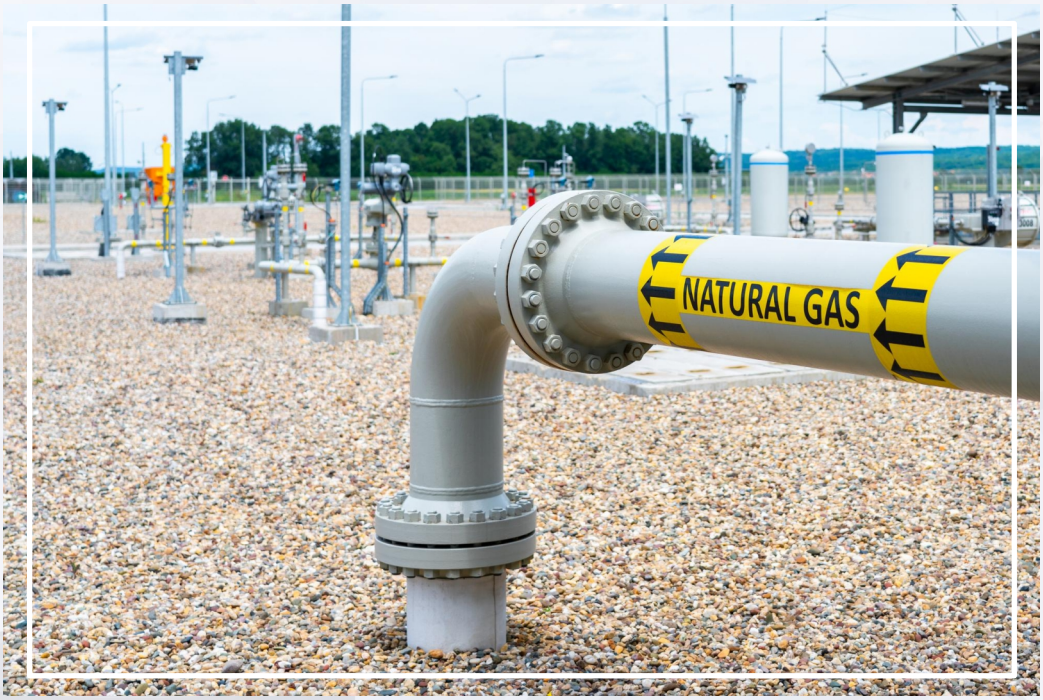
Examining historical data reveals a strong correlation between global oil price movements and India's inflation rates:

- **2008 Oil Crisis:** The global financial crisis saw crude oil prices soaring to unprecedented levels, with Brent crude reaching approximately $147 per barrel in July 2008. This surge translated into elevated domestic fuel prices, contributing to higher inflation rates in India.

- **2014-2016 Oil Price Decline:** Between June 2014 and January 2016, crude oil prices plummeted from $111.66 per barrel to $28.08 per barrel. This decline provided respite to India's inflation, as lower fuel prices helped moderate the overall price level.

- **2022-2023 Volatility:** The geopolitical tensions, notably the Russia-Ukraine conflict, led to a resurgence in crude oil prices. India's import dependence exposed the economy to imported inflation, as higher crude prices translated into increased retail fuel prices and broader inflationary pressures.

4. NATURAL GAS: AN EMERGING CONTRIBUTOR TO INFLATION



While crude oil has traditionally been the focal point, natural gas prices are increasingly influencing India's inflation dynamics:

- **Industrial Usage:** Natural gas serves as a critical input for industries such as fertilizers, chemicals, and power generation. Elevated natural gas prices can escalate production costs, leading to higher prices for end consumers.

- **City Gas Distribution (CGD):** The expansion of CGD networks has increased the consumption of compressed natural gas (CNG) and piped natural gas (PNG) in urban areas. Price hikes in natural gas can directly affect urban inflation through increased household and transportation costs.

5. POLICY RESPONSES: BALANCING INFLATION AND GROWTH

The Indian government and the Reserve Bank of India (RBI) have employed various strategies to mitigate the inflationary impact of volatile energy prices:

- **Fuel Subsidies:** The government has historically provided subsidies on fuels like LPG and kerosene to shield consumers from abrupt price hikes. For instance, the Direct Benefit Transfer for LPG (DBTL) scheme, introduced nationwide in 2016, streamlined subsidy distribution by transferring benefits directly to consumers' bank accounts.



- **Monetary Policy Measures:** The RBI monitors inflation trends closely, adjusting policy rates to anchor inflation expectations. For example, in response to rising inflation partly attributed to high fuel prices, the RBI has maintained a cautious stance on rate cuts and has prioritized inflation control through monetary tightening during periods of global price surges.

6. RECENT DEVELOPMENTS: A CLOSER LOOK

Recent data underscores the persistent influence of energy prices on India's inflation:



- **December 2024 Inflation Data:** India's annual retail inflation eased to 5.22% in December 2024, down from 5.48% in November. This moderation was primarily due to a deceleration in food price increases. However, components like oil, fats, and cereals continued to exert upward pressure on the Consumer Price Index (CPI). Economists highlighted that while food inflation slowed, the persistent inflation in oil-related components posed challenges for monetary policy.

- **Currency Depreciation Concerns:** The Indian rupee's depreciation against the U.S. dollar has disrupted expectations of imminent interest rate cuts by the RBI. A weaker rupee increases the cost of oil imports, thereby exerting additional inflationary pressures. This scenario complicates the RBI's monetary policy decisions, as it balances the need to control inflation with supporting economic growth.



7. FUTURE OUTLOOK: NAVIGATING THE ENERGY-INFLATION NEXUS

As India progresses, several factors will shape the interplay between energy prices and inflation:

- **Diversification of Energy Sources:** Investing in renewable energy and enhancing domestic production of oil and natural gas can reduce dependence on imports, thereby insulating the economy from global price shocks.

CONCLUSION

The interplay between crude oil and natural gas prices and India's inflation is a complex yet crucial economic dynamic. As a nation heavily reliant on energy imports, India remains vulnerable to global price volatilities, with significant implications for inflation, fiscal deficits, and monetary policy. While government initiatives, such as targeted subsidies and the Direct Benefit Transfer (DBT) framework, have provided temporary relief



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