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INDIA'S MONETARY POLICY

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OIL SUPPLY CUT

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INDIA'S MONETARY POLICY

A monetary policy of a country is a tool used by the government to regulate the demand and supply of money in the economy. Its goal is to stabilise the economy by keeping various factors in check. Although this is a major government policy, it is not as such controlled by the government. Studies show that if the policy setting body is dependent on the government, it would have an adverse long term impact on the economy. The regulatory body would take short sighted steps for small bursts of growth to account well for the government ignoring the long term side-effects. So, in most cases, the regulating body is the central bank of the country. In India, this independent body is the Reserve Bank of India.

The government has many other tools at its disposal for regulating money supply, for example, the fiscal policy. But changes in the fiscal policy take a lot of time to be implemented as these changes require changes in the law. So, monetary policy is the best tool we have to ensure a healthy flow of funds. There are two types of monetary policy.

1. Contractionary Monetary Policy: This type of policy is used by the central bank during times of inflation and excess demand. Its goal mainly is to reduce the money supply in the economy.

2. Expansionary Monetary Policy: This type of policy is used during periods of recession and deficient demand. Its goal mainly is to inject funds into the economy

Let's look in detail at how each of these policies are used by the RBI.

- Interest rates: These are the rates at which the central bank of a country lends money to other banks. By regulating these rates, RBI can take control of the interest rates offered to all sectors as changes in these rates would result in a subsequent, often proportionate change in the interest rate at which these banks offer loans to the rest of the country. Under a contractionary monetary policy, the RBI decreases its interest rates to encourage borrowing and investment. While under a contractionary policy, these interest rates are hiked in order to cut down the excess demand in the economy.
- Reserve Requirements: RBI requires all banks to maintain a minimum reserve of their deposits. In a contractionary policy, RBI increases these requirements. As such, banks have an imposed lending restriction and the money supply in the economy is cut down. In an expansionary policy, RBI reduces the reserve requirements. As a result, banks have more funds to lend which helps inject money into the economy.
- Open market operations: This is the sale and purchase of securities by the central bank. Under a contractionary policy, RBI purchases securities from the open market to increase the money supply in the economy. It enhances the purchasing power and helps restore demand. Under an expansionary policy, RBI sells these securities at attractive rates of return to cut down the money supply in the economy. This helps reduce excess demand.

THE MONETARY POLICY COMMITTEE

The monetary policy committee was founded on 27 June 2016. It is mainly responsible for fixing the interest rate for the country. It is chaired by the governor of the Reserve Bank of India, presently Shaktikanta Das and has 5 other members which include three officials of the Reserve Bank of India and three external members nominated by the government of India. Presently, it has the following members

- Governor of the Reserve Bank of India – Chairperson, - Shaktikanta Das
- Deputy Governor of the Bank in charge of monetary policy – Michael Debrat Patra
- Executive Director of the Bank in charge of monetary policy – Rajiv Ranjan
- Ashima Goyal is a member of Prime Minister Narendra Modi's economic advisory council. Ms Goyal is a professor at the Indira Gandhi Institute of Development Research in Mumbai and was a visiting fellow at Yale University.
- Shashanka Bhide is a senior advisor at the National Council for Applied Economic Research, a New Delhi-based think-tank, whose work has involved research into agriculture, poverty analysis and macroeconomics.
- Jayanth Varma is a finance and accounting professor at the Indian Institute of Management, Ahmedabad. He was formerly on the board of the country's capital markets' regulator.

The MPC conducts at least 4 times during a financial year, once every quarter. It’s most recent meeting was in June 2023 for three consecutive days on 6, 7 and 8 which concluded with a unanimous decision to keep the repo rates unchanged at 6.5 percent.

RBI’S TIES WITH THE FED

The monetary policy influences the entire domestic market and is majorly responsible for the course of the economy. But our own monetary policy has a considerable influence from the US’ monetary policy set by the Federal Reserve System, or Fed. In the recent months, you must have often seen headlines in India news reporting that the Fed is going to increase its interest rates. Why is the monetary policy of another country so important to our own? Sure, the US is a very developed economy and a major player of the market but why do changes in its monetary policies are so highly anticipated in the Indian market? RBI’s policy is always formed keeping in mind the Fed’s interest rates. Oftentimes, modifications were required in our policy because of changes in the Fed’s rates. Let us see why.

The reasons behind this are numerous. Some are obvious and some are a ripple effect. Some are listed below:

- Following hikes in interest rates, there is a decrease in the money supply in the US. There is a fall in output and employment. Subsequently, companies are forced to lay off employees which decreases purchasing power. Most big companies in India are not Indian-owned. There is a chain ownership involved that in a larger part, links to the US. For example, most IT companies in India are US owned so their layoffs would also result in unemployment in our country, which you would know is something that has been happening a lot lately......

- Hikes in the Fed rates increase the cost of India's overseas finance. Most of the investment in the Indian financial market is through foreign investors with diversified portfolios. And even though our market offers higher rates of interest, in times of hiking rates, investors prefer to put their funds into the US bonds which is without the risk of currency depreciation. There is a risk of rupee depreciation due to increases in Fed's interest rates because as the FED hikes its rates, RBI also has to modify its monetary policy and increase its own rates to retain investors.
- The share of India's exports in its GDP has been on an upwards slope since liberalisation. Currently, exports contribute to more than 20 % percent of the GDP. In such a case, a hike in interest rate in the US market would cut down demand and is bound to have an adverse impact on this percentage

RBI'S TIES WITH THE FED

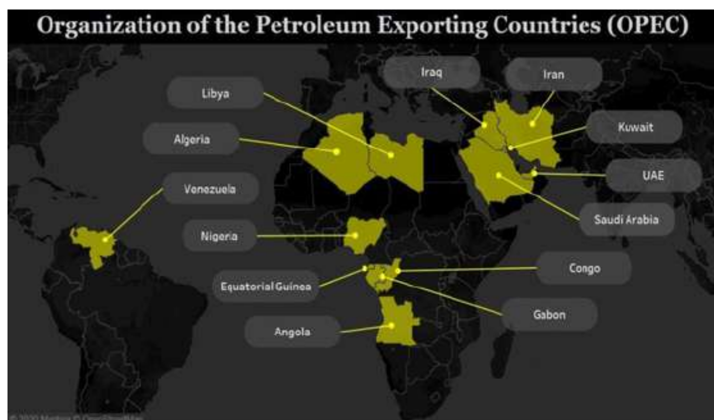
The main challenge of RBI post-covid is to control inflation. Inflation levels across the country have skyrocketed since the pandemic making the lives of the middle class yet more difficult. India's retail inflation target rate is 4 percent. But the Indian economy has been buffeted by multiple shocks over the last three-and-a-half years, starting with the coronavirus pandemic, the consequent supply-chain shocks, and then the war in Europe. As a result, the Consumer Price Index (CPI) inflation has surged and remained above 4 percent for 43 months in a row. It peaked at 7.79% in April 2022. But in more positive news, the latest data from the Ministry of Statistics and Programme Implementation reveals that India's retail inflation, as measured by the consumer price index (CPI), dropped to a more than two-year low of 4.25% in May 2023.

India's Monetary Policy is formed keeping in view a number of different factors. India's economy is vast and complex. So surely, the task to regulate and control it is a challenging one. Despite being one of the biggest economies, it is still a developing one. As such, aside from internal factors it is also significantly influenced by external factors too. Thus, we have an independent body of policy setters set up for the job- the Monetary Policy Committee. They meet at least four times during a year, once in every quarter to decide the future course of the economy or whenever the situation demands a change. This task, as said, comes with a lot of challenges, especially with the whole world still recovering from the pandemic. But nonetheless, we are weathering through, on a way to a better nation tomorrow.

-Adeeba Haider

OIL SUPPLY CUT

INTRODUCTION ABOUT OPEC and OPEC+ countries



OPEC is a permanent intergovernmental organisation of 13 oil-exporting developing nations that coordinates and unifies the petroleum policies of its Member Countries which was created in the Conference of Baghdad in 1960. As of 2019, OPEC has a total of 14 Member Countries viz. Qatar, Indonesia, Libya, the United Arab Emirates , Algeria,, Nigeria, Ecuador, Gabon, Angola, Equatorial Guinea and Congo are members of OPEC.

OPEC's objective is to coordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry.

OPEC members function as a cartel, seeking to maximise their oil sales revenue by adjusting output in light of prevailing world economic conditions and demand.

In December 2016, OPEC formed an alliance with other oil-exporting nations that were not a part of the organisation, creating an entity that is commonly referred to as OPEC+, or OPEC Plus.OPEC Plus countries include Azerbaijan ,Bahrain,Brunei,Kazakhstan,Malaysia, Mexico,oman,Russia,South Sudan ,Sudan.

HISTORY OF OIL MARKET

Below we look at the major events since 1960 that have shaped the oil markets in the wake of the formation of OPEC. Initially, OPEC did not wield its full pricing power as a cartel in the 1960s. Oil prices were relatively stable until the 1970s amid U.S. oil companies' continued dominance of global crude markets, and due to plentiful U.S. oil reserves.

Arab Oil Embargo-

Arab countries stopped exporting crude to the United States in retribution for American support of Israel during the Yom Kippur War in 1973.The organisation declared an oil embargo on countries perceived as supporting Israel during the Yom Kippur War. This resulted in reduced oil supply and higher prices globally.As a result the price of crude oil had skyrocketed from roughly $24 to $56 per barrel

Iranian Revolution-

A sharp drop in Iranian production as a result of the political unrest sent crude oil prices even higher than during the Arab oil embargo. Oil jumped from about $56 per barrel to over $125

Reagan Deregulates U.S. Oil Industry-

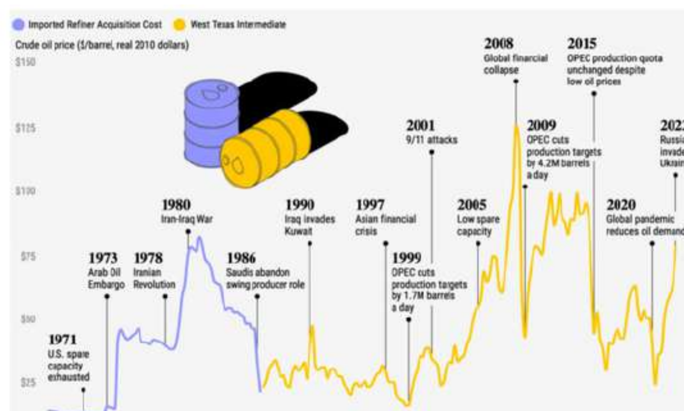
In 1981, President Ronald Reagan signed an executive order abolishing price and allocation controls on domestic oil ultimately leading to fall in the price of crude oil from almost $113 per barrel to about $26 by mid-1986

First Gulf War-

In August 1990, Iraq invaded Kuwait, sending the price of oil soaring from about $34 per barrel to nearly $77 which later fell to about $37

The 2008 Oil Shock-

A sequence of incidents in 2008, like Venezuela cutting off sales to Exxon Mobil ,labour strikes reducing output in Nigeria and the U.K.'s North Sea oil fields, caused a steep increase in oil prices from about $118 per barrel in December 2007, the price of oil rose to above $165 by mid-2008.



Source - ***U.S energy information administration (march 2022)***

Recession and Financial Crisis-

The second half of 2008 was marked by a deepening economic recession,Oil sank to the low $50s per barrel by January 2009 before rebounding to nearly $95 by year-end as the global economy recovered.

The U.S. Shale Oil Revolution -

U.S. oil and gas output increased by about 57% over the past decade until early 2020 as advances in fracking technology.Partly as a result, the price of crude oil fell from about $87 per barrel in early 2010 to just under $51 by January 2020.

HOW OPEC INFLUENCES THE GLOBAL OIL PRICES?

As a cartel, the OPEC+ member countries collectively agree on how much oil to produce, which directly affects the ready supply of crude oil in the global market at any given time. OPEC+ subsequently exerts considerable influence over the global market price of oil and, understandably, tends to keep it relatively high to maximise profitability.

Roughly 40% of the world's oil production and 60% of the world's petroleum market come from the group's member countries and they accounted for more than 80% of the world's proven oil reserves in 2021.

Within the OPEC group, Saudi Arabia is the largest crude oil producer in the world and remains the most dominant member of OPEC.Each time there is a cut in Saudi oil production, there is a sharp rise in oil prices, and an increase in Saudi oil production stimulates a drop in oil prices.

OPEC naturally keeps the market price of oil high in order to maximise its profits, as was seen when the organisation slashed production in early April to just 3.7 percent of the global demand. This caused the price per barrel to hit $85, a six-percent bump.

TOP 5 OIL PRODUCERS IN THE WORLD

Top 5 Oil Producers (2021)	Millions of Barrels Per Day	% of World Total	OPEC/Non-OPEC/ OPEC+
United States	18.9	19.8%	Non-OPEC
Saudi Arabia	10.8	11.3%	OPEC
Russia	10.8	11.3%	OPEC+
Canada	5.5	5.8%	Non-OPEC
China	5.0	5.2%	Non-OPEC

1)UNITED STATES

The United States has grown to become the top petroleum liquids producer in the world, averaging 18.9 million b/d to account for 20% of the world's production in 2022. It's also the top producer of crude oil and lease condensate The United States produces a diverse range of crude oils. However, the type of oil that the U.S. produces the most is referred to as "tight oil" or "shale oil.

- ***US -The OPEC Independent Nation***

The United States became less reliant on OPEC member countries for oil supply.The development of shale oil and the use of hydraulic fracturing techniques in the United States led to a significant increase in domestic oil production. As the U.S. reduced its dependence on imported oil, its relationship with OPEC changed.

The growth of U.S. oil production, particularly from shale, has increased global oil supply, leading to changes in global market dynamics. The increased supply from the United States, along with other factors, has put downward pressure on oil prices and impacted impacted OPEC's ability to control prices through production adjustments.

2)SAUDI ARABIA

Saudi Arabia contributed 10.8 million b/d, the second-largest producer of the world's total petroleum liquids production in 2022 the petroleum sector accounts for roughly 42% of the country's gross domestic product (GDP) 87% of its budget revenues, and 90% of export earnings.

3)RUSSIA

Russia remains one of the world's top oil producers, coming in the #3 spot despite economic sanctions and trade restrictions following its invasion of Ukraine in 2022.Russia is known for producing a variety of crude oils, but the most significant type it produces is Urals crude oil.

- ***RUSSIA -AN OPEC+ ALLIANCE***

Russia's cooperation with OPEC has been instrumental in supporting oil market stability.As part of the OPEC+ alliance, Russia, along with other non-OPEC oil-producing countries, including major producers like Saudi Arabia, agreed to adjust their oil production levels collectively. These production agreements involve setting production quotas for participating countries to manage global oil supply and support oil prices. The joint efforts of OPEC and non-OPEC countries, including Russia, have helped to rebalance global oil supply and demand, particularly during periods of market volatility.

As one of the world's largest oil producers, oil export revenues are crucial for Russia's economy. Cooperation with OPEC and efforts to stabilise oil prices align with Russia's economic interests,

as higher oil prices can benefit the country's budget and support its energy-dependent economy.

4)CANADA

Canada held the fourth spot among the world's petroleum liquids producers. The EIA estimates its crude oil and condensate production of 4.2 million b/d in 2020 could grow to 6.9 million b/d by 2050, primarily from oil sands production.

5)CHINA

China rounds out the top 5 global oil producers. The country surpassed the U.S. to became the world's largest oil importer in 2017, and it is now the world's second-largest consumer in the world after the U.S.

China's domestic production is insufficient to meet its overall demand, and it relies heavily on importing crude oil from countries like Russia, Saudi Arabia, Iraq, and Angola.

CAUSES OF OPEC'S CUT IN OIL SUPPLY

The group will make a deep cut to its output in July 2023 on top of a broader OPEC+ deal to limit supply into 2024 as the group faces flagging oil prices.They agreed to reduce overall production targets from January 2024 by a further 1.4 million bpd to a combined output of 40.46 bpd.

This cut is a response to higher interest rates and a weaker global economy which has led to lower demand and an increase in the number of unsold barrels. This cut might be to protect their profits.

The global economy is heading for a long deflationary phase as the demand compression is getting more visible in the declining commodity and crude prices.The possible reasons for the oil supply cut by OPEC are as follows-

- *China fall in demand for crude oil*

The economic recovery after the coronavirus lockdown by world's largest oil consumer China is losing steam. Producers had an overabundance in supply with no place to store it, as the world experienced lockdowns cutting down demand.

The increase in expected oil consumption was sharply revised downwards, with growth falling from 5.5% to 3.5% in 2023,Crude oil prices remain absurdly high for the purchasing power of Chinese consumers, now grappling with an economy in severe crisis. Consumers act rationally and prefer to buy electricity, not least because it is heavily subsidised, than to buy expensive oil products

- *US debt crisis*

Oil prices also recently came under pressure from concerns about U.S debt ceiling negotiations. A US debt ceiling deal boosted risk appetite but investors are reluctant to step up buying amid worries over inflation and potential further increase in the interest rate.

Fears of another banking crisis in recent months have led investors to sell out of riskier assets such as commodities with oil prices falling to near $70 per barrel from a peak of $139 in March 2022

- *Economic Recession In Germany*

Germany is now officially in a recession after contracting for two successive quarters.

While economic recessions in Germany or other major economies, can contribute to reduced oil demand, OPEC's supply cuts are typically more focused on managing supply levels rather than specifically responding to economic downturns in specific countries or regions.While a German recession might not directly trigger supply cuts by OPEC, the broader global economic conditions, including the health of major economies, can influence oil demand and indirectly impact OPEC's decision-making process.

- *US-Iran Tensions*

Escalating tensions between the United States and Iran have periodically impacted the oil market. Sanctions and geopolitical disputes have restricted Iran's oil exports, leading to supply disruptions. Concerns over potential further disruptions or escalations in the Persian Gulf region due to geopolitical tensions have influenced OPEC's decisions on supply cuts.

- *Venezuela Crisis*

The ongoing political and economic crisis in Venezuela has resulted in a decline in oil production. As a founding member of OPEC, Venezuela's production decline has contributed to supply cut discussions within the organisation to manage the impact on global oil supply.

- *Libyan Instability*

Political instability and conflicts in Libya have resulted in disruptions to oil production and exports. Factional fighting, militia clashes, and blockades of oil facilities have hindered the country's oil production capabilities.

The disruptions from Libya have affected global oil supply, prompting OPEC to consider supply cuts to stabilise the market.

CONCLUSION

The recent supply cuts by OPEC were aimed at addressing the challenges posed by the COVID-19 pandemic, geopolitical tensions, and disruptions in oil-producing countries. These supply cuts were intended to rebalance the global oil market, manage oversupply, and support oil prices. The decisions were made collectively by OPEC member countries, along with cooperation from non-OPEC oil-producing nations within the OPEC+ alliance.

The recent supply cuts implemented by OPEC have had different implications for Russia and the United States, two major players in the global oil market. Russia's collaboration with OPEC in the OPEC+ alliance has allowed it to align its production levels with OPEC's objectives and maintain stability in the global oil market. However, the supply cuts may also impact Russia's market influence and its position as a major oil producer

On the other hand, the United States, with its significant growth in shale oil production, has reduced its dependence on imported oil. While the supply cuts by OPEC can support oil prices, they may also create opportunities for the U.S. shale industry to increase production and market share. Furthermore, the United States' energy independence and relatively low reliance on OPEC oil mitigate the direct impact of OPEC's supply cuts on its energy security and oil supply.

Overall, the recent supply cuts by OPEC have presented a mixed impact on Russia and the

the United States. While Russia stands to benefit from the support to oil prices and its collaboration with OPEC, the United States may find opportunities for its shale industry amidst a changing global oil market. The long-term consequences will depend on various factors, including market conditions, geopolitical dynamics, and the ability of each country to adapt to the evolving landscape of the oil industry.

-Gayatri Mohapatra

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: @sifa.scac

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