Oil Prices Clubbed with Covid-19: Impact on Pakistan's Industrial Sector and Inflation

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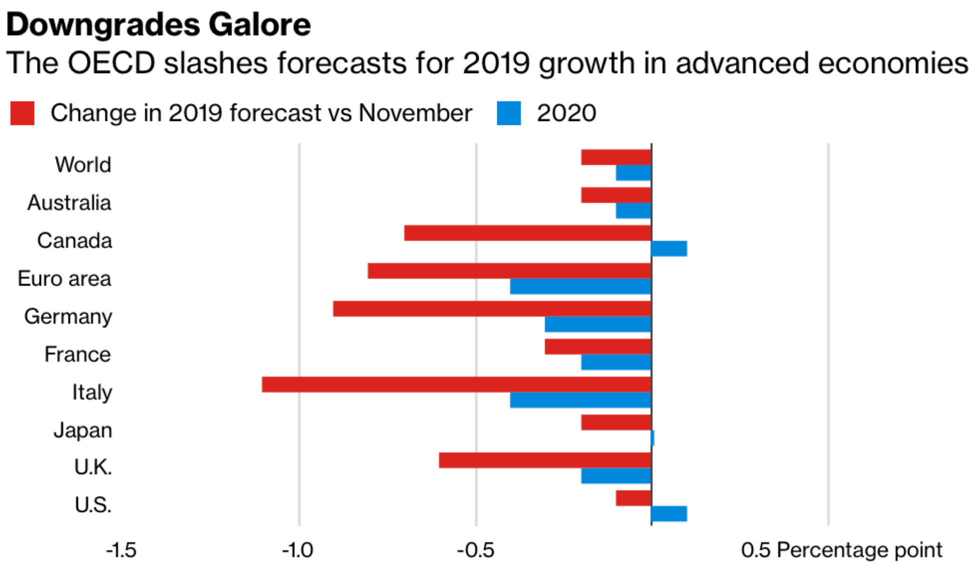
Amid the predictions of anemic growth rates, the global economy is likely to receive a major blow owing to persistent oil crisis. Kingdom of Saudi Arabia and Russia failed to reach an agreement in recent Vienna conference of OPEC. As Russia is more resilient to a price cut in comparison to KSA, so it is not favoring steeper cuts in oil production. It is quite insouciant in maintaining the current levels of production even at a meager price of $10 per barrel. In contrast, KSA considers it viable to allow for deeper plummeting in oil output.

Let's have a cursory look on oil pertaining statistics to accurately gauge the intensity of looming crisis. OPEC current oil market report indicated that Opec Reference Basket (ORB) fell sharply in February by 15% month-on-month which is lowest since September 2017 and it continues to free fall in March as well. This fall in oil price is attributed to a number of factors including global economic meltdown, Brexit, geopolitical tensions, fiscal challenges in selective economies and the recent pandemic declared coronavirus.

Dampened oil demand is directly responsible for price decline. World oil demand in 2020 is adjusted lower by 0.92 mb/d to 0.06 mb/d (million barrel per day). The oil demand has been negatively affected due to measures taken to contain the virus. Some of these measures include the shutting down of industries and travel bans thus hampering the economic activity. Resultantly the GDP growth rate for 2020 has been revised downwards from 3% to 2.4%.



Source:OECD

The impacts of this impasse are multipronged. A number of industries are likely to take a severe blow with aviation industry front in line. In Atlantic basin, the products market lost grip in February 2020. Oil price conundrum clubbed with Covid-19 would continue in second quarter of 2020 specifically Asia, the Euro-zone, US and Middle East. IMF chief also predicted a global recession with recovery in 2021 as 80 countries have sought for IMF help due to corona. The scenario is even graver in case of developing economies. These fears have been well intimidated by joint statement issued by the leaders of International Energy Agency(IEA) and Organization of Petroleum Exporting Countries (OPEC). Based on IAEA analysis, the statement predicts the oil and gas income of developing countries to fall by an alarming 50% to 85% in the middle of already shrinking economic activity.

Pakistan is not immune to the current aggravating economic scenario. Even prior to oil supply cut issues and Covid-19, we were facing acute economic turbulence. With inflation soaring to double digits crippling purchasing power of poverty stricken individuals, shaky investors' confidence owing to documentation drive and global recession, repeatedly downwardly revised growth rate targets, surging unemployment rates, our economy presents quite a bleak scenario. The sector that is likely to be the most adversely affected is Oil and Gas Exploring and Producing sector as reported by Topline Securities. Pakistan Oilfields Limited, PPL, OGDC and MARI would be bearing the brunt of the price reduction. In addition, the oil marketing companies (OMCs) are also quite vulnerable to the oil supply and demand related uncertainties plundering the global economic stage. They would face lower prices as furnace oil and RLNG (Reliquidified Natural Gas) margins are fixed as percentage of oil prices. These fears have started to materialize as ARL (Attock Refinery Limited) has closed its second unit of 5000 barrels per day due to low off take by the oil marketing companies. Resultantly, the ARL's operational capacity has been reduced to 62%. Banking sector is also likely to bear the brunt of the prevailing situation.

The oil crisis is now compounded with the Corona Outbreak. Pakistan has so far reported 997 confirmed cases of corona and 7 deaths have also been reported. The province of Sindh has reported the maximum cases i.e. 410. The entire province has been locked down on orders of provincial government. Punjab government has also locked down the province apart from essential services and is second with 296 cases. Baluchistan has also suspended transport services for 15 days as 115 cases have been confirmed there despite having the lowest population density of all the provinces. Prime Minister in his latest address to the nation also opined that economy of the country is not in a position for a complete lockdown. The shock absorbing capacity of the economy is quite low and shutdown would cause an unprecedented loss to the already ailing economy. The need of the hour is to recognize individual responsibility as citizens of this country. The overcrowding of the hospital on facing flu like symptoms is inane. Self-quarantine is more viable in such cases.

However, the report of Topline Securities also proved to be a silver lining in dismal horizons. It pointed out that the net effect of decline in oil prices would be positive. The benefits would be reaped by a number of sectors in the country including auto, cement, glass and steel industries.

The cement sector would be advantaged as 40% of the cement cost is contributed by raw materials like coal and clinker. The will reduce the cement prices and construction businesses would be encouraged. Automobile sector would be impacted profoundly as a plunge in interest rates is expected which would translate in potentially increased disposable income. This would lead to increase in purchase of durables like vehicles. Some sectors would remain insulated from fall in oil prices which include chemicals, independent chemical producers, and textile and fertilizer sectors.

Inflation is one of the scathing issue in our ailing economy which reached at 12.4% in month of February. The current dip in global oil prices would have a soothing effect on strained inflation scenario. Pakistan is heavily dependent on imported energy which contributes 25% in total imports and it meets 70% of Pakistan's energy requirements. So, Pakistan can save around $4-5 billion which would dampen the skyrocketing inflation. Also, the State Bank of Pakistan has announced the 150 basic points cut in interest rate that would allow businesses to acquire cheaper financing for new and already operational production lines. This monetary easing could also raise Eurobonds and Sukuks from the international markets. Reduction in import bill would also pose favorable impact on current account as trade deficit would reduce. Pakistan's external account could potentially improve by $2.2 to 2.8 billion which is about 50% of current account deficit. The exchange rate is also expected to remain stable in near term. All these developments would decrease the general price level in the economy as every reduction of $10 per barrel would decrease the Consumer Price Index would by 0.3%. Furthermore, 10% -10.5% inflation rate is predicted for the current month and it would further decrease in the month of April. Falling oil prices would also grant government some fiscal space though it is unlikely to complete pass the impact to consumer. Accumulation of circular debt of energy sector would also be halted.

The drop in oil prices would also positively affect the life of a common man in Pakistan. An expected plunge in inflation reading should reduce kitchen budget so essential needs would be met more easily. Partial pass-on of the massive drop in international oil prices to domestic consumers and its wide robust impact on business and economy, would help people to reap the benefits.

The global economy at the moment is rattling with a multitude of issues and oil market distortions are one of them. The calculation of eventual impact of these transitions on the economy of Pakistan at this moment is an uphill task. Moreover, any final verdict would prove to be premature as the developments are going on. Also, the oil price rivalry between KSA and Russia and its impact on Pakistan, ceteris paribus, seems to be a blessing in disguise on the whole. But the positive impacts are likely to manifest in short term as we live in an interconnected world and global recession would negatively impact our economy in long run. However, the situation is evolving currently and the impacts would also continue to evolve.

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