Crude Oil Boon

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Overview

Crude oil prices have fallen sharply over the peaks attained earlier with prices of Brent and WTI at USD 70.2/ bbl and USD 60.2/bbl respectively. Prices of WTI have entered the bear market. As per the latest report by World Bank oil prices are expected to average around $74/bbl in 2019, up from a projected $72/bbl in 2018, but with prices declining over the course of 2019, it could average around $69/bbl in 2020 as U.S. oil production increases over time.

CARE Ratings price outlook

Price of Brent could range between USD 68/bbl -USD 73/bbl in the coming few months*. The rise in the US production and the temporary waivers granted by the US government towards countries importing Iranian oil will bring down the prices but on the flipside the prices of oil can rise given the conclusion of the meeting held by the OPEC+ members where the committee has noted there could be a prospective widening of the gap between supply and demand in 2019 due to the dampening of global economic growth prospects, in addition to associated uncertainties.*

Saudi Arabia has decided to pump 500,000 bpd lesser in December than in November and the other members are too considering new strategies to balance the market with regard to new production cuts in 2019. In fact there are talks of reduction of 1 mn barrels a day from OPEC.

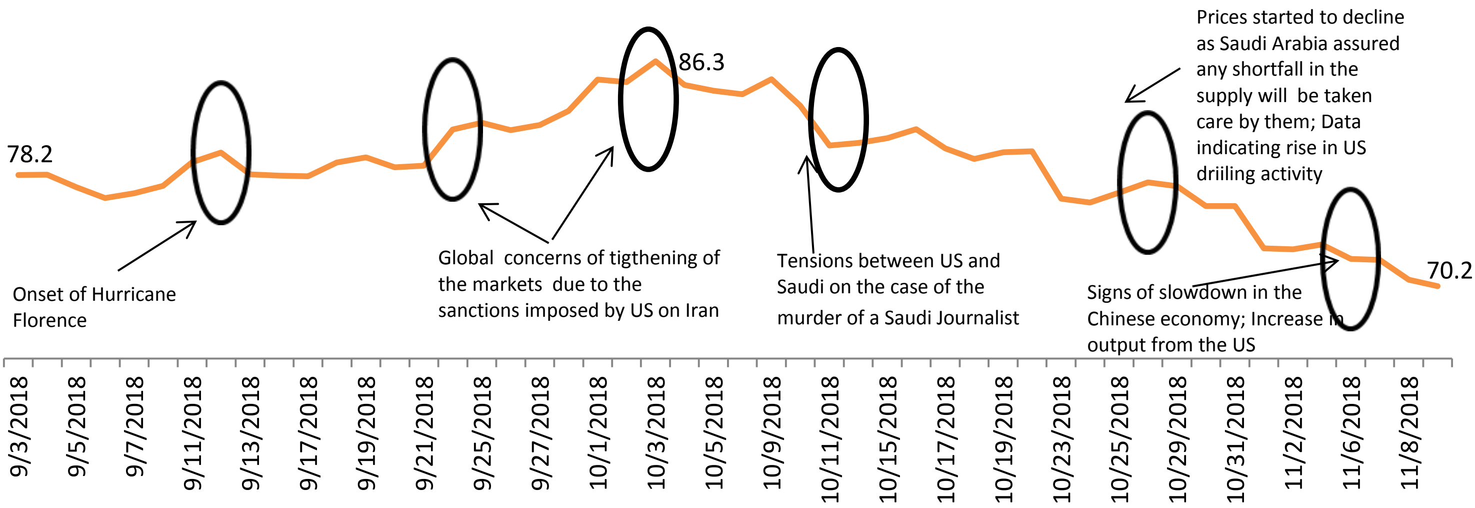
Fall in oil prices

Price of oil has fallen due to the rise in US tight oil production and the global sentiment hovering towards the slowdown in the global economy due to the on-going trade wars between US and China. EIA has reported an increase of 400,000 bpd in U.S. oil production in the first week of November, pushing the total US output up to 11.6 million barrels per day (mb/d).

Concerns of tightening of the oil markets with the US sanctions on Iran have been reversed with the US granting a temporary 180-day waiver to 8 countries - India, China, Italy, Greece, Japan, South Korea, Taiwan and Turkey as long as they work to reduce imports to zero.

Amidst the respite in oil prices the dollar has strengthened against the euro; USD/EUR was 1.17/1.18 during September, 2018 and is currently trading at 1.13/1.14 since the start of November, 2018.

Chart 1: Price trend (Daily) of Brent Oil (USD/bbl) since September and Major landmark events which caused movements in the prices.



Source: Bloomberg, CARE Ratings

India Crude Oil Scenario

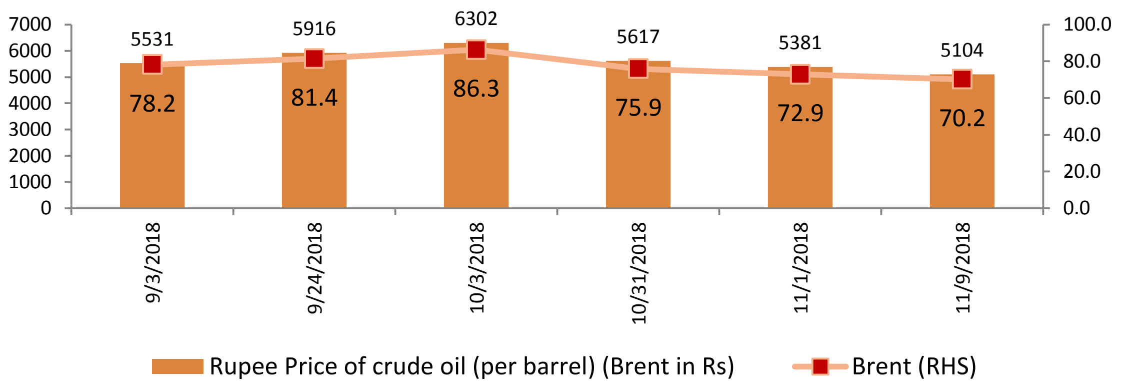
Import Bill

India is the third largest oil consuming nation followed by the US and China and has **imported 4.5 (mb/d) in the current fiscal year (till September 2018)**. Crude oil is mainly sourced by the refineries for the manufacturing of LPG, naphtha, MS-III, MS- IV, MS others, ATF, SKO, HSD-III, HSD- IV, HSD others, LDO, Lubes, FO, LSHS, Bitumen and RPC/Petcoke.

*MS: Motor Spirit, LPG: Liquefied Petroleum Gas, ATF: Air Turbine Fuel SKO: Superior Kerosene Oil HSD: High Speed Diesel, LDO: Light Diesel Oil, FO: Furnace Oil, LSHS: Low Sulphur Heavy Stock, RPC: Raw Pet Coke.

Iran is the third largest supplier of crude oil to India, after Iraq and Saudi and under the temporary exemptions; India is allowed to import up to 300,000 barrels a day.

Chart 2: Rupee Price of crude oil (per barrel) (Brent in Rs)



Source: CARE Ratings

Note: We have considered Brent oil price, Indian basket of crude is usually USD 1-2/bbl lower.

Exchange rate on 3/9/2018- 70.8, 24/9/2018- 72.7, 03/10/2018- 73.0, 31/10/2018- 74, 1/11/2018- 73.8 and 09/11/2018- 72.7

As seen on Chart 2 we can notice there has been 19% fall from the rupee cost of crude oil, when crude oil was as high of USD 86.3/bbl as compared with it hovering around USD 70.2/bbl currently.

At the macro level with imports of 1643 million (4.5*365) barrels of crude oil in FY19 a dollar decrease in prices on a permanent basis would decrease the bill by roughly USD 1.6 billion per annum. Crude oil import bill during FY18 was around USD 108 billion and in the current fiscal is USD 70 billion (till September 2018). Thus the fall in crude oil prices is to aid in softening the CAD.

Note: Cumulative imports of oil have been 11,29,61,309 MT which when converted to barrels is around 828 million barrels (828/183= 4.5)

Inflationary Impact

Rise in crude oil prices and depreciation of the Indian rupee have posed a double whammy threat for fuel inflation in India in the past few months.

Crude oil and its products have a weight of 10.4% in the WPI. Of this crude oil and natural gas have a weight of 2.4% and mineral oils around 8%. With the exception of LPG and kerosene (with combined weight of 0.83%), the rest would be driven by market forces. Therefore, any decrease in the price of crude oil would tend to impact the WPI inflation number commensurately. In terms of the CPI, fuel related items have a weight of nearly 2.7-2.8% directly. Fall in the crude oil prices will impact the WPI more than the CPI.

Currently the government (centre plus states) is collecting around 87% taxes (Excise Duty and VAT) on the base price of petrol and 54% taxes (Excise Duty and VAT) on the base price of diesel.

With the sudden fall in crude oil prices we do not foresee a change in the revenues of the central government but there could be a potential decline in the revenues of the States given the extra revenue earned by them when the prices of crude oil had risen will be negated to an extent.

Concluding remarks

- Price of Brent could range between USD 68/bbl -USD 73/bbl in the coming few months. The rise in the US production and the temporary waivers granted by the US government towards countries importing Iranian oil will bring down the prices but on the flipside the prices of oil can rise given the conclusion of the meeting held by the OPEC+ members where the committee has noted there could be a prospective widening of the gap between supply and demand in 2019 due to the dampening of global economic growth prospects, in addition to associated uncertainties. Saudi Arabia has decided to pump 500,000 bpd lesser in December than it has been in November and the other members are too consider new strategies to balance the market with regard to new production cuts in 2019.
- We assume at the macro level with imports of 1643 million barrels of crude oil in FY19 a dollar decrease in prices on a permanent basis would decrease the bill by roughly USD 1.6 billion per annum.
- With the sudden fall in crude oil prices we do not foresee a change in the revenues of the central government but there could be a potential fall in the revenues of the States given the extra revenue earned by the states when the prices of crude oil had risen.

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