Crude compulsions in the Budget

Strong oil and natural gas prices in FY24 will pressure government finances. Freeing the industry from administrative pricing could be the best way forward

S DINAKAR
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The twin spectres of global recession and sticky inflation, which threaten to trip India's growth prospects in 2023-24, may become a set of triplets with oil and gas prices heading north. Finance Minister Nirmala Sitharaman must be cognizant of a potential uptick in oil and gas rates to make realistic assumptions in the upcoming Budget. More so after Budget estimates for fuel prices this financial year missed actuals by a mile, thanks to the Russia-Ukraine war.

In 2023, crude oil and natural gas rates are expected to stay strong despite a global recession, as China, the world's biggest energy user, emerges from the pandemic-induced lockdowns, Saudi Arabia and Russia-led OPEC+ continue to flex their muscles, and Western sanctions eliminate Russian gas exports to Europe, and send use of LNG higher.

Miscalculations in budgetary fuel price forecasts are fraught with consequences. The government will be forced to accommodate as much as ₹2 trillion in additional spending on fuel and fertiliser subsidies after budgetary estimates made last February fell well short of actuals, as the Black Swan event of Russia's invasion of Ukraine sent crude oil prices to near records, and gas and shipping rates to all-time highs. Surging fuel prices also sent fertiliser subsidies to a record high.

Goldman Sachs forecasts global oil demand to grow by 2 million barrels a day, or by over 2 per cent, in 2023 as China reopens. OPEC expects India's oil demand to be strong this year. That may help European benchmark Brent oil average $98 a barrel in calendar 2023, with second-half prices at $105 a barrel; Brent would average $105 a barrel in 2024, the bank said in a forecast early last month.

"We are bullish on crude prices," said Prashant Vasisht, vice president and co-group head, at ratings agency ICRA. The reopening of China coupled with a reduction in oil release from the strategic petroleum reserves of US and other Western nations are reasons crude prices will rise. Squeezing supplies further is the price cap on Russian oil, Europe stopping fuel imports from Russia and OPEC+ actively managing crude output, Vasisht added. He expects prices to move in the range of $80-$95 a barrel this year.

"In terms of likely oil prices for subsidy assessment, we believe the Indian basket of crude oil could be $80-$85 per barrel for FY24," said Sudhir Kumar, director, CareEdge Ratings. "Increased budget allocation is needed for compensating losses incurred by the oil marketing companies on sale of auto fuels and LPG apart from a one-time grant of ₹22,000 crore," he added.

The finance ministry must also prepare for elevated LNG prices, which meets nearly half the country's gas demand. LNG will continue to stay strong despite Europe's benign winter, analysts reckon. Overflowing gas inventories in Europe will dry out this summer, and Russian gas will not be available this year for refills.

"The realignment of global LNG trade structure following the Ukraine crisis has led to skyrocketing LNG prices in CY 2022," said Hetal Gandhi, director-research, CRISIL Market Intelligence and Analytics. "While we expect the prices to correct, they will remain elevated."

"The tightness in LNG prices will continue till 2025-26," Vasisht said.

Indian policymakers set a conservative $70 per barrel as the price of crude oil in the budget for the 2022-23. The price set for natural gas, a feedstock for fertiliser makers and city gas utilities, is typically pegged to the price of domestic supplies, fixed by the government twice a year. The rate of gas under the administered pricing mechanism (APM), the bulk of India's local supplies, averaged $2.3 per million British thermal units (MMbtu) in 2021-22 fiscal, the basis for estimates in the Budget.

Let us see by how much fuel prices deviated from government estimates. The Indian crude basket, which represents the average of Oman & Dubai benchmarks for sour grades and physical cargoes of Brent for sweet grades in the ratio of 75-25, averaged $96 a barrel in the April-January period on a monthly basis, according to oil ministry data. The average for the 2020-21 fiscal, based on which the government sets the budget rate, was $79 a barrel. So New Delhi's forecast was off by $26 a barrel, or by 27 per cent from current levels.

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The variation in oil and gas prices from budgeted estimates have burnt a hole in government finances. "The spike in natural gas prices has resulted in the subsidy bill to double in fiscal 2023 (against budgeted Rs 1.05 trillion)," said Gandhi. Subsidies on urea may now exceed ₹2.2 trillion, a fertiliser industry official said.

Recently oil minister Hardeep Puri mentioned $82 a barrel as a reference point for current prices of petrol and diesel, $14 a barrel lower than the average crude rates this fiscal. The government earmarked a little over ₹20,000 crore to compensate state-oil refiners for a part of their losses, incurred from selling petrol, diesel and LPG below market rates.

But that may be inadequate. The retail prices of auto fuels have not been revised for an extended period of time, which has resulted in sizeable marketing losses for oil marketing companies, ICRA said in a new report. IOC, BPCL and HPCL have posted a combined net loss of around ₹21,200 crore for the April-September period, excluding ₹22,000 crore they are yet to receive from the government to compensate for losses from LPG sales. Oil companies are further expecting ₹50,000 crore from the government to compensate for a freeze in petrol and diesel prices for the past eight months, according to industry officials.

Prime Minister Narendra Modi's government, which faces key state polls and a general election next year, will be hard pressed to let fuel prices move higher. Policy tweaks in the gas sector — including imposing a ceiling on APM gas prices, capping gas trading margins, and letting fertiliser companies procure LNG via the Indian Gas Exchange — will mitigate urea subsidies in the upcoming Budget. But, in the long term, price controls imperil exploration — leaving the nation even more susceptible to volatility in global fossil fuel rates, and increasingly dependent on foreign suppliers.

STRESS TESTS FOR THE FM

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