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Professional Risk Opinion

15th OPEC and non-OPEC Ministerial meeting: May-July supply cuts and its Impact on India

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Overview

The OPEC+ group surprised the markets by deciding to ease the production cuts for May, June and July while the number of cases continue to rise and pandemic enforced lockdowns continue to prevail in many countries.

In the previous meeting, the cartel had decided to continue the production levels of March-21 (7.05mb/d) for the month of April-21, with the exception of Russia and Kazakhstan (they were allowed to increase production by 130 and 20 thousand barrels per day respectively). Saudi Arabia was to continue to extend the additional voluntary adjustments of 1 mb/d for the month of April 2021 as well.

Since the April 2020 meeting, OPEC and its allies had contributed to adjusting downward global oil supply by 2.6 billion barrels of oil by the end of February 2021, which has accelerated the rebalancing of the oil market

Verdict: OPEC+ members decided to cut production by 6.55 mb/d (million barrels per day), 6.2 mb/d and 5.759 mb/d in May, June and July respectively. The cartel will be pumping in 0.35 mb/d in May (compared with the 6.9 mb/d cuts undertaken in April), an additional 0.35 mb/d in June and increasing it by 0.441 mb/d in July.

Participating members who have not been able to maintain and achieve its requisite quota of cuts were requested to achieve full conformity and make up for pervious compensation shortfalls by the end of September 2021.

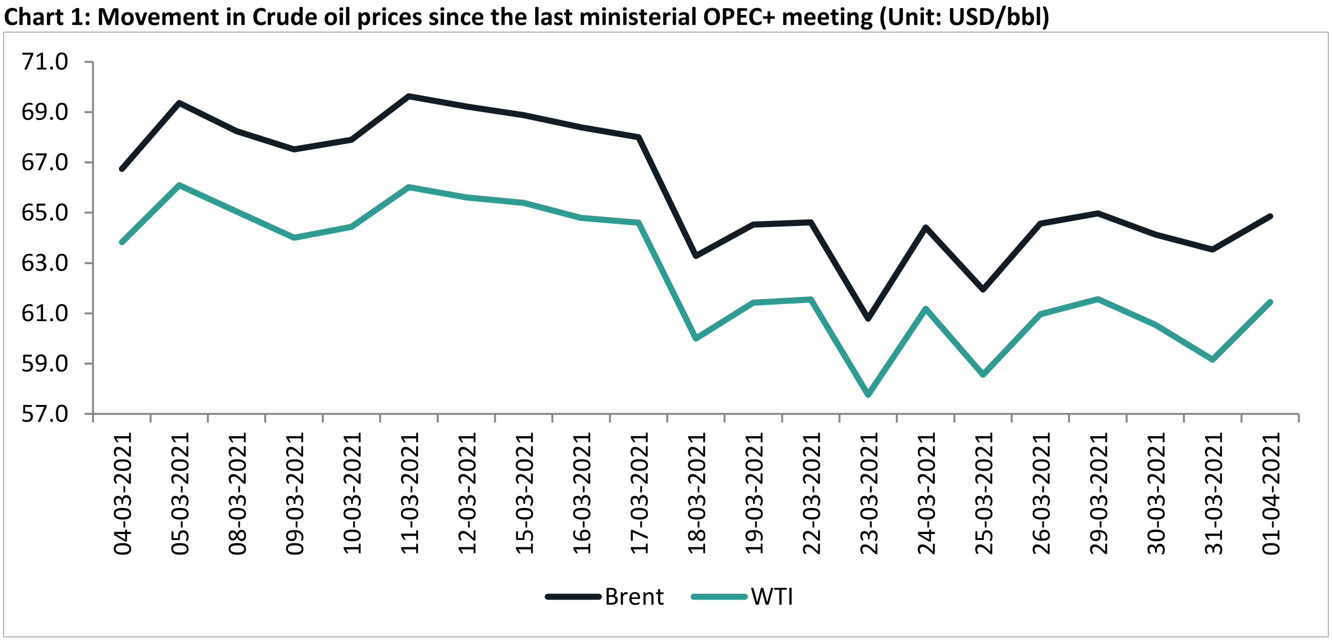
Table 1: OPEC+ Production Accord (Unit: mb/d)

	May-21	June-21	July-21
Required Production	37.303	37.653	38.094
Adjustment	6.55	6.2	5.759

Source: OPEC, CARE Ratings

*Note: Reference production is 43.853 mb/d

Chart 1: Movement in Crude oil prices since the last ministerial OPEC+ meeting (Unit: USD/bbl)



Source: Bloomberg

Since the previous meeting held on March 4, 2021 till March 31, 2021, Brent crude oil price and WTI have fallen by 4.8% and 7.3% respectively.

Crude oil prices had initially increased following the decision by the OPEC+ to keep crude oil output unchanged in April coupled with continuation of a voluntary production cut by Saudi Arabia for another month. Improved fuel demand conditions amid ongoing stimulus measures and progress of the vaccination drive had also pushed the prices higher. Oil prices had also risen because of the attack on Saudi Arabia's oil facilities by the Houthi rebels in Yemen but prices had settled once the situation was under control.

During the course of the month, oil prices fell on account of demand concerns due to a slow vaccination campaign in Europe and increase in US crude oil inventory. During the 3rd week of March, crude oil prices started to rally, after falling sharply in recent sessions, as a container ship blocked the Suez Canal raising supply concerns because it was also blocking many ships using that trade route.

However, prices fell once again once the ship struck was finally freed and there was a resumption of the movement in carrier traffic. The month ended with price of crude oil falling by 1% and 2.3% due to the rising coronavirus cases and reinforcement of lockdowns in some countries, which acts as a major impediment in the oil demand outlook.

Post the announcement and decision taken during the 15th Ministerial OPEC+ meeting, crude oil prices (Brent oil and WTI) have increased by 2.9% and 2.9% respectively.

Concluding Remarks
Oil markets had been reacting positively with the supply cuts undertaken by the cartel and US oil production too has been restrained to a certain extent, which is supporting the increase in price. Though there has been improvements in the oil markets supported by global vaccination programmes and stimulus packages in key economies, a significant amount of volatility is still present coupled with the ongoing coronavirus crisis which continues to cloud the demand outlook.

Price call
Price of crude oil is to **range between USD 64-67/bbl** creating a new base for oil prices. Vaccination programs against the coronavirus have been gathering pace, potentially leading to increased economic activity but increase in COVID cases globally along renewed lockdowns in many countries is also acting as a dampener in an oil-based recovery.

Impact on the Indian economy
The recent increase in oil price has not been favourable for the Indian economy considering how the country imports more than 80%-85% of its oil requirements.

- **Trade:** On a macro level, increase in oil price with imports of million barrels of crude oil (3.9*365) during FY21, a dollar increase in prices on a permanent basis would increase the bill by roughly USD 1.4 billion per annum. India's crude oil import bill had come down by 8.7% during FY20 to USD 102.2 billion and currently value of crude oil imported too has fallen by 43.7% during 11M-FY21 to USD 53.8 billion.
- **Inflation:** Crude oil and its products have a weight of 10.36% in the WPI. Of this, crude oil and natural gas have a weight of 2.41% and mineral oils around 7.95%. With the exception of LPG and kerosene (with combined weight of 0.83%), the rest would be driven by market forces. Therefore, any increase in the price of crude oil would tend to impact the WPI inflation number commensurately. In case of the CPI the impact of crude oil prices is directly related to the pass through to transportation fuels which has weight of 2.39%. Thus increase in the crude oil prices will impact the WPI more than the CPI.
- **Government Revenues:** The price of petrol and diesel is high at the moment and not reflective on the global crude oil prices. Going forward a significant amount of volatility is expected in the price of crude oil and keeping that in mind, unless the government does not cut the taxes levied on petrol and diesel, prices of the auto fuel is expected to remain stable at its current retail price, which will aid in filling the coffers.

    - Currently as per the latest available data on price build of petrol and diesel) the government is able to collect around 163% taxes, (Excise Duty and VAT) on the base price of petrol and 126% in the case of diesel (as on April 1 2021). Taxes now make up around 59% of the retail price of petrol 54% of the retail price of diesel (as on 1st April 2021).
    - Price of petrol currently is retailing at Rs 90.6/ltr in Delhi, in Rs. 97/ltr in Mumbai, Rs. 92.6/ltr in Chennai and Rs. 90.8 /ltr in Kolkata respectively while that of diesel was retailing at Rs 80.9/ltr in Delhi, Rs 88/ltr in Mumbai, Rs 85.9/ltr in Chennai and Rs 83.8/ltr in Kolkata.

Note: OMCs take appropriate decision on pricing of petrol and diesel in line with their international product prices, exchange rate, tax structure, inland freight and other cost elements. Oil firms consider the trade parity pricing which is based on the prevailing prices in the international markets. Retail prices of petrol and diesel in India are linked to their prices in the global markets. Prices of petrol and diesel in India are worked out based on the average of the trailing 15 days of benchmarked Arab-Gulf fuel prices, which move in tandem with global crude oil prices. The pricing formula involves 80% of import price and 20% export price of the fuel. Which means indirectly prices of petrol and diesel are correlated to that of crude oil.

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