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Crude boost for India Inc as global oil demand dips

Crude-dependent sectors such as aviation likely to gain from price drop

Expectations high on 'mini' trade deal during Trump's visit: India Inc.

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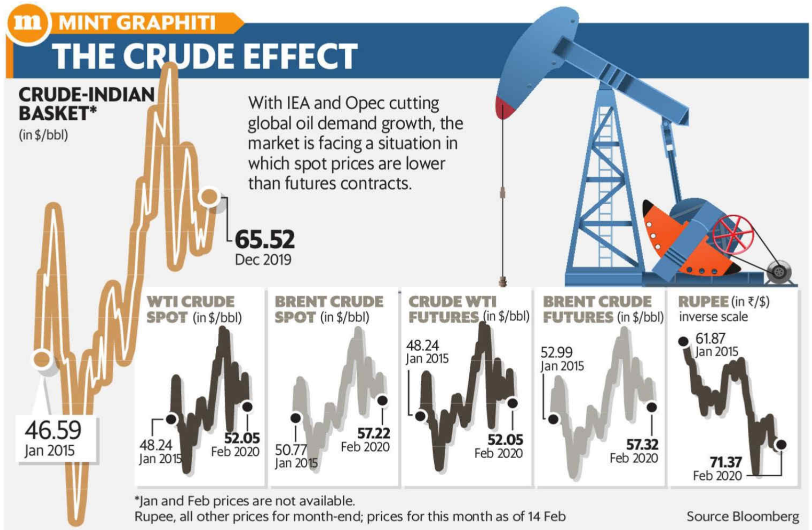

SARVESH KUMAR SHARMA/MINT

The sluggish Indian economy and industries that are heavily dependent on crude oil such as aviation, shipping, road and rail transportation are likely to gain from a sudden drop in crude oil prices due to the coronavirus epidemic in China, the world's biggest oil importer, said economists, chief executives and experts.

With various industries realigning their strategy amid energy demand forecasts being slashed due to the coronavirus outbreak, major oil importers such as India are seeking to drive a better bargain. India is the world's third-largest oil importer and the fourth-largest buyer of liquefied natural gas (LNG).

The oil market is currently facing a situation called contango, wherein spot prices are lower than futures contracts.

"Estimates by several agencies are suggesting that Chinese Q1 crude demand will be down by 15-20%, resulting in a contraction of global crude demand. This is reflecting in the prices of crude and LNG, which are both benign for India. This will help India in its macroeconomic parameters by containing current account deficit, maintaining stable exchange regime and consequently inflation," said Debasish Mishra, partner at Deloitte India.

Industries are realigning their strategy amid energy demand forecasts being cut due to the virus outbreak

The International Energy Agency (IEA) and the Organization of the Petroleum Exporting Countries (Opec) have cut global oil demand growth outlook following the coronavirus outbreak.

"Sectors such as aviation, paints, ceramics, some industrial products, etc. would benefit from a benign price regime," Mishra added.

India is a key Asian refining hub, with an installed capacity of more than 249.4 million tonnes per annum (mtpa) through 23 refineries. The cost of the Indian basket of crude, which averaged $56.43 and $69.88 per barrel in FY18 and FY19, respectively, averaged $65.52 in December 2019, according to data from the Petroleum Planning and Analysis Cell. The price was $54.93 a barrel on 13 February. The Indian basket represents the average of Oman, Dubai and Brent crude.

"In the past, benign oil price

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Cheer for Indian companies as crude prices decline over China coronavirus epidemic

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has seen airline profitability improving significantly," said Kinjal Shah, vice president of corporate ratings at rating agency ICRA Ltd.

Amid an economic slowdown, India's air travel industry saw a 3.7% passenger traffic growth in 2019 to 144 million passengers.

"This could be a good time for airlines to make up for the losses. Airlines can use this to recoup losses, while travellers can use this moment to plan for travel as the cost of air tickets would become more pocket friendly," said Mark Martin, founder and CEO at Martin Consulting Llc, an aviation consultant.

The outbreak of coronavirus in China has forced energy firms there to suspend delivery contracts and reduce output. This has impacted both global oil prices and shipping rates. Trade tensions and a slowing global economy also have an overhang on energy markets.

Officials at the Indian Chemical Council, an industry body, said India depends on China for chemicals across the value chain, with that country's share in imports ranging from 10-40%. The petrochemical sector serves as the backbone for various other manufacturing and non-manufacturing sectors such as infrastructure, automobile, textiles and consumer durables.

"A wide variety of raw material and intermediaries are imported from China. Though, so far, companies importing these are not significantly impacted, their supply chain is drying up. So, they may feel an impact going forward if the situation does not improve," said Sudhir Shenoy, country president and CEO of Dow Chemical International Pvt. Ltd.

This may benefit domestic producers of rubber chemicals, graphite electrodes, carbon black, dyes and pigments as lower Chinese imports may force end-consumers to source them locally.

Lower crude prices also bring good tidings to the government's exchequer amid a revenue shortfall and a burgeoning fiscal deficit. Given the tepid growth in revenue collections, finance minister Nirmala Sitharaman, while presenting the Union budget, invoked the escape clause to take a 50-basis point leeway in the fiscal deficit for 2019-20, taking the revised estimate to 3.8% of GDP.

RBI governor Shaktikanta Das on Saturday said declining oil prices would have a positive impact on inflation. "The main spike is coming from food inflation, that is, vegetables and protein items. Core inflation has slightly edged up because of revision of telecom tariffs," he added.

REUTERS

While the spike in crude prices due to tensions between the US and Iran was short-lived, the coronavirus outbreak and imminent output cut by Opec have introduced an element of uncertainty.

Weighed down by a decline in the manufacturing sector, India's factory output contracted in December, while retail inflation accelerated for the sixth consecutive month in January, raising doubts about the recovery process of the fledgling economy. India's economic growth is estimated by the National Statistical Office to hit an 11-year low of 5% in 2019-20 on the back of sluggish consumption and investment demand.

Madan Sabnavis, chief economist at CARE Ratings, said lower oil prices have been a blessing for India. "However, upward pressure cannot be ruled out, with some cuts expected by Opec and other exporting countries. Therefore, we need to focus on how to increase exports and look to leverage the cause of lower oil prices, that is, coronavirus, and push our goods to China, while looking for alternatives to suppliers on imports. Fortunately, due to steady capital flows, pressure on the rupee is not an issue," he added.

Concerned about the oil demand situation, Opec may advance its 5-6 March meeting, with its technical panel recommending a provisional cut to the Opec+ arrangement.

"Due to the healthy trade imports from the East, the impact on container ports like JNPT (Jawaharlal Nehru Port Trust) will be high, while the impact on Mundra port will be limited," said Jagannarayan Padmanabhan, director and practice lead of transport and logistics at Crisil Infrastructure Advisory. "The flip side is that some of the manufacturing may shift from China to India temporarily."

While the spike in crude prices due to rising tensions between the US and Iran was short-lived, the coronavirus outbreak and imminent output cut by Opec countries have introduced an element of uncertainty.

"Though the oil prices are low, the exchange rate (rupee against the dollar) is rising, which is also leading to higher costs. We are comfortable when rupee is about 65-70 against the dollar. Since a large part of our expenses, including that for aviation fuel, is paid in dollar terms, foreign exchange is an important aspect of our costs," a senior executive at a New Delhi-based budget airline said on condition of anonymity.

To be sure, a rebound in oil demand could again stoke prices that could fan inflation and hurt demand.

Higher oil prices also have an indirect impact through higher production and transportation costs and exert upward pressure on food inflation. Any effort to cushion the burden on consumers by lowering the excise duty on petrol and diesel would hamper revenue collections.

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