

India Macro Flash

Fuel Price Hike/Duty Re-jig – A Big Sentiment Positive, Despite Impact on Inflation and Public Finances

- **Diesel prices raised by 12%, duties re-jigged** — In a long-awaited move, the government finally raised prices of diesel and re-jigged the duty structure. Key measures: (a) Diesel prices raised by Rs5/ltr i.e ~12% (of this Rs1.5/ltr is on account of an increase in excise duty); (b) Subsidized LPG cylinders capped at 6 per household (c) Excise duty on petrol diesel reduced by Rs5.3/ltr. These measures, though overdue, are positive and if not rolled back due to political pressures would send a strong signal on government's willingness and ability to act.

- **Macro Implications – Inflation; Public Finances; Policies**

- **Inflation: Overall impact ~125bps; suppressed inflation remains elevated:**

The hike in diesel prices will have a ~55bps direct impact on inflation and an additional 40bps from second-round effects. As regards LPG, assuming that 1/3rd of the cylinders will now be at market prices, the impact on inflation would be ~30bps. Thus, the total impact on inflation would be ~125bps. However, this could be offset by the recovery in monsoons, which will douse fears of a rise in ag-flation. We thus maintain our view of inflation averaging 8% in FY13. But key to note, is that despite the price hike, retail prices are still below international prices and consequently suppressed inflation remains high at 340bps. (see pg 2).

- **Public Finances: Subsidy provision way too low; deficit to touch 5.9%:**

While the price hike is positive and will reduce the under-recoveries (losses by oil companies) by Rs203bn, key to note is that retail prices are way below global prices. Unless further measures are taken, the Ministry estimates under-recoveries to the tune of Rs1670bn for FY13. Thus assuming no change in the current subsidy sharing mechanism, the govt's share of losses would touch Rs1002bn – higher than Rs835bn in FY12 (see pg 2 for detailed break-down). Accounting for other expenditure and revenue slippages, we maintain our view of the fiscal deficit coming in at 5.9% of GDP vs. the government's target of 5.1%.

- **Policies: Positive, but much more needed; will the RBI follow?** (1) If not rolled back, it would send a strong signal on government's willingness and ability to act despite coalition pressures. (2) The re-jig in duties – i.e lower excise on diesel and higher on petrol will result in a narrowing on the price differential between petrol and diesel. This is a positive as diesel accounts for 60% of losses and consumption has risen to 14% from 8% in FY12 (3) The impact of capping LPG cylinders to 6 is the first step towards ensuring that subsidy should be given to those that need it. (4) While our rate call is that of the RBI easing in 2HFY13, the fuel price hike does increase the probability of the RBI easing in its policy on Monday, especially if the govt takes steps later today/weekend on the FDI front.

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With thanks to

Ipsita Pal; Abha Agarwal

WHAT's INSIDE

- Overall Subsidy Bill
 - Under-recoveries by Oil Companies
 - Impact on Inflation
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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Oil Price Hikes – Key Macro Implications

SUBSIDIES- WAY UNDER BUDGETED

The overall subsidy bill of Rs1900bn in FY13 is unrealistic. The budget factors in oil subsidies at Rs436bn; but this incorporates Rs385bn deferred oil subsidies from FY12.

OIL LOSSES REMAIN HIGH

Despite the price hike, oil under-recoveries are expected to touch Rs1670bn. (Without the price hike, losses would have been higher by Rs203bn). Taking into account govt's share of losses, our deficit assumptions remain at 5.9% v/s govt estimates of 5.1%.

The loss in govt revenues from the excise cut in petrol(Rs5.3/ltr) will be offset by the hike in diesel (Rs1.5/ltr), as volumes of diesel are higher than petrol

INFLATION IMPLICATIONS

The diesel price hike by Rs.5/litre (i.e ~12%) would result in first round impact on inflation of ~55bps.

Capping of LPG cylinders to 6, would have an impact on inflation ~30bps

Suppressed inflation stays high at 3.4%

MKTING MARGINS WOULD IMPROVE

As analysed by our oil analyst – Saurabh Handa, mktg margins on both petrol and diesel would improve driven by (1) the net Rs3.5/ltr increase in diesel prices (2) the Rs5.3/ltr increase in petrol duties.

Negative marketing margins are an adjustment factor after the government fixes the ex-storage price of gasoline/diesel on which excise/sales taxes are levied.

Figure 1. Trends in Subsidies (Rs Bn)

	FY06	FY07	FY08	FY09	FY10	FY11	FY12RE	FY13BE
Food	231	240	313	438	584	638	728	750
Fertilizer	185	262	325	766	613	623	672	609
Fuel	27	27	28	29	150	384	685	435
Total	475	571	709	1,297	1,414	1734	2163	1900
% YoY	3.4	20.2	24.2	82.9	9.0	22.7	24.7	-12.2
% GDP	1.3	1.3	1.4	2.3	2.2	2.3	2.4	1.9

Source: Budget Documents

Figure 2. Subsidy Sharing Mechanism (Rs Bn)

	FY09	FY10	FY11	FY12	FY13E	FY14E
Gross under-recoveries	1,033	461	782	1385	1670	811
Diesel	575	144	365	812	1030	407
LPG	176	143	220	300	320	162
Kero	282	174	197	273	320	242
Less: upstream sharing	329	144	303	550	668	324
% of Total		31%	39%	40%	40%	40%
Less: oil bonds/cash	713	260	410	835	1002	405
% of Total		56%	52%	60%	60%	50%
Net under-recoveries	-9	56	69	0	0	81
Brent Crude (US\$/bbl)	85	71.5	87%	115	110	96
USD/INR		47.5	45.6	48	54	53

Source: Ministry of Petroleum and Natural Gas, Citi Research

Figure 3. Direct Impact on the WPI

	Weight in WPI	Price Hike	Impact on Inflation	Current Price	Current Losses	Required Price Hikes	Impact on Inflation
Liquefied petroleum gas	0.90%		0.30%	400	350.0	88%	0.6%*
Kerosene fuel	0.70%			14.8	33.0	223%	1.6%
High speed diesel	4.70%	12%	0.55%	47	14.0	30%	1.4%
Overall impact	6.30%		0.85%				3.4%

Source: Office of the Economic Advisor, Citi Research* Assumes 1/3rd is at mkt prices

Figure 4. Diesel and Petrol Prices – Fuel Tax Structure in India

	Diesel (Old)		Diesel (New)		Petrol (Old)		Petrol (New)	
	Rs/litre	% of retail price	Rs/litre	% of retail price	Rs/litre	% of retail price	Rs/litre	% of retail price
International price US\$/bbl	130		130		130		130	
International price	45.8	101%	45.8	91%	48.2	61%	48.2	61%
C&F	0.8	2%	0.8	2%	0.5	1%	0.5	1%
Customs Duty/Import Charges	1.6	4%	1.6	3%	0	0%	0	0%
Marketing Margins	-16.3	-36%	-13.8	-27%	-3.9	-5%	1.6	2%
C&F Surcharge/other premia	0.9	2%	0.9	2%	0.4	1%	0.4	1%
Marketing Cost	1.4	3%	1.4	3%	0	0%	0	0%
Ex-Storage Price	33.7	74%	36.2	72%	45.2	57%	50.6	64%
Excise Duty	2.1	5%	3.6	7%	14.8	19%	9.3	12%
Sales Tax	8.6	19%	9.6	19%	17.1	22%	17.1	22%
Dealer Commission	0.9	2%	0.9	2%	1.5	2%	1.5	2%
Retail Price in Mumbai	45.3	100%	50.3	100%	78.6	100%	78.6	100%

Source: Citi Research

Statistical Snapshot

Figure 5. India – Macroeconomic Summary, FY01-14E (%)

Year to 31 March	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
National Income Indicators*														
Nominal GDP (Rs bn)	21,840	23,676	25,500	28,617	32,422	36,934	42,947	49,871	56,301	64,574	76,741	88,558	101,399	116,609
Nominal GDP (US\$ bn)	478	493	528	623	720	834	950	1,241	1,224	1,362	1,684	1,841	1,844	2,159
Per Capita GDP (US\$)	469	474	500	582	662	754	847	1,090	1,061	1,163	1,416	1,526	1,511	1,718
Real GDP growth (%)	4.3	5.5	4.0	8.1	7.0	9.5	9.6	9.3	6.7	8.4	8.4	6.5	5.4	6.2
Agriculture growth (%)	0.0	6.0	-6.6	9.0	0.2	5.1	4.2	5.8	0.1	1.0	7.0	2.8	0.5	3.0
Industry growth (%)	6.0	2.6	7.2	7.3	9.8	9.7	12.2	9.7	4.4	8.4	7.2	3.4	3.2	4.4
Services growth (%)	5.4	6.9	7.0	8.1	8.1	10.9	10.1	10.3	10.0	10.5	9.3	8.9	7.5	7.8
By Demand * (%YoY)														
Consumption	3.0	5.3	2.3	5.4	2.3	8.6	7.9	9.3	7.6	8.1	8.1	5.4	5.0	5.7
Pvt Consm	3.4	6.0	2.9	5.9	2.1	8.5	8.7	9.2	7.1	7.0	8.1	5.5	5.0	5.5
Public Consm	0.9	2.3	-0.4	2.6	3.4	8.9	3.8	9.6	10.4	14.3	7.8	5.1	5.0	7.0
Gross Fixed Capital Formn	0.0	7.4	6.8	13.6	20.7	16.2	13.8	16.2	3.5	6.8	7.5	5.5	4.5	6.0
Cons; Invst, Savings ** (%GDP)														
Consumption	78.5	78.9	77.2	75.0	70.3	69.3	68.3	67.4	68.8	69.4	68.4	67.7	67.0	67.0
Gross Capital Formation	23.8	22.3	24.6	26.9	32.8	34.7	35.7	38.1	34.3	36.1	35.8	35.5	35.0	35.0
Gross Domestic Savings	23.2	22.9	25.7	29.1	32.4	33.4	34.6	36.8	32.0	33.8	32.3	32.0	31.8	31.5
Real Indicators (%YoY)														
Cement dispatches (domestic)	-1.9	9.8	8.7	5.8	8.1	10.1	10.2	9.8	8.5	11.2	5.2	7.0	8.0	9.0
Commercial vehicle sales	-11.9	-4.5	40.4	37.5	25.5	12.3	32.2	5.8	-22.3	39.2	27.0	19.5	5.0	10.0
Car sales	-5.3	3.2	5.3	32.1	19.2	7.4	19.7	11.7	7.0	25.7	29.3	3.9	5.0	20.0
Two-wheelers	0.7	15.3	15.8	12.6	16.8	15.0	12.1	-4.8	4.7	25.8	25.8	13.9	6.0	10.0
Diesel consumption	-3.4	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	8.0	8.0	8.0
Mobile Tele density	0.3	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.5	66.8	75.1	79.0	81.9
Monetary Indicators (% YoY)														
Money supply	16.8	14.1	14.7	16.8	12.0	21.4	21.3	21.1	19.3	16.7	16.0	16.0	16.0	17.0
Inflation – WPI (Avg)	7.1	3.6	3.4	5.5	6.5	3.7	6.5	4.8	8.0	3.6	9.6	8.8	8.0	7
CPI (Avg)	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	12.3	10.5	8.4	8.0	7
Bank credit growth	17.3	15.3	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.9	21.5	17.0	17.0	17.0
Deposit growth	18.4	14.6	16.1	17.5	13.0	24.0	23.8	22.4	19.9	17.0	16.0	16.0	16.0	16.0
Fiscal Indicators (% GDP)														
Centre's fiscal deficit)	-5.4	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.5	-4.9	-5.9	-5.9	-5.5
State fiscal deficit	-4.0	-4.0	-3.9	-4.2	-3.3	-2.4	-1.8	-1.5	-2.4	-2.9	-2.7	-2.5	-2.5	-2.5
Combined deficit (Centre+State)	-9.2	-9.6	-9.2	-8.2	-7.2	-6.5	-5.4	-4.1	-8.4	-9.7	-8.3	-8.4	-8.4	-8.0
Off Balance Sheet Items	-	-	-	-	-	-0.5	-0.9	-0.6	-1.7	-0.2	-	-	-	-
Combined liabilities (dom+ext)	77.1	82.0	85.5	85.4	85.2	83.0	79.3	76.1	76.1	75.0	71.3	70.5	69.2	69.2
External Sector (% YoY)														
Exports (US\$bn)	45.5	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.4	250.5	309.8	303.6	327.9
% YoY	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	37.3	23.7	-2.0	8.0
Imports (US\$bn)	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	381.1	499.5	477.1	505.7
%YoY	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	26.7	31.1	-4.5	6.0
Trade deficit (US\$bn)	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-130.6	-189.8	-173.5	-177.8
Invisibles (US\$bn)	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	84.6	111.6	118.4	131.7
Current Account Deficit (US\$bn)	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-45.9	-78.2	-55.1	-46.1
% to GDP	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.7	-4.2	-3.0	-2.1
Capital Account (US\$bn)	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	51.6	62.0	67.8	55.6	54.6
% GDP	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.7	3.7	3.0	2.5
Forex Assets (excl gold) (US\$bn)	39.6	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	260.9	261.4	269.9
Months of imports	8.2	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	6.3	6.6	6.4
External Debt (US\$bn)	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	261.0	305.9	345.8	360.8	375.8
Short Term Debt	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	78.2	83.2	88.2
Exchange Rate														
US\$/INR - annual avg	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	55.0	54.0
% depreciation	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	14.3	-1.8
US\$/INR - year end	46.5	48.9	47.5	43.6	43.8	44.6	43.6	40.1	50.7	44.9	44.6	50.3	55.0	53.1
% depreciation	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.3	-8.0	26.4	-11.4	-0.7	12.8	9.3	-3.5

** At current prices. Source: CSO, RBI, Ministry of Finance and Citi Research Estimates

Appendix A-1

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