

India Macro View

Fuel Reforms – Positive Signal, Bodes Well for Ratings; Implementation Could Lower Subsidy Bill by 0.5% of GDP in FY14

- **Fuel Reform: Part II** — The incremental fuel price reform momentum seen since Sept 12 has been significantly better than expectations. Following the 12% hike in diesel prices last Sept, late last night the govt (1) Authorized oil marketing companies (OMCs) to raise diesel prices by Rs0.5/ltr per month till losses are nullified (2) Bulk users of diesel (~16% of total consumption) will henceforth have to pay market prices (3) Raised the cap on subsidized LPG cylinders from 6 to 9 cylinders for FY14 and increased price of non-subsidised cylinders by Rs46.50/cyl.

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

- **Public Finances: Subsidy Bill to be lower by 0.5% of GDP:** Currently diesel prices are at Rs51/ltr resulting in a Rs9/ltr loss for OMCs. As diesel currently accounts for 60% of under-recoveries (losses by OMCs), implementation of a monthly hike would result in gross under-recoveries falling sharply from Rs1.67trillion in FY13 to Rs1.1trillion in FY14. Assuming no change in the current subsidy sharing mechanism, the govt's share of losses could come in at Rs698bn in FY14 v/s Rs1030bn expected in FY13. This could result in a saving of 0.5% of GDP. Under-recoveries LPG remain unchanged as the price hike on non-subsidised cylinders negates the increase in subsidy cap. (see p 2 for math)
- **Inflation: Direct impact ~60bps; Suppressed Inflation Decreases:** Diesel has a weight of 4.67% in the WPI. On an annualised basis, the implementation of the proposed hike will have a ~60bps direct impact on WPI and an additional 30bps from second-round effects/increase in prices for bulk users.
- **Imports:** As diesel accounts for ~50% of petroleum consumption, the phased increase in diesel prices could in time moderate the import bill.
- **Policy Implications:** — Following the reforms announced last year (pls see p17/18 of [India Macroscope –The Capital Question](#) for measures since Sept 12) the fuel price reform and recent rail hike are yet another sign that the govt is willing to take tough decisions. While its implementation is dependent on the OMCs, we believe this will send a strong signal to the rating agencies and reduces the probability of a downgrade. As regards monetary policy, we believe the measures should go down well with the RBI, which has stated that "in the absence of pass-through from international crude prices to domestic prices, the consumption of petroleum products remains strong distorting price signals and preventing the much-needed adjustment in demand". Given elevated levels of the CAD and CPI, we maintain our view of a modest 75bps easing in 2013, with a 25bps cut in the Jan 29 policy.

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With thanks to
Abha Agarwal

WHAT'S INSIDE: Macro Implications

- Overall Subsidy Bill
 - Under-recoveries by Oil Companies
 - Impact on Inflation
 - Statistical Snapshot
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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: THE STORY SO FAR

Fuel subsidies typically account for 1/3rd of the total subsidy bill.

FY13 Budget estimates factor in oil subsidies at Rs436bn; but this incorporates Rs385bn deferred oil subsidies from FY12.

OIL LOSSES: REDUCE BY 30%

If implemented, the hike in diesel prices is likely to lower losses by ~30%.

As diesel accounts for 60% of total losses, the overall subsidy bill could be lower by 0.5% of GDP.

Note by our oil analyst – Saurabh Handa on [Fuel Reform – Impact on Oil Companies](#)

INFLATION: IMPLICATIONS

Taking into account the proposed diesel hike (~60bps impact on WPI)...

....suppressed inflation stands at 2.7% v/s 3.3% earlier.

DIESEL CONSUMPTION

Bulk buyers (railways, industry etc; ~16-18% of consumption)

The proposed hike in prices would go down well with the RBI who in the past have stated "in the absence of pass-through from international crude oil prices to domestic prices, the consumption of petroleum products remains strong distorting price signals and preventing the much-needed adjustment in aggregate demand"

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	1163
Diesel	575	144	365	812	1030	474
LPG	176	143	220	300	320	365
Kero	282	174	197	273	320	324
Less: upstream sharing	329	144	303	550	668	465
% of Total		31%	39%	40%	40%	40%
Less: oil bonds/cash	713	260	410	835	1002	698
% of Total		56%	52%	60%	60%	60%
Net under-recoveries	-9	56	69	0	0	0
Brent Crude (US\$/bbl)	85	71.5	87%	115	110	110
USD/INR		47.5	45.6	48	54	53

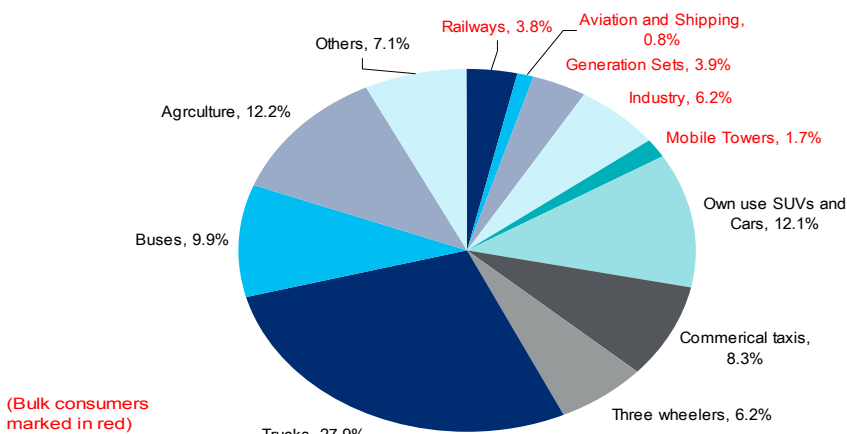
Source: Ministry of Petroleum and Natural Gas, Citi Research

Figure 3. "Suppressed" Inflation and WPI

	Weight in WPI	Current Price	Current Losses	Required Price Hikes	Impact on Inflation
Liquefied petroleum gas	0.90%	423	490	116%	1.0%
Kerosene fuel	0.70%	15	31	207%	1.5%
High speed diesel	4.70%	51+6	3.	5.3%	0.2%
Overall impact	6.30%				2.70%

Source: Office of the Economic Advisor, Citi Research; Prices as on Jan 14 (Current diesel price = 51)

Figure 4. India diesel consumption by sector



Source: Citi Research, Gov't

Statistical Snapshot

Figure 5. Macro Economic Summary (FY01- FY14E)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E
Fiscal 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	624	721	834	950	1241	1224	1362	1684	1,841	1,878	2,180
Per Capita GDP (US\$)	469	474	500	582	662	754	847	1,090	1,061	1,164	1,420	1,532	1,539	1,734
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 Consumption	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 Consumption	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 Formation	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	70.1	69.2	68.0	67.2	68.6	69.4	68.4	67.7	67.1	66.2
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	35.4	35.1
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	1.2	12.9
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	2.9	22.0
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	5.0	11.0
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	80.0
Monetary Indicators (% YoY)														
Money supply	15.9	16.0	16.1	13.0	14.0	15.9	20.0	22.1	20.5	19.2	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	7.5	7.0
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	7.0
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	256.2	309.8	291.2	314.5
% YoY	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	40.4	20.9	-6.0	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	383.5	499.5	479.6	508.3
%YoY	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	27.6	30.3	-4.0	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	-127.3	-189.8	-188.4	-193.8
Invisibles (US\$bn)	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	79.3	111.6	112.4	116.5
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	-48.1	-78.2	-76.0	-77.3
% to GDP	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.9	-4.2	-4.0	-3.5
Capital Account (US\$bn)	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	51.6	63.7	67.8	77.6	79.6
% GDP	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.8	3.7	4.1	3.7
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	262.5	264.7
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	6.2
External Debt (US\$bn)	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	260.9	305.9	345.4	360.4	375.4
Short Term Debt (US\$bn)	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	54.0	53.5
% 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	12.3	-0.9

** At current prices.

Source: CSO, RBI, Ministry of Finance, Citi Research Estimates

Appendix A-1

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