

Economics

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India Macro Flash

Fuel Price Hike – Macro Implications

- **Auto Fuels Adjusted by 6%-9%** — Late last evening, the government raised retail prices of petrol by 9% (Rs4/ltr) and diesel by 6% (Rs2/ltr). Although this is still less than current international prices (*petrol and diesel would need to be raised by an additional Rs2.5/ltr as margins are negative – see table below*), the hike is positive, bodes well for the reform process and is a step towards fiscal consolidation.
- **Impact on Oil Bonds** — Assuming that transport fuels are fully adjusted to international prices, Rahul Singh, our oil analyst believes that the under-recoveries on cooking fuels would be Rs274bn. (*Rs 400bn if transport fuels are not adjusted any further.*) The key is what portion of the under-recoveries is provided in the budget - explicitly or via oil bonds. Our base case assumes 1/3rd subsidy sharing by the upstream companies and net under-recovery for the oil marketing companies to be at the same level as FY08. This would thus limit the oil bond issuance to Rs30bn v/s Rs710bn last year. (*Oil bonds are currently treated as an off-balance sheet item in the budget*) See <https://www.citigroupgeo.com/pdf/SAP28733.pdf> for the oil sector note.
- **Impact on Inflation and Policy Rates** — Given that petrol and diesel have a weight of 2.9% in the WPI, the fuel price hike would have a ~30bps impact on inflation. We expect inflation to cross 4% levels by year end. On rates, we expect bond yields are likely to stay in the 6%-7% range due to the RBI's continued participation in the borrowing program. We maintain our view that RBI will reverse its easy money policy next year.

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Government's Oil Subsidy-Sharing Mechanism (Rs bn)

	FY07	FY08	FY09	FY10E
Gross under-recoveries	587	772	1047	274
less: Oil Bonds	241	353	710	30
% to GDP	0.6	0.7	1.3	0.1
less: Upstream contribution	205	257	330	91
less: Price hike & Duty Cuts	90			
Net under-recovery	51	163	7	152

Margins on Fuels – As on July 1

Under-recovery		MS	HSD
Price	US\$/bbl	77.9	76.7
Margin*	Rs/litre	-2.9	-2.6
Blended margin	Rs/litre	-2.7	
Gross Loss		LPG	SKO
Price	US\$/T, US\$/bbl	505	77.5
Loss	Rs/cyl, Rs/litre	-128	-17.5

* Post price-hike. Source: Citi Investment Research and Analysis, Bloomberg

See Appendix A-1 for Analyst Certification and important disclosures.

Appendix A-1

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