

Economics

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India Macro Flash

EGoM De-Regulates Petrol; Raises Diesel, LPG, Kerosene Prices

- **Petrol prices de-Regulated; diesel, LPG, kerosene hiked**— The much-awaited Empowered Group of Ministers (EGoM) meeting today culminated in a number of sweeping changes on fuel prices; including: (1) shift to market-driven prices for petrol – this would result in prices rising by 6.7% (an increase of Rs3.5/ltr), (2) while diesel would also be de-regulated over time, prices have been raised by 5% (Rs2/ltr) for now, (3) Prices of cooking fuels – LPG and kerosene – have been raised by 11.2% (Rs35/cylinder) and 33.3% (Rs3/ltr) respectively; but continue to remain administered. Changes signal a move towards recommendations of the Kirit Parikh Committee and bode well for the fisc.
- **Implications for Public Finances** — Given this adjustment, assuming current oil prices (US\$75/bbl), under-recoveries would reduce from ~Rs770bn to Rs530bn. Our Oil and Gas analyst, Saurabh Handa, believes that while under-recoveries on petrol, which comprise ~10% of total losses, would now be wiped out, oil marketing companies would continue to make losses on diesel, LPG and kerosene (*see below for estimated losses*). The impact on public finances would thus depend on how the under-recoveries would be financed. Moreover, while the Kirit Parikh Committee report has sought to address the subsidy formula, as of now there is no clarity on subsidy sharing (*see p. 2*).
- **Impact on Inflation and Rates** — Given that the impacted fuels have a wt of 5.44% in the WPI, measures would impact inflation by ~100bps. This could result in inflation averaging ~8% levels in FY11 from 7.4% estimated earlier. With the economy on the road to recovery, as reflected in industrial production gathering steam, non oil imports and bank credit posting a recovery; coupled with inflation remaining sticky, we maintain our view of 75bps of tightening in 2010. We expect the RBI to raise rates in the coming weeks.

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Figure 1. Subsidy Sharing Mechanism (Rs bn)

	FY06	FY07	FY08	FY09	FY10	FY11E
Gross under-recoveries	400	587	772	1,033	460	530*
less: Bonds/ cash subsidy	115	241	353	713	260	?
less: Upstream contribution	140	205	257	320	145	?
less: Refineries sharing	30	-	-	-	-	-
less: Price hike /Duty Cuts		90	-	-	-	-
Net under-recovery	115	51	162	-	55	?

Figure 2. Impact on Under-Recoveries (Rs Bn)

	Pre-hike/deregulation	Post-hike/deregulation
Petrol	75	-
LPG	239	210
Kerosene	199	170
Diesel	257	150
Total	770	530

* Assuming post June 10 de-regulation and price hikes. Source: CIRA estimates

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Kirit Parikh Committee Recommendations

Current Pricing Policy: A key reason behind high petroleum subsidies has been pricing policy, whereby the prices of petrol, diesel, liquefied petroleum gas (LPG) and kerosene, which comprise 63% of the total consumption of petro products, are controlled by the Government. Under this system, oil marketing companies have been making losses with the burden being borne by: (1) upstream oil sector companies, (2) the government – by issuing oil bonds, and (3) the residual amount absorbed by downstream OMCs. Apart from imposing a huge fiscal strain, the policy regime has discouraged competition, since private sector players do not receive financial support.

Reforms proposed by the Kirit Parikh Committee include:

- **Petrol and Diesel:** Complete de-regulation of petrol and diesel pricing, with prices being market-determined at both the refinery gate and the retail level. It also recommends an additional excise duty on diesel car owners.
- **LPG and Kerosene:** The Committee recognizes that these fuels be subsidized, since kerosene is a primary source of lighting in most rural households, while LPG is a clean-cooking fuel, and therefore a merit good. However, it has pointed out that there is scope to rationalize allocation, given that the poorest rural households spend only 2% of their monthly expenditure on kerosene and much of it is currently being adulterated with diesel and/or smuggled to the neighboring economies where the price is 3 to 4 times that of India. To this end, it recommends:
 - An increase in kerosene prices by Rs6/ltr (current price at Rs9/ltr), and thereafter periodic increase in prices in-line with nominal agri GDP growth.
 - An increase in LPG prices by Rs100/cylinder (this would keep subsidy provided at FY04 levels), and thereafter a periodic increase in prices in-line with per capita income.

What would this mean for petroleum subsidies?

By implementing these recommendations in full, the Committee estimates that the government's share of the subsidy would be capped at Rs200-230bn at all crude levels. As seen in the table below, this would be achieved by: (1) Eliminating auto fuel losses, (2) LPG/kero price hikes bringing down overall losses by ~Rs137bn, and (3) Upstream share linked to crude through a formula. However, given political compulsions, we expect a diluted implementation of the proposed measures.

Figure 7. Recommended financing of under-recoveries at different crude levels (RsB)

Crude (US\$/bbl)	70	80	100	120	140
Petrol/diesel gross under-recoveries	-	-	-	-	-
LPG/kero gross under-recoveries	365	435	573	712	850
Less:					
- Reduction in kero allocation by 20%	41	48	64	80	95
- Increase in kero price by Rs6/ltr	61	61	61	61	61
- Increase in LPG price by Rs100/cyl	76	76	76	76	76
- Upstream contribution	17	50	166	299	432
Under-recoveries to be borne by the gov't	170	200	206	196	186
Subsidies provided through the Budget	27	27	27	27	27
Gov't's total subsidy share	198	228	233	224	214

Source: Report of the Expert Group headed by Kirit S Parikh

Appendix A-1

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