Impact of Covid-19 on Indian PETROLEUM Sector and Recovery Thereof

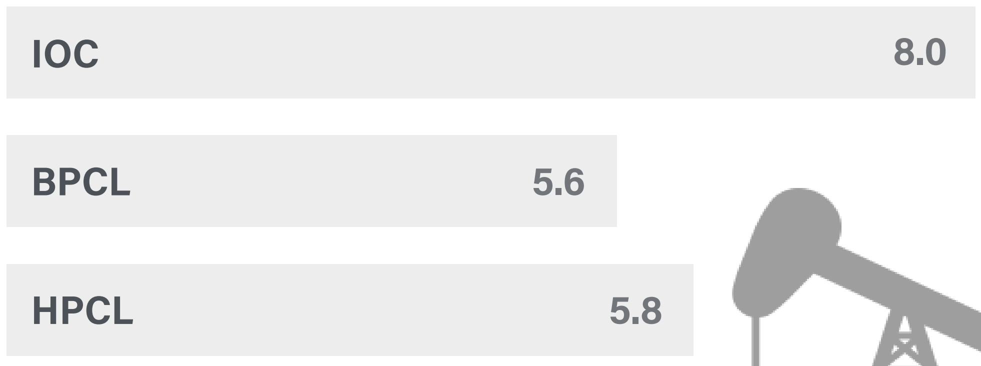
Global Crude Oil prices during this pandemic are among the lowest that have been seen in decades

For a good part of the last one and a half years, crude oil price was hovering between US$ 60 – US$70 per bbl. Opposing forces of OPEC and Shale drillers had kept the price range bound during this period. While OPEC was trying to maintain the price above US$ 60 per bbl through supply cuts, possibilities of Shale gas flooding the market above US$ 70 per bbl kept the oil price in check. However, Global crude oil prices have been in a free fall ever since the Covid-19 spread has reached pandemic proportions affecting the major economic centres around the world, including Europe & USA. The falling demand for oil around the globe with major economies entering lockdowns has seen the Brent crude marker fall to a 16-year low – in the range of US$ 20 per bbl. Closer to home, the Indian Basket of crude has followed the global trend to reach US$ 24.30 earlier this week.

Figure 1 - Price of Indian Basket of Crude
Source: oilprice.com

A large part of this fall in prices can be attributed to the diminished industrial activity, reduction in global air travel, and the drastic fall in automobile use under the lockdown conditions. This has driven the demand for the popular fuels, such as petrol & diesel, ATF and industrial fuels & oils into the ground. These problems were exacerbated by the supply side dynamics being out of sync, as Saudi Arabia & Russia had been refusing to back down crude oil production in a bid to capture market share in the already flooded market. However, with production control agreement being reached between the two oil-producing giants on April 9, prices are expected to stabilize, if not increase in the near future.

The falling crude oil prices have failed to spark joy in the Indian petroleum industry as the reduced demand for fuels is hitting the OMCs'



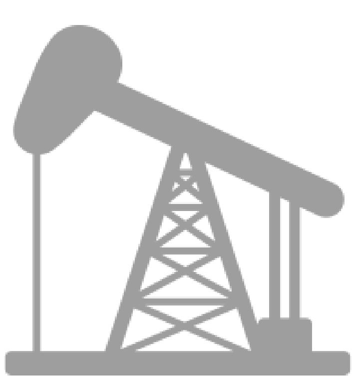


Figure 2 - Estimated Crude Inventory Loss in Q4FY'20 based on Dubai price of $34/bbl on 13.03.2020
Source: Financial Express

It is estimated that the 21-day lockdown imposed in India starting 24 March, has slashed the demand for diesel by 40%, and that of petrol by as much as 50%. This fall in sales has hit the OMCs hard with the companies staring at huge inventory losses during this period. To tide over this situation, the OMCs are considering exporting refined petroleum products so as to keep the refineries working and the inventory flowing.

The revenue & inventory losses estimated during the lockdown period are expected to outweigh any benefits that the reduced oil prices might bring to the industry. For this reason, the retail fuel prices in the country have not been allowed to fall in tandem with the global crude prices. With the lockdown in India being extended beyond 14 April, the woes of the industry are expected to continue to rise.

Post Covid-19, **recovery is expected to take place at a slow pace over the rest of the year and only a partial recovery is expected by 2021**

The recovery of oil prices post Covid-19 is expected to be much slower than the downfall which crashed the markets within a matter of weeks. Demand recovery is expected to take place in a phased manner. As the first victim of the pandemic – China gradually ramps up its economic output, USA, France and the other European countries are yet to reach peak casualty levels. It will take another 4-5 months (around September 2020) for these economies to begin their recovery process. Among the various consumer segments, domestic & industrial demand is expected to come back online fairly quickly. Aviation and travel & tourism segments would see an extremely drawn out recovery cycle due to inhibitions surrounding travel.

As a result, in the short term, the global crude oil prices are expected to rise to the range of US$ 40-45 per bbl and remain at that plateau till mid-2021. The demand for crude oil is likely to gain pace post mid-2021, and reach to US$ 70 per bbl mark by 2022. A significant challenge to this recovery could be presented by the alternative & renewable energy industry that might continue to grow stronger during this period as countries grow more sensitive to climate change.

In India, a good chunk of the demand for petroleum products is expected to come back online within weeks of lockdowns being lifted as industrial output & commercial activity is quickly ramped up to meet the pent up demand from the lockdown. Demand from the railways & airlines segments may take a considerable amount of time to recover, but this recovery might be stronger than what is expected from their counterparts in the western economies.

With this recovery trajectory, the Indian petroleum industry is expected to tide through with minimal consequences. With price controls in place, the financial impact currently faced by the OMCs is expected to be resolved by H1-2021. All OMCs had laid down huge investments in the recent past to switch to BSVI fuel standards. With the BSVI conversion out of the way, other investments in the pipeline, such as expansions and capacity additions, are likely to be deferred till beginning of 2022.

India needs to *capitalize* on the current dip in the Global Crude Oil Price

With Indian Government likely to spend huge amount towards Covid-19 infrastructure and fiscal stimulus in order to boost the economy, significant reduction in the crude oil import bill will provide necessary relief to the already burdened budget of Indian Government. Cashing in on the lower prices, **India needs to top up its 3 strategic petroleum reserve caverns** with a cumulative capacity of 5.33 million tonnes, as an insurance against supply irregularities that might arise in the future. India also needs to **explore opportunities to increase export of petroleum products.** Since much of India's LNG import contracts are linked to crude oil price markers, India can use this opportunity to **re-negotiate the LNG pricing with some of its suppliers,** which can help reduce retail natural gas prices and increase demand in the country.