PIONEER, Delhi, 11.4.2023
Page No. 7, Size:(24.49)cms X (37.04)cms.

Inflation versus growth: RBI's dilemma

UTTAM **GUPTA**

Too much reliance on monetary policy instruments such as a hike in repo rate is of little help

Having already increased the repo rate or RR (interest rate at which the Reserve Bank of India lends to banks) by a cumulative 2.5 per cent in the past 11 months, the RBI's six-member Monetary Policy Committee (MPC) on April 6 voted unanimously to keep it unchanged at 6.5 per cent. However, RBI Governor Shaktikanta Das pledged to hike the RR again if needed, saying the decision to pause was "for this meeting only".

In 2016, the Government put in place an institutionalised framework, the MPC, to formulate monetary policy and determine the key interest rates. It mandated the RBI to fix rates, especially the RR, in such a manner as to maintain inflation—as represented by the consumer price index (CPI) —within the target range of 4 per cent (+/-2 per cent) for five years ending March 31, 2021 (the mandate has since been extended till March 31, 2026).

In the case of a failure to maintain the inflation target for three consecutive quarters, the central bank is required to submit a report to the Government explaining the reasons and spelling out the remedial actions it would be taken to check the price rise. For the first time, this situation arose during 2022 when the CPI remained above the higher end of the range i.e., 6 per cent for three consecutive quarters beginning January 2022.

Post-September 2022, the MPC brainstormed on the subject matter but its report is not in the public domain. Meanwhile, it has continued to deliver more hikes in October, December 2022 and February 2023 adding to 1.1 per cent on top of 1.4 per cent already delivered in June and August 2022 policy reviews (besides May 2022 which was out of turn). In the policy review announced now, it has paused but its tight orientation remains intact.

This is evident from a concomitant decision of the MPC to retain a policy stance focused on "withdrawal of accommodation". The terminology was coined by Das way back in June 2019 when he talked of an 'accommodative' stance pointing towards a cut in RR and an increase in credit availability. Withdrawal of accommodation is its reverse implying that the RBI would go for more hikes in RR and less cash with the banks. It shifted to this stance in June 2022 and has stuck to it to date.

> INFLATION IS DRIVEN BY BOTH THE DEMAND AND SUPPLY SIDE FACTORS. BUT THE RBI IS OBSESSED ONLY WITH DEMAND MANAGEMENT EVEN THOUGH THE SPURT IN INFLATION DURING 2022-23 WAS PREDOMINANTLY SUPPLY-DRIVEN

Have the measures taken by RBI helped in reining inflation?

The cue is available in the following statement by Shaktikanta Das: "When we started the rate cut cycle in February 2019 to provide support to growth, the CPI inflation was around 2 percent and the policy repo rate was 6.50 percent. Now, the policy rate is 6.50 percent but inflation is 6.4 percent (February 2023)".

Das took charge in December 2018 when growth was emerging as a major constraint (from the third quarter of 2018-19 onwards, GDP growth was dipping) even as the RR had reached a peak of 6.5 per cent. Beginning in February 2019, he went for an aggressive cut in RR which had plummeted to 4 per cent by May 2020.

Despite the cuts, growth didn't revive. During 2019-20, it had reached a historic low of 4 per cent. During 2020-21, it was negative at 6.6 per cent, courtesy of the overpowering effect of the Corona pandemic. During 2021-22, when the pandemic effect waned, GDP growth rebounded to 8.9 per cent. Low-interest rates helped revival.

Meanwhile, a spurt in inflation from January 2022 onwards forced the RBI to shift focus to inflation management which has continued all through 2022-23. During 2022-23, even as GDP grew by 7 per cent, inflation remained stubborn. This is despite the RBI having raised RR to 6.5 per cent. The Governor admits it when he says, "Now, the policy rate is 6.5 percent but inflation is 6.4 percent".

The hike in interest rates hasn't helped. To say that inflation would have been much higher but for a hike in the RR is a tautological argument. The central bank has lowered its inflation forecast to 5.2 per cent for FY 2023-24 from 5.3 per cent (given in February 2023). This being lower than the threshold of 6 per cent at the upper end, it might not go for a further hike in interest rate. In case, however, inflation remains above this cap, it won't hesitate to strike again. The RBI seems to be missing the wood for the trees.

Inflation is driven by both the demand and supply side factors. But the RBI is obsessed only with demand management, even though the spurt in inflation during 2022-23 was predominantly supply-driven. It was due to geopolitical tension and disruption in global supply chains (caused primarily by the Ukraine War), and the resultant steep increase in prices of commodities, mostly food, fuel and fertilisers.

India imports 85 per cent of its crude requirement and close to 55 per cent of natural gas (NG), both being the basic ingredients for making a whole range of products viz. petrol, diesel, LPG, CNG, PNG, ATF, etc. A major disruption in supplies from the war region has led to their skyrocketing international prices impacting the cost of their imports. In recent months, these prices have softened; for instance, last month crude declined to around $70 per barrel.

But this relief could be temporary. A slight change in global supply-demand dynamics could reverse the trend. For instance, the recent 'sudden' decision of the Organization of the Petroleum Exporting Countries (OPEC) plus to cut output by 1.16 million barrels per day (mbd) has led to a jump in the price of crude oil to $80 per barrel. According to Goldman Sachs, this could lead to oil hitting $95 per barrel by December 2023.

Another major source of inflation is food. The spurt in its price too has a lot to do with disruption in supplies caused primarily by seasonal factors (for instance, the impact on the wheat crop during Rabi 2021-22 triggered by unusually high temperatures). During the current Rabi 2022-23 also, rains accompanied by the hailstorm in some areas have impacted wheat production. During February 2023, cereals and product inflation skyrocketed to 16.7 per cent. Likewise, inflation for 'milk and milk products' was high at 9.6 per cent.

This too was caused mainly by disruption in supply. In such a scenario, too much reliance on monetary policy instruments such as a hike in RR or sucking out liquidity (these instruments work on the demand side) is of little help. The RBI ought to have avoided it. But it hasn't.

Continuing with this course could pose a serious risk to growth due to a rise in lending rates, an increase in EMIs of millions of borrowers and higher cost loans to industries, especially MSMEs. The RBI should abandon it; a mere pause in raising RR won't take us very far. The RBI should change gear to make way for some cuts and provide adequate liquidity to support the growth momentum.

There should be a greater focus on supply-side management. Here, the government should play a bigger role by vigorously pursuing a strategy that reduces India's vulnerability to disruption in the global supply chain. It should go for measures such as increasing domestic production of oil, gas, and fertilizers, diversifying their sources of supply, reduction in import duties, cutting in CED on petrol and diesel to bring them under GST within a specified time frame etc.

(The author is a policy analyst)

BUSINESS LINE, Delhi, 11.4.2023
Page No. 3, Size:(19.33)cms X (21.58)cms.

Reduction in gas prices may prune fertilizer subsidy bill

MAJOR BOOST. '$1 decrease in price can benefit fertilizer firms up to ₹1,000 cr a year'

Shishir Sinha
New Delhi

TOP CONSUMER. The fertilizer sector has largest share among various sectors using natural gas

Subsidy bill for fertilizers is likely to come down on account of the new domestic gas pricing mechanism that has come into effect from April 1. The fertilizer sector is the biggest consumer of natural gas. Domestic gas contributed over 53 per cent of the overall gas requirement.

"We estimate that a $1 decrease in the gas prices can benefit fertilizer companies up to ₹1,000 crore a year," a senior government official told *businessline*. Following the Cabinet decision, the price of domestic natural gas for April 8-30 has been notified as $7.92 per million British thermal units (mBtu) on a gross calorific basis (GCV).

Further, for the gas produced by ONGC/Oil India (OIL) from their nomination fields, the above mentioned APM price shall be subject to a ceiling of $6.50 per mBtu on GCV basis for the same period. Before the revision, the price was $8.57.

According to the Petroleum Planning and Analysis Cell (PPAC), the fertilizer sector has the largest share among various sectors using natural gas. During April-January 2023, the consumption of natural gas was 55.5 BCM (billion cubic metre), out of which the fertilizer sector had the highest share of 29 per cent. With respect to FY22, sectoral consumption in FY23 in the fertilizer sector decreased by 4 percentage points.

34 UREA UNITS

The Fertilizer Ministry data show that there are 34 gas-based urea manufacturing units in the country with installed annual capacity of 258.34 LMT approx.

As cost of natural gas is key to fertilizer output price, any reduction in former will bring down the latter, which in turn will have an impact on the subsidy bill. According to the International Energy Forum, natural gas is used as a feedstock to produce ammonia, a source of nitrogen essential for fertilizer plants.

Ammonia is further processed and combined with other plant nutrients like phosphorous and potassium to produce different types of fertilizer. While a majority of global ammonia production uses natural gas, coal gasification is also used.

"Because of the prevalent use of natural gas in the production of ammonia-based fertilizers, natural gas prices tend to be correlated with the fertilizer prices. Positively correlated (close to 1) when the rising natural gas prices push fertiliser prices higher and negatively correlated (close to -1) when the falling natural gas prices cause the fertilizer prices to go down," it said in an article titled 'High natural gas prices contribute to rising fertilizer and food prices,' some time back.

SUBSIDISED COST

The government provides urea to farmers at a statutorily notified maximum retail price which is ₹242 per 45 kg bag of urea (exclusive of charges towards neem coating and taxes as applicable).

The difference between the delivered cost of urea at the farm gate and the net market realisation by the urea units is given as a subsidy to the urea manufacturer/importer by the government which ensures farmers getting urea at subsidised cost.

Due to the steep increase in the international prices of fertilizers and inputs including gas prices, the government decided to absorb the increased prices by increasing the subsidy on P&K fertilizers, including DAP. This resulted in revising the subsidy estimate for all types of fertilizer to ₹2.25-lakh crore in FY23 from the Budget estimate of ₹1.05-lakh crore. For FY24, the Budget estimate is ₹1.75-lakh crore.

PETROLEUM CONSUMPTION GREW 10.2% YOY TO 222.30 MT

India's petroleum use at record high in FY23 on surging fuel demand

SUKALP SHARMA
NEW DELHI, APRIL 10

INDIA'S CONSUMPTION of petroleum products hit a new record in financial year 2022-23, underscoring robust demand for transportation fuels and some other refined products, shows an analysis of data released by the Petroleum Planning & Analysis Cell (PPAC) of the oil ministry.

For the year ended March, consumption of major fuels--diesel, petrol, and liquefied petroleum gas (LPG)--broke all previous records. Petroleum product consumption is considered a measure for crude oil demand, alongside being a proxy for tracking industrial activity and domestic consumption trends.

India consumed a total of 222.30 million tonnes of petroleum products in 2022-23, 10.2 per cent higher year on year (YoY). An analysis of historical data shows that the previous consumption record for petroleum products was 214.13 million tonnes in 2019-20. Demand took a hit in 2020-21 due to the pandemic, and posted a modest recovery in 2021-22. In 2022-23, demand for most products breached pre-COVID highs as various sectors of the economy made a full recovery from the pandemic's impact. As per PPAC's projections released late February, the country's petroleum product consumption will touch a new high of 233.81 million tonnes in 2023-24.

Diesel consumption is expected to rise to 90.56 MT. *File*

India consumed 85.90 million tonnes of diesel 2022-23. Diesel is the most-consumed fuel in India, accounting for close to 40 per cent of the country's overall consumption of petroleum products, followed by petrol at around 16 per cent. The country's consumption of petrol in 2022-23 was 34.98 million tonnes, up 13.4 per cent YoY. India's LPG consumption in 2022-23, although just 0.9 per cent higher YoY, also hit a new consumption record at 28.50 million tonnes.

As per PPAC's projections for 2023-24, diesel consumption is expected to rise to 90.56 million tonnes. Petrol consumption is seen at 37.80 million tonnes. Higher demand for these two fuels reflects robustness in the transportation and some industrial segments. LPG consumption is seen rising to 29.12 million tonnes in the current financial year.

PPAC's data bank has consumption data from fiscal year 1998-99. Given consumption levels at the time, it is safe to assume that prior to 1998, consumption of petroleum products did not exceed the levels seen in recent years.

The consumption trends in March also broke several previous records. At 20.50 million tonnes, overall petroleum product consumption in March was the highest-ever in a single month. The same was true in case of diesel and petrol. India consumed 7.80 million tonnes of diesel and 3.11 million tonnes of petrol in March. On a YoY basis, the country's overall petroleum product consumption in March was about 5 per cent higher.

India is the world's third largest consumer of crude oil and depends on imports to meet over 85 per cent of its requirement. The country currently has a refining capacity of around 250 million tonnes per annum (MTPA), and plans are afoot to scale it up to around 450 MTPA over the next few years as India's oil demand is expected to be on the ascent for the foreseeable future.

As per a projection by the International Energy Agency, India's oil demand could rise from 4.7 million barrels per day (bpd) in 2021 to 6.7 million bpd by 2030 and 7.4 million bpd by 2040.

OIL & GAS

Long-term benefits to CGDs unlikely

Cabinet approves Kirit Parikh Committee's gas pricing suggestions

Valuation Summary

Company	EPS (₹)		P/E (x)		EV/Ebitda (x)		ROE (%)	Div. Yield	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E
ONGC	40.6	48.0	3.7	3.1	3.0	2.1	19.1	20.1	12.9
Oil India	60.4	38.9	4.2	6.6	3.8	5.3	21.4	12.5	9.8
Gujarat Gas	20.6	21.3	22.5	21.9	13.9	13.1	22.8	19.5	0.5
Mahanagar Gas	69.2	77.1	14.2	12.7	7.9	7.1	18.0	18.0	2.8
Indraprastha Gas	20.1	20.3	23.0	22.9	14.2	13.8	19.0	16.8	1.3

Source: Company, MOFSL

LAST WEEK, THE Union Cabinet approved Kirit Parikh Committee's recommendations for natural gas pricing. Going forward, natural gas produced from legacy fields will be priced at 10% of the Indian crude basket's price, subject to dynamic floor and ceiling prices.

The initial floor price has been set at $4/mmBtu and the initial ceiling price has been set at $6.5/mmBtu. The ceiling and floor prices are set to go up by 0.25/mmBtu per year after two years. In its earlier proposal, the Committee had suggested a fixed floor price of $4/mmBtu, while the initial ceiling price was proposed to be $6.5/mmBtu with an annual hike of $0.5/mmBtu. The approved pricing mechanism will have a negative impact on CGDs, as it will increase the gas cost to USD6.5/mmBtu as long as the Indian crude basket remains above USD65/mmBt. The new mechanism is positive for ONGC/OINL as the floor price is higher than their cost of production, vis-à-vis selling gas at much lower realisation than the production cost for a long time in the older regime.

While the recommendations will help CGDs reduce their input costs in the near term, we do not expect margin accretion for CGDs as the benefit is expected to be passed on to consumers. The floor price of $4/mmBtu provides much needed respite to ONGC and OINL as they had to sell gas below the cost of production for quite a long time.

MOTILAL OSWAL

ECONOMIC TIMES, Delhi, 11.4.2023
Page No. 14, Size:(5.46)cms X (10.46)cms.

Saudi Maintains Crude Supply to Asian Refiners Despite OPEC+ Cuts

Reuters

Singapore: State oil giant Saudi Aramco will supply full crude contract volumes loading in May to several North Asian buyers despite its pledge to cut output by 500,000 barrels per day, several sources with knowledge of the matter said on Monday.

This comes after the Organization of the Petroleum Exporting Countries (OPEC) and allies, known as OPEC+, surprised markets last week by announcing an extra output cut of 1.16 million barrels per day (bpd) from May for the rest of the year.

Saudi Aramco's monthly allocation was being keenly watched by investors as an indicator of whether planned output cuts could tighten supplies in Asia, the world's biggest crude import market.

People are wondering whether the additional voluntary cut will actually affect supply, or whether it is designed just to shore up oil prices, said a source at an Asian refiner who declined to be named as he is not authorised to speak to media. The OPEC+ announcement caused Brent and US West Texas Intermediate crude futures to jump 6% last week, returning to levels last seen in November. Last week, Saudi Aramco also surprised the market by raising prices for the flagship Arab Light crude it sells to Asia for a third month in May.