Indian Oil & Gas Sector: Refining & Marketing

Consumption of petroleum products slows down after blistering growth

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March 2017

What's inside?

Executive Summary

Post slowdown in growth to 4.3% in Dec-2016; the petroleum products consumption decreased 4.5% (YoY) in Jan-2017

Sale of petroleum products barring LPG and ATF declined in January 2017 primarily due to economic slowdown driven by demonetisation along with destocking of some products and high base effect

The total domestic petroleum products sales volumes registered a decline of 4.5% (YoY) in January 2017 with fall in consumption of all major products except LPG and ATF. The yoy decline in Jan-2017 is first such instance of overall fall in a month in the recent years and follows high growth of 8.8% (yoy) in 9M FY2017 and 10.9% (yoy) in FY2016. The major reasons for fall in sales volumes are temporary economic slowdown driven by demonetisation, high base effect due to high growth of 16.5% (yoy) in Jan-2016, destocking in Jan-end due to price fall expectation and high restocking in Dec 2016-end due to anticipation of rise in prices.

Economic slowdown driven by demonetisation and rise in prices of crude oil and petroleum products post OPEC deal would moderate the growth rates in the near-term

The demand for petroleum products is expected to be higher than the long-term average over the medium term, following prospects of increased economic activity. However, the recent rise in crude oil prices following OPEC deal is likely to have a moderating impact on the demand of liquid fuels especially industry fuels. Further, the demonetisation of high value currency notes leading to economic slowdown and thus lower consumption of products in various sectors would also adversely impact the demand of petroleum products in the near term.

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Light distillate crack spreads increased in Q3 FY2017 vis-a-vis Q2 FY2017. Naphtha crack spreads increased in Q3 FY2017 vis-à-vis Q2 FY2017 owing to strong petrochemical demand from Japan and South Korea, increased gasoline blending demand and high seasonal prices of LPG which led to higher share of naphtha in petrochemical feedstock. Gasoline crack spreads increased in Q3 FY2017 vis-à-vis Q2 FY2017 due to healthy demand in Asia owing to low pump prices and firm import demand from Latin America and West Africa. In the middle of the barrel, gasoil cracks improved in Q3 FY2017 over Q2 FY2017 owing to strong Indian demand amid refinery turnarounds in Asia. Jet/kero crack spreads increased in Q3 FY2017 as against Q2 FY2017 due to strong kerosene demand in the far East owing to sever weather and healthy jet fuel demand. At the bottom of the barrel, fuel oil crack spreads improved in Q3 FY2017 vis-à-vis Q2 FY2017 due to lower supply from Russia and the Middle East amid higher demand for power generation from Japan and South Korea and firm bunker fuel demand. Additionally, with the international prices of crude oil rising from US$48/barrel as on September 30, 2016 to US$56/barrel as at December 2016 end, gross refining margins (GRMs) of domestic refineries were buoyed by inventory gains in Q3 FY2017.

Demand growth of petroleum products expected to remain moderate though China's growth remains stronger than expected

Global supply additions, net of closures, likely to exceed demand growth

Globally, GRMs are expected to weaken in the medium term due to additions to global refinery capacity, net of closures exceeding the demand growth. The demand growth is expected to remain moderate though China's growth remains stronger than expected supported by continued policy stimulus. Delays in commissioning of some of the proposed projects and closure of unviable refinery capacities could support GRM levels over the medium term.

GRMs expected to weaken with global capacity additions exceeding demand growth

Outlook for domestic refining and marketing industry is stable

The global refinery capacity additions are expected to exceed the demand growth over the medium term owing to which GRMs are expected to weaken. The domestic demand of petroleum products could face pressure in the near term due to economic slowdown driven by demonetisation; however, the same may revive following improving economic activity over the medium term. The crack spreads of most of petroleum products are expected to decline, leading to weakening of GRMs in the near to medium term. However, volatility in crude oil prices may lead to inventory gains or losses for the refiners. Notwithstanding temporary setback in demand, the marketing margins are expected to be moderate to healthy due to soft prices of petroleum products apart from anticipated healthy demand growth over the medium to long-term. Despite rise in crude oil prices, the oil marketing companies (OMCs) are likely to continue to share nil or low burden in gross under-recoveries (GURs) on sensitive petroleum products, which are anticipated to be at moderate levels. Apart from brownfield expansion/debottlenecking projects, the new investments in the sector are still in the planning stages. The investment in auto-fuel retailing is the major area of interest for private companies in the near to medium term. Overall, notwithstanding moderation in GRMs, the credit outlook for companies in the refining and marketing sector remains stable owing to high capacity utilisations of domestic refiners, low GURs of OMCs and timely subsidy reimbursement from the GoI.

Please contact ICRA to get a copy of the full report

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