

Excise Duty Cut on Fuels

Rollback in excise on MS and HSD to pre-pandemic levels can prevent jump in pump prices, at a cost of ~Rs. 0.9 trillion

FEBRUARY 2022





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We estimate the lagged revision in RSPs of MS and HSD warranted by current surge in crude prices at Rs. 6-8/litre

The impact of the latter on RSPs and the CPI inflation can be absorbed by a roll back in excise duties on these fuels to pre-pandemic levels

If excise duty on MS and HSD is reduced to pre-pandemic rates, the total revenue loss to the Centre in FY2023 is estimated at Rs. 920 billion



- The international crude oil price, in Indian basket terms, surpassed the US\$100/bbl mark on Feb 24, 2022 for the first time since Sep 4, 2014, fueled by intensifying geopolitical tensions between Russia (world's third largest oil producer) and Ukraine, as well as restrained supply.



- The monthly average retail selling prices (RSPs) of Motor Spirit (MS) and High Speed Diesel (HSD) have been unchanged at Rs. 102.9/litre and Rs. 90.5/litre, resp., in Feb 2022 (till Feb 24) for the third consecutive month, despite the recent rise in crude oil prices.



- After the partial cut in Nov 2021, central excise rates on MS and HSD presently stand at Rs. 27.9/litre and Rs. 21.8/litre, resp., higher than pre-pandemic period of July 2019-Mar 2020 by Rs.8/litre and Rs. 6/litre, respectively.



- The Union Budget for FY2023 has forecast the excise duty collections to contract by 15.0% to Rs. 3.4 trillion, after a tepid 0.6% rise included in FY2022 RE (Rs. 3.9 trillion), following the excise reduction undertaken in November 2021.



- If the Centre reinstates the excise duty on MS and HSD to the pre-pandemic rates, before April 1, 2022, followed by the budgeted rise of Rs. 2/litre each on unblended fuel in H2 FY2023, we estimate the revenue loss to the Centre in FY2023 at Rs. 0.9 trillion.



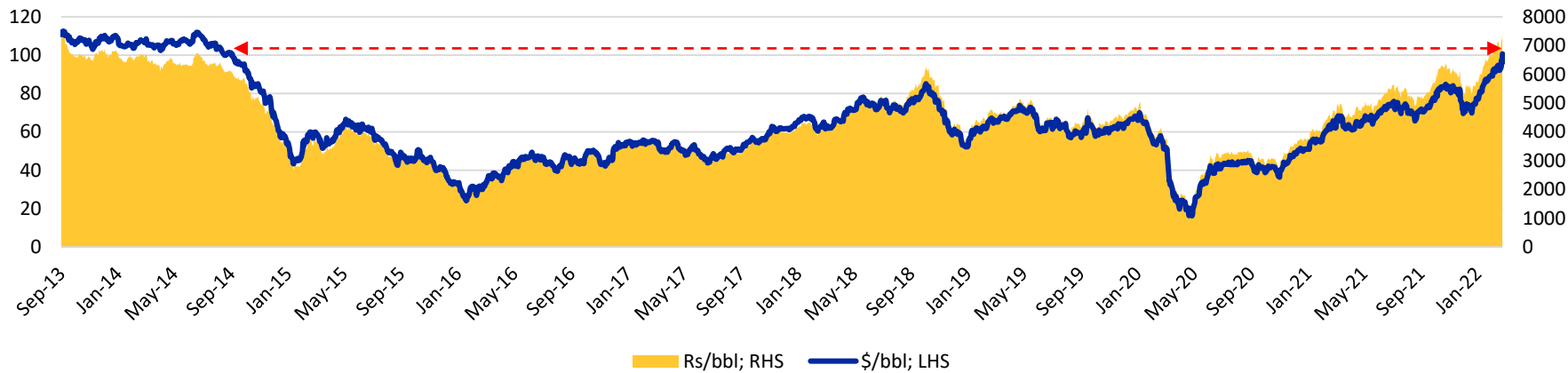
- While it is difficult to pinpoint the exact amount of lagged revision in RSPs of MS and HSD that is warranted by the surge in crude oil prices to the current levels, we expect it to be in a range of Rs. 6-8/litre, i.e. similar to the cushion offered by potential excise reversion to pre-Covid rates.



- In our assessment, a rollback in excise duties to pre-pandemic levels can prevent any major jump in pump prices, thereby softening the impact on the CPI inflation trajectory, albeit at a fiscal cost of ~Rs. 0.9 trillion to the GoI.

Escalation in geopolitical tensions between Russia and Ukraine pushed crude oil prices above \$100/bbl mark on Feb 24, 2022

EXHIBIT: Crude Oil Price Movement of Indian Basket

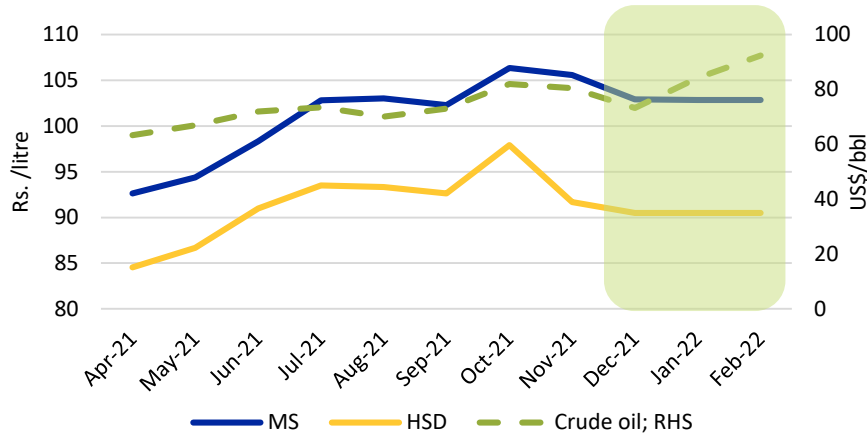


Source: PPAC; ICRA Research

- The international crude oil price, in Indian basket terms, surpassed the US\$100/bbl mark on Feb 24, 2022 for the first time since Sep 4, 2014, fueled by intensifying geopolitical tensions between Russia (world's third largest oil producer) and Ukraine, as well as global demand outweighing the current supply.
- The price of the Indian crude oil basket has averaged US\$93.1/bbl so far in Feb 2022 (Feb 1-24), a 10.5% surge relative to US\$84.2/bbl in Jan 2022.
- On Feb 2, 2022, OPEC+ group had affirmed its planned monthly increase in crude oil output of 0.4 million barrels/day, contributing to the ongoing rally in prices to an extent.
- We expect the price of the Indian basket of crude oil to remain volatile in the near term, until the geopolitical tensions ease or OPEC decides to materially raise the magnitude of production.

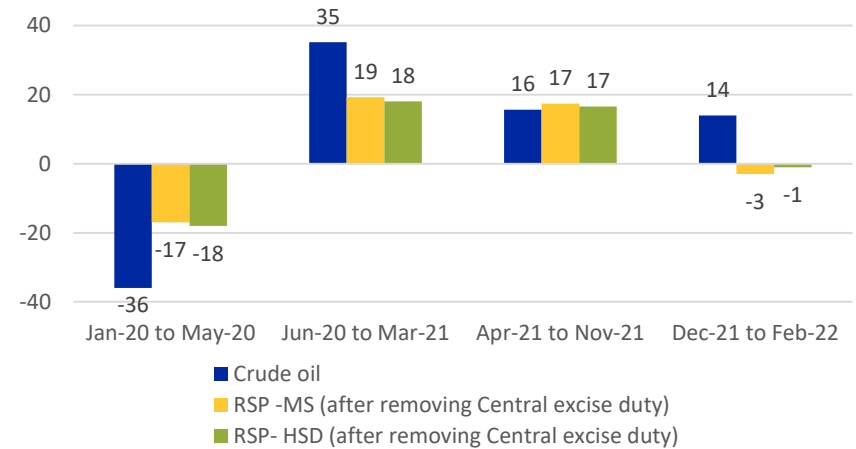
RSPs of petrol and diesel have not been revised since Dec 2021

EXHIBIT: Average Retail Selling Prices (RSPs) of MS and HSD in four metro cities* and Crude Oil Price of Indian basket



*Namely, Delhi, Mumbai, Chennai and Kolkata; Till Feb 24, 2022; Source: PPAC; ICRA Research

EXHIBIT: Change in Average Crude Oil Price (US\$/bbl) and RSPs of MS and HSD (in INR; after removing respective Central excise duties)

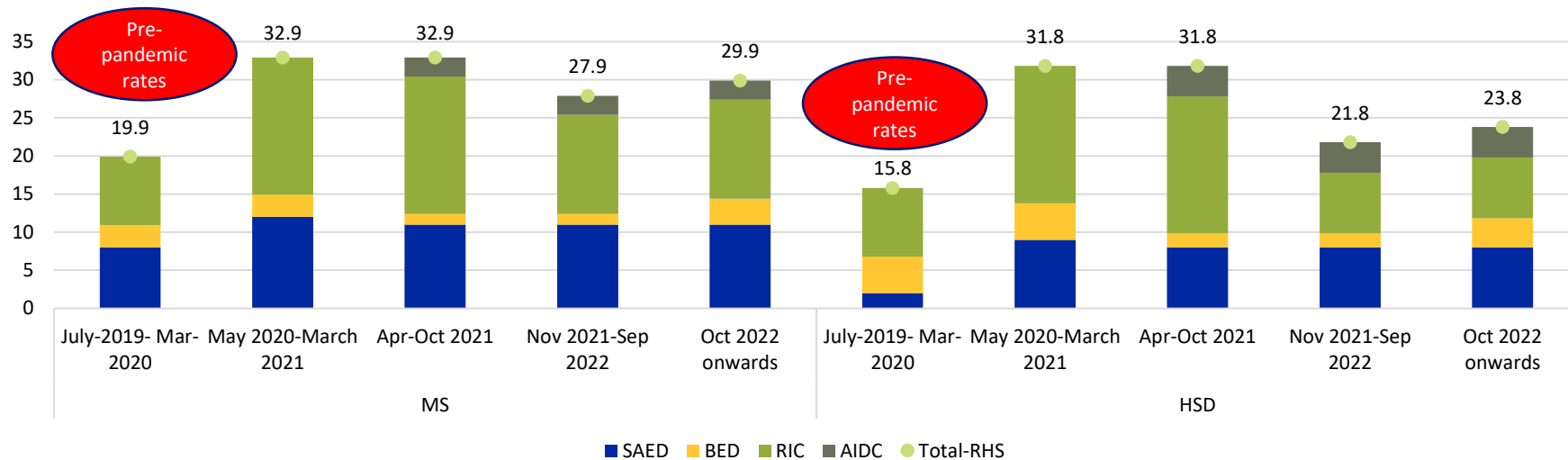


Till Feb 24, 2022; Assuming crude oil price to average 95/bbl in Feb 2022; Source: PPAC; CBIC; ICRA Research

- The monthly average RSPs of MS and HSD in the four metro cities have remained unchanged at Rs. 102.9/litre and Rs. 90.5/litre, respectively, in February 2022 (till Feb 24, 2022) for the third consecutive month, in spite of a considerable US\$19/bbl increase in crude oil prices in this period (Dec-Feb FY2022).
- After removing the Central excise rates levied on MS and HSD from their RSPs, the transmission of the increase in crude oil prices during Apr-Nov FY2022 appears to have been higher than what was undertaken during Jun-20 to Mar 2021, suggesting some buffer to compensate for the recent rise in crude oil prices.

After the partial cut in Nov 2021, central excise rates on MS and HSD are Rs.8/ltr and Rs. 6/ltr higher than pre-pandemic period of July 2019-Mar 2020

EXHIBIT: Central Excise Duty Structure of unbranded Motor Spirit (MS) and High Speed Diesel Oil (HSD) (Rs./litre)

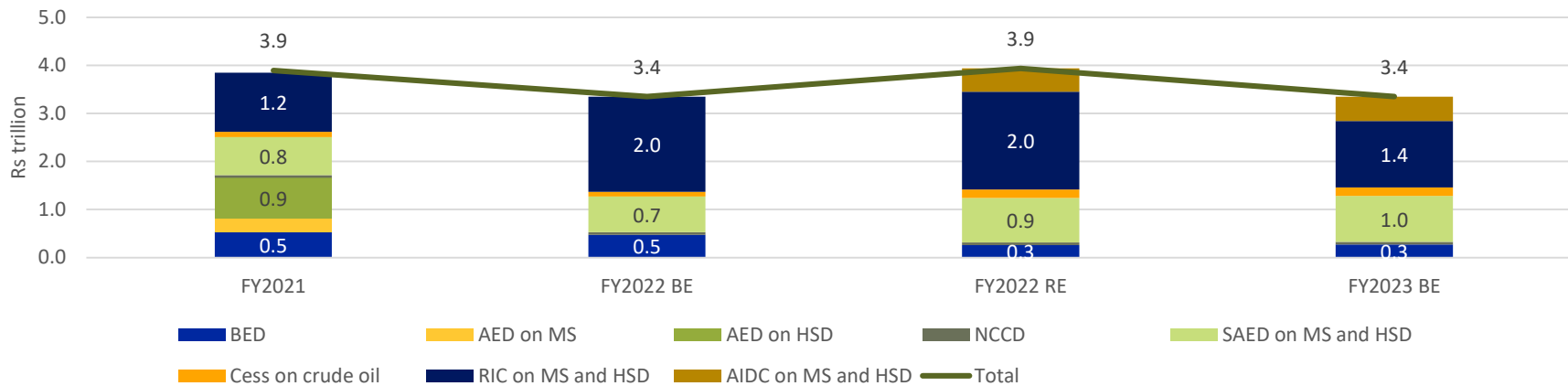


In Apr 2020, the Centre had raised the excise rates on MS and HSD by Rs. 3/litre each, followed by an increase of Rs. 10/litre and Rs. 13/litre, resp., in May 2020; Source: CBIC, Gol; ICRA Research

- During Apr 2020 and May 2020, the Centre had enhanced the excise duty on MS and HSD by a cumulative Rs. 13/litre and Rs.16/litre, respectively, to Rs 32.9/litre and Rs. 31.8/litre, respectively, owing to the plunge in crude oil prices after the onset of the Covid-19 pandemic.
- Subsequently, in Nov 2021, the Gol had announced a cut in the central excise duty, by Rs. 5/litre on MS and Rs. 10/litre on HSD (in the RIC component). Effectively, the total cesses levied on MS and HSD by the Gol stand at Rs. 27.9/litre, and Rs. 21.8/litre, respectively, at present. These are higher than the rates levied during the pre-pandemic period of July 2019-Mar 2020 by Rs. 8/litre and Rs. 6/litre, respectively.
- The Union Budget FY2023 announced an increase in the basic excise duty on unblended MS and HSD by Rs. 2/litre each with effect from October 1, 2022.

Union excise duty collections are budgeted to contract by 15.0% to Rs. 3.4 trillion in FY2023, relative to FY2022 RE

EXHIBIT: Breakup of Union Excise Duty Collections

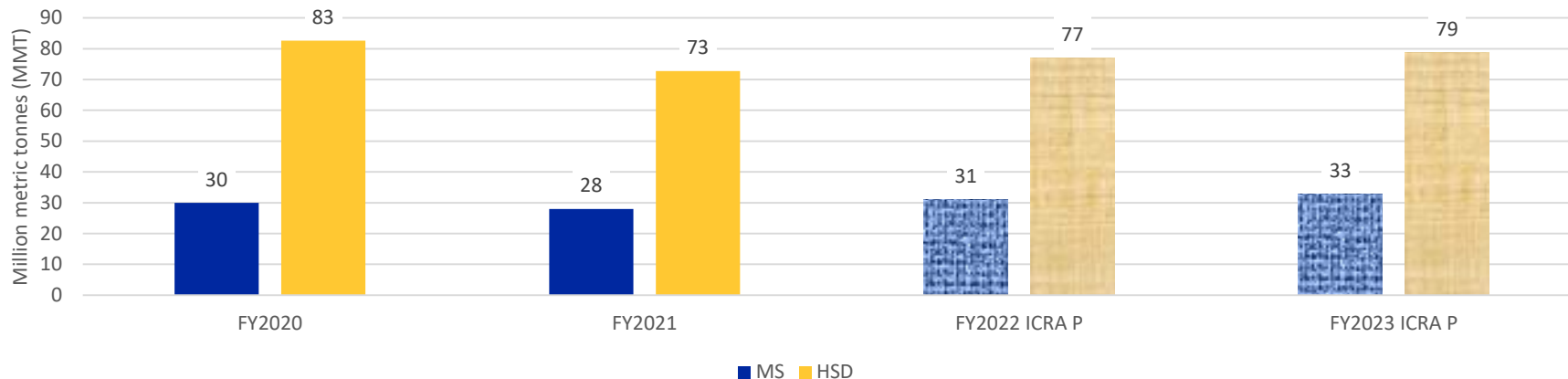


BED: Basic Excise Duty; NCCD: National Calamity Contingent Duty; RIC: Road and Infrastructure Cess; SAED: Special Additional Duty of Excise *Additional Excise Duty of Excise (AED) on MS and HSD was replaced with RIC in FY2021; Source: CGA, Ministry of Finance, GoI; CEIC; ICRA Research

- Excise duty collections have been forecast to contract by a significant 15.0% to Rs. 3.4 trillion in FY2023 BE, after a tepid 0.6% rise included in FY2022 RE (Rs. 3.9 trillion). This follows from the reduction in excise duty relief provided by the Centre on motor spirit and high-speed diesel oil in November 2021.

A reduction in excise duty on MS and HSD to pre-pandemic rates would entail a total revenue loss to the Centre of Rs. 920 billion in FY2023

EXHIBIT: ICRA's Estimated Consumption of MS and HSD in FY2022-23



Source: PPAC; ICRA Research

- ICRA expects the consumption of MS and HSD to grow by 5% and 2%, respectively, on a YoY basis to 33 MMT and 79 MMT, respectively, in FY2023. While the MS consumption is likely to exceed the pre-Covid level of FY2020 by ~9%, that of HSD will trail the same by ~5%.
- Based on our forecast of volumes, a continuation of the status quo on excise rates would entail collections in line with the FY2023 BE of Rs. 3.35 trillion.
- **If the Centre reinstates the excise duty on MS and HSD to the pre-pandemic rates of Rs. 19.9/litre and Rs. 15.8/litre, respectively, before April 1, 2022, followed by the budgeted rise of Rs. 2/litre each on unblended fuel in H2 FY2023, we estimate the cess collections in FY2023 at Rs. 2.4 trillion, around 27.5% lower than the BE of Rs. 3.35 trillion.**
- Accordingly, we estimate the revenue loss to the Centre in FY2023 from a rollback in cesses to the pre-pandemic level at Rs. 920 billion.

Impact of excise duty cut on CPI inflation would be muted if such rates are rolled back to pre-pandemic levels

While it is difficult to pinpoint the exact amount of lagged revision in RSPs of MS and HSD that is warranted by the surge in crude oil prices to the current levels, we expect it to be in a range of Rs. 6-8/litre, i.e. similar to the cushion offered by the potential excise reduction back to the pre-pandemic level.

In our assessment, a rollback in excise duties on MS and HSD to the pre-pandemic levels can prevent any major jump in pump prices, thereby softening the impact on the CPI inflation trajectory, albeit at a fiscal cost of ~Rs. 0.9 trillion to the Gol.

We expect nominal GDP expansion of 13.5-14% in FY2023, higher than the growth of 11.1% assumed in the Union Budget. The Gol's tax growth assumptions (14.2% excluding excise duty) for FY2023 appear to be mildly conservative, suggesting a cushion for a further excise cut to offset the inflationary pressures instigated by the surge in crude oil prices.



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