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Brent Crude breached \$80/barrel

Reasons for Spike in crude price

Brent Crude surged to its highest level since June 2014 and touched \$ 80 per barrel. The surge in crude price is primarily due to geopolitical reasons and an unexpected fall in US inventories which lifted the price to the north. U.S. crude inventories fell by 1.4 million barrels in the week to May 11, and gasoline stocks fell by 3.79 million barrels. Also, looming U.S. sanctions against Iran, which currently produces 4% of global oil supplies, raised fears that oil markets will face shortages later this year when trade restrictions take effect. In Venezuela, production also plunged to 1.5 million barrels last month, its lowest level in decades due to its ongoing economic crisis.

Impact on INR

The direct impact of higher crude prices will be felt on the Indian Rupee. For every \$1 a barrel rise in crude prices will lead to country's imports bill rising by \$1.33 bn. thereby depreciating rupee significantly. For every 1 rupee weakening in INR-USD exchange rate will lead to rise in import bills by \$1.03 bn. thereby putting pressure on the nation's fiscal deficit.

Sectors to benefit

The primary sector to benefit from the rising crude prices is Oil & Gas sector. This sector has underperformed ever since crude went down from \$ 100 per barrel. We feel stocks like GAIL, MRPL & CHENNAIPETRO will benefit with rising crude oil prices. With crude rising, due to cascading effect on INR, IT companies will also stand to benefit, thereby companies like TCS, INFOSYS and TECHMAHINDRA will stand to gain. We believe, ONGC might not benefit as due to nearing of state and central elections, Government might ask ONGC to take up subsidies as witnessed in the past.

OMCs and Aviation sectors have very limited authority to proportionately pass on the cost prices to its customers due to higher crude price.

All stocks in the Paints, Chemicals and Plastic Industries would be impacted due to rising crude price.

Brent crude breaching \$80 per barrel is sign of worry for the country's fiscal deficit.

Rise in crude price leaves high possibility to rise in inflation which might force RBI to hike up the interest rates in the next monetary policy meeting.

Sectors to get impacted

The direct impact of rising crude prices will be felt on the Oil Marketing Companies (OMCs) and Aviation sectors. Both OMCs and Aviation sectors have very limited authority to proportionately pass on the cost to its customers due to higher crude prices. Also in aviation sector, fuel cost comprises of 20%-25% of its net sales thereby impacting the profitability of the companies. Stocks like BPCL, HPCL, IOC, JET, SPICEJET and INDIGO will be impacted on account of higher crude oil prices.

The second set of sectors where the derivative of crude is used as a raw material will be impacted. Sectors like Paint industries, Chemical and Plastic industries will be impacted. Companies in these sectors have 10-15% of the total expenses coming from Raw Material Expenses which will impact the companies at an operational level.

Outlook

As Brent crude is taken into consideration for calculation of CAD, we feel Brent crude breaching \$80 per barrel is a reason to worry for the country's fiscal deficit. We feel, there is high possibility of government cutting on excise duty due to nearing of elections which will further dent the fiscal deficit. Rise in crude price leaves high possibility to rise in inflation which might force RBI to hike up the interest rates in the next monetary policy meeting. Hence we strongly believe we are in the start of rate hikes and may see further rate hikes if the oil prices escalate in the current calendar year. This will lead to shift in demand from equity to commodities like Gold and further weakening of INR-USD. We certainly feel crude beyond \$80 per barrel is a sign of worry and any levels beyond \$80 per barrel will widen the fiscal deficit further.

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