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Concerns on low margins, BPCL sale: Post elections, fuel prices likely to rise

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OIL MARKETING companies (OMCs) cut the prices of petrol and diesel by 14-16 paise per litre across major cities on Thursday, after a 15-day halt in price revisions, amid election in four states — West Bengal, Tamil Nadu, Kerala and Assam.

The halt in price revision during elections could have an impact and consumers could end up paying higher prices for petrol and diesel once elections are over.

PRICES CUT LAST THURSDAY

- Last Thursday, OMCs cut prices of petrol and diesel by 14-16 paise a litre across major cities, after a 15-day halt in price revisions
- A correction in crude oil prices to about $62 per barrel in early April has allowed OMCs to cut petrol and diesel prices by about 75 paise per litre

Why are there lower prices during elections?

EXPLAINED E.

Even though OMCs are notionally free to set the prices of petrol and diesel, as both the products have been deregulated, the companies often cut the price of these fuels or hold them constant around elections as fuel prices often become a political issue. In the latest instance, OMCs have revised the prices of petrol and diesel only four times in a 47-day period, which has witnessed significant volatility in the price of crude oil, the key input cost for auto fuels.

Experts said that in early March, OMCs faced negative marketing margins on petrol and diesel as Brent crude price rose to $70 per barrel but OMCs kept prices constant.

A correction in crude oil prices to about $62 per barrel in early April has allowed OMCs to cut petrol and diesel prices by about 75 paise per litre. As on Thursday, Brent crude prices again rose to about $66.8 per barrel.

The impact of crude oil prices on domestic fuel prices is felt with a lag as refiners benchmark petrol and diesel prices to a rolling 15-day average of international prices of the products.

A report by ICICI securities noted that lower margins in the first three months of this year have pushed overall marketing margins for OMCs down to about Rs 1.2 per litre in the quarter ending March compared to about Rs 3.2 per litre in Q4FY20.

How will prices change post elections?

Experts noted that OMCs are likely to increase the prices of petrol and diesel to restore their marketing margins to normative levels. Experts noted that customers may have to shell out more later as OMCs may be slower to pass on the benefit of any fall in crude oil prices to customers to make up for lower margins during the elections.

How do price halts impact OMCs?

Experts said that investors had come to expect such moves during elections and subsequent reversions to normative margins post the election period.

The share price of Indian Oil Corporation Ltd (IOC) has fallen by about 8 per cent since the beginning of February 27, when OMCs initially stopped revising prices, while that of Bharat Petroleum Corporation Ltd (BPCL) has fallen by 10 per cent and Hindustan Petroleum Corporation Ltd (HPCL) by 1.4 per cent.

Analysts noted that such practices could impact long term valuations of OMCs, notably in the case of BPCL which is set to be privatised.

"Why would anyone give a high valuation (for BPCL) when the government can cut your marketing margins every time it is politically expedient to do so," said an analyst, adding that even after the privatisation, BPCL would have to match prices with the remaining state-owned refiners IOCL and HPCL if they cut prices during elections.

The analyst, who did not wish to be named, said OMCs may take the view that inventory gains from rising crude price can help boost earnings despite lower marketing margins, but noted that investors evaluate refiners on their marketing margins and not on factors outside the company's control such as global crude prices.