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King Abdullah Petroleum Studies and Research Center

India’s Oil Imports: Achilles' Heel or Economic Javelin?

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Summary

Presenting India's 2019 budget on July 5, Finance Minister Nirmala Sitharaman sketched out the Modi government's vision of becoming a $5 trillion economy by 2024, almost doubling the country's current gross domestic product (GDP) of $2.73 trillion. To achieve this ambitious goal, India plans to liberalize foreign direct investment (FDI) rules and tap international bond markets to fund its budget deficit. The latter is a risky enterprise and ensures exchange rate policy becomes a future battleground. However, India's economic growth has been slowing over the past two quarters, and the government has limited options to raise funds domestically, forcing it to look at external foreign currency borrowing. The government is betting that external borrowing combined with FDI inflows will lead to greater domestic investment and thus higher growth.

Sitharaman is betting that her twin policies will generate enough export growth to guarantee debt repayments. India is dependent on imports for 80% of its crude oil consumption, and this dependence will only increase as its economy grows. Already, oil is a key element of India's balance of payments and any change in oil prices has a direct impact on the current account deficit (CAD). High crude oil prices caused India's CAD to deteriorate in early 2018-19, with falling international crude prices helping to moderate it in the latter half of the fiscal year.

In the face of its oil import dependence and inability to influence global oil prices, India has become expert in maximizing arbitrage and commercial opportunities in a market where discounts are hard to find, and refiners in Asia are subject to premiums levied by Middle East suppliers. Indian refiners have scoured the world for cheap oil, buying wholesale from countries such as Iran and Venezuela.

However, United States (U.S.) sanctions on Iran and falling Venezuelan production mean that India has had to widen its pool of suppliers at a time of growing demand. Recent heavy investments in Indian refineries mean that they can process a wide range of crude grades, giving importers the ability to optimize the crude oil feedstock mix. In recent months, U.S. and Mexican crudes have been trading at a discount to Middle East grades, and Indian refiners have ramped up their imports of both Mexican and U.S. crudes. Making the most of their refinery flexibility, they have been able to blend heavy sour grades from Mexico with light sweet oil from the U.S. As a result, Indian imports from the U.S. rose from an average of 40,000 barrels per day (bbl/d) to 184,000 bbl/d during the 12-month period ending May 2019. During the same period, imports from Mexico jumped by 13% to 268,000 bbl/d.

The jump in imports of U.S. crude allows the Indian government to court favor with the U.S., which has been lobbying for increased energy imports to reduce its trade deficit with India. In June, the Trump administration ended the country's preferential trade treatment for India under the Generalized System of Preferences (GSP), leading India to retaliate with its own set of tariffs. As trade relations sour, the Indian government is keen to do anything to appease the U.S. Buying more oil is an easy option.

However, despite the rapid increase in oil imports from the U.S. East Coast, albeit from a low base, Gulf Cooperation Council (GCC) countries remain India's biggest and most important suppliers. Even as U.S. imports quadrupled to 184,000 bbl/d, imports from Saudi Arabia rose by 11% to 804,000 bbl/d, and imports from the United Arab Emirates (UAE) were up 37% to 360,000 bbl/d in the 12-month period to the end of May 2019.

GCC crudes will always have the advantage of lower transportation costs. With India being one of the few remaining countries with high growth potential, key regional producers such as Saudi Arabia and the UAE will be prepared to invest in India in order to secure long-term oil market share, something the U.S. is unlikely to do. Both Saudi Arabia and the UAE have recently committed to multi-billion dollar investments in India's oil infrastructure, clearly aimed at securing their market shares. Oil imports were once regarded as India's Achilles' heel, but they have the potential to be a mighty economic javelin at a time of slowing global oil demand.

Background

With daily imports of little more than 4.25 million barrels per day (MMbbl/d) and rising, India represents one of the last significant markets for global oil producers. Historically, this market has been skewed in favor of Middle Eastern producers, with Iraq, Saudi Arabia, and Iran the key suppliers. Sanctions imposed by the U.S. have meant that Iranian oil exports to India have reduced drastically as India tries to adhere to the sanctions regime. While India has attempted to ensure a balanced approach in replacing Iranian crude with alternative supplies, imports from the U.S. have increased exponentially during the past couple of years as India has tried to diversify its sources of imported crude to reduce its supply risk.

American oil exports to India

The increase in oil imports into India from the U.S. followed a bilateral meeting in Washington between President Donald Trump and Prime Minister Narendra Modi. The talks during Mr. Modi's official visit on June 26, 2017 focused on ways to enhance the U.S.-India energy sector trade as part of measures to reduce the U.S. trade deficit with India. Subsequently, India placed orders to import U.S. crude oil through both state and private refineries, with the first shipment (1.6 MMbbl of U.S. Mars crude and 400,000 barrels of Western Canadian Select) arriving in early October 2017 (The Hindu Business Line 2017) at the state-owned Indian Oil Corporation Limited (IOCL) Paradip refinery on the east coast of India. Indian state-owned refineries had signed contracts for a total supply of 7.85 MMbbl in 2017 (Behera and Jacob 2017). IOCL had placed orders for 3.9 MMbbl, and state-owned Bharat Petroleum Corporation Limited (BPCL) and Hindustan Petroleum Corporation Limited (HPCL) placed orders for 2.95 MMbbl and 1 MMbbl, respectively (Behera and Jacob 2017). Both BPCL and HPCL had bought high-sulfur U.S. Gulf Mars and Poseidon crudes. Indian refineries can operate with both low-and high-sulfur crude as they have been upgraded to be able to produce high-quality gasoline from heavy and sour crudes.

U.S. crude exports to India consist of a mix of U.S. Gulf Coast crudes, lighter U.S. shale and heavier Canadian crudes. As most of the volumes were to be shipped on very large crude carriers, India had to allow the refineries to buy on a delivered ex-ship basis. It meant that they had to use foreign-owned vessels, a departure from the norm of using Indian carriers for their regular crude imports from the Middle East, for which Indian governmental approval had to be granted.

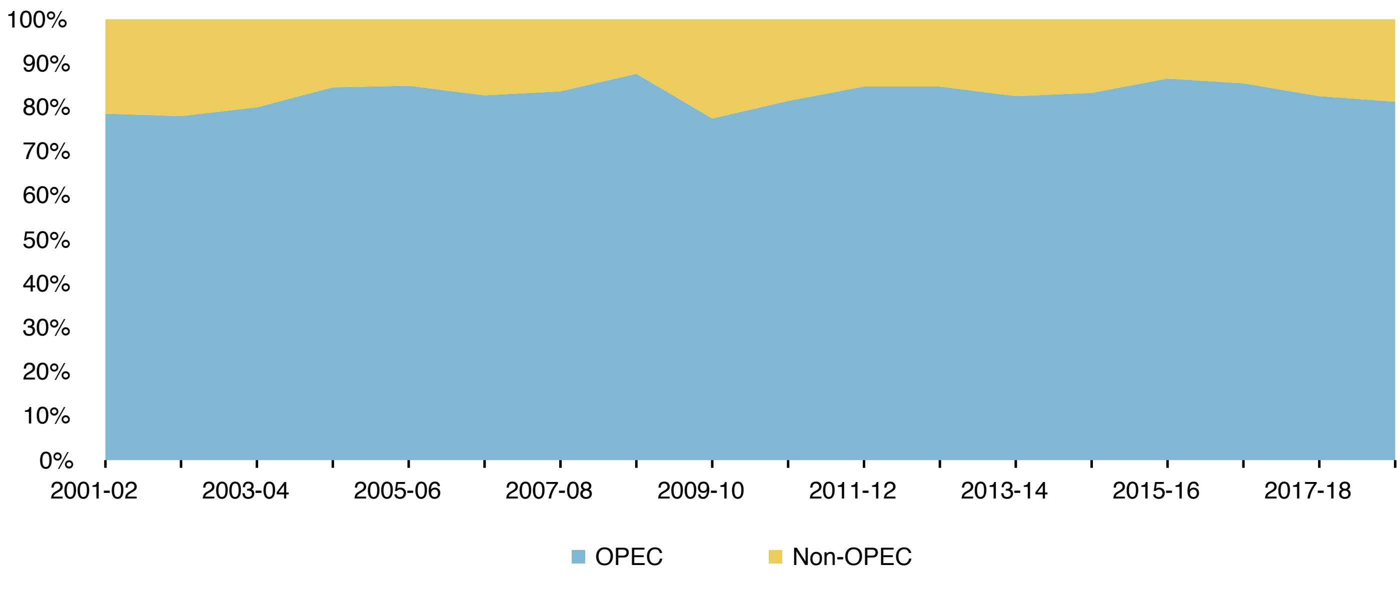
During 2017-18, the trade balance between the U.S. and India was in India's favor, with Indian exports to the U.S. standing at $47.9 billion and imports from the U.S. at $26.7 billion (Suryamurthi 2019). U.S. crude oil imports enable India to reduce the two countries' trade imbalance, which could mitigate any U.S. pressure on India over bilateral trade such as China is currently facing. IOCL has signed a contract to import almost 22 MMbbl of crude oil from the U.S. during the 2019-2020 fiscal year. However, this represents less than 1.5% of Indian crude imports, which in the 2018-19 fiscal year stood at 4.383 MMbbl/d (DGCI&S 2019). Crude imports from the U.S. have grown significantly over the past couple of years, from 10.6 MMbbl in 2017-18 to almost 47 MMbbl in 2018-19. Current volumes seem set to grow, especially as issues surrounding the loading infrastructure in U.S. load ports, which had acted as a bottleneck, are gradually resolved.

Increasing imports from the U.S. provides Indian refiners with a scalable supply option that can also enhance crude diversification. Importantly, it provides a clear signal that the growing Indian market for oil imports is open to all comers, and therefore provides India with a hedge when negotiating with established Middle Eastern suppliers.

India and OPEC

India has been trying to engage with OPEC on the twin issues of high oil prices and the prevailing 'Asian premium': the the differential paid by Asian countries to OPEC countries in relation to Europe and the U.S. In his speech at the 6th OPEC International Seminar in 2015 in Vienna, The minister for petroleum and natural gas, Dharmendra Pradhan, raised the issue of the Asian premium. In 2017, during the second High-Level Meeting of the OPEC-India Energy Dialogue in Vienna, he stressed the need for what India considers to be 'responsible pricing,' which is essential if India is to meet its socio-economic and developmental

Figure 1: OPEC and non-OPEC share of crude oil imports.



Source: Ministry of Petroleum and Natural Gas (MoPNG).

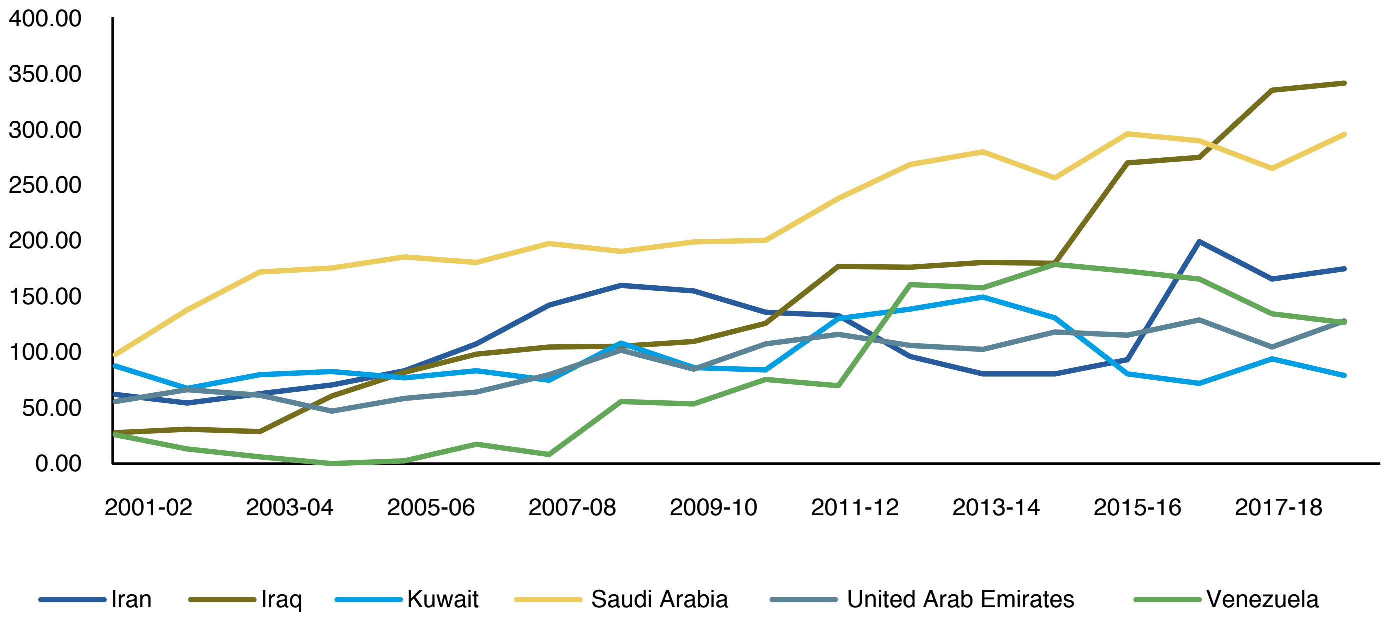
goals. India has raised the issue of high oil prices several times and at various bilateral and multilateral events, including energy conferences and the G20 Summit in Buenos Aires. Mr. Modi raised a similar issue with H.E. Khalid Al-Falih, Saudi Arabia's energy minister. Indian government officials have been highlighting price volatility and are laying the groundwork to encourage OPEC to follow a stable pricing regime, which would enable India to continue importing the energy it needs. In his address to OPEC member countries in 2017, Mr. Pradhan noted that India imports 86% of its crude, 70% of its natural gas, and 95% of its cooking gas from OPEC countries (Pradhan 2017).

Indian crude sourcing – Threat to existing suppliers?

While it is generally believed that diversifying crude supplies to reduce risks results in increased costs, in India's case these increased costs have been negated by technical upgrades to its refineries. These upgrades enable India to process a wide variety of crudes and ensure that it can mitigate its supply risks by sourcing different grades of crude from several regions. The recent U.S. sanctions on Iran and Venezuela have meant that 830 thousand bbl/d of oil previously imported from Iran and Venezuela (DGCI&S 2019) will now need to be sourced from other regions. As Figure 2 shows, replacement volumes are primarily being met by increased imports from Saudi Arabia and the UAE.

India has previously been able to manage supply disruptions by increasing imports from Kuwait, the UAE and Saudi Arabia. The availability of U.S. crude provides Indian refiners with a non-OPEC alternative in case of supply disruption.

Figure 2: Indian crude oil imports (MMbbl/year).



Source: MoPNG.

What happens next?

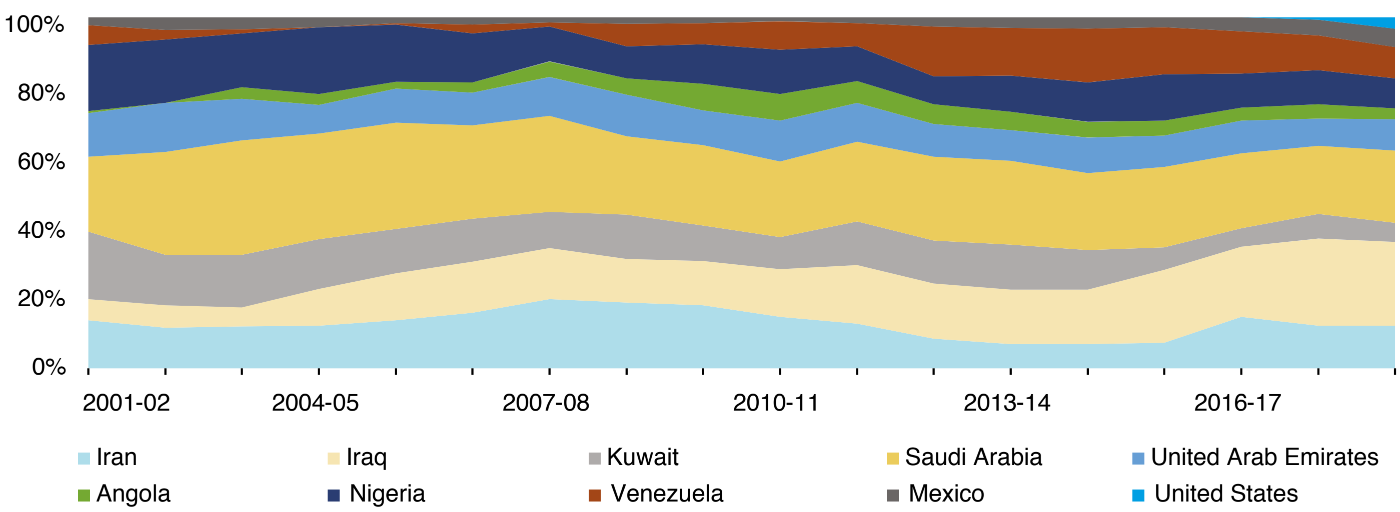
India's concern is not only about secure oil supplies but, above all, economic growth. Mr. Pradhan used a bilateral meeting in May 2019 with H.E. Khalid Al-Falih to invite the Kingdom to invest in the country's refining sector and to store oil in its strategic oil reserves. In April 2019, Saudi Aramco was reported to be in talks with Reliance Industries Limited to buy a stake in Reliance's refining and petrochemicals business. Last year, state-owned Abu Dhabi National Oil Company (ADNOC) and Saudi Aramco signed an agreement to jointly invest in a $44 billion refinery on India's west coast. They will jointly develop the 1.2 MMbbl/d Ratnagiri refining and chemicals complex in the western Indian state of Maharashtra with a group of Indian refiners.

U.S. Secretary of State Mike Pompeo used a recent policy speech in New Delhi to assure India of its continued access to crude oil. He also lobbied for India to acquire technology developed by the U.S. Westinghouse Electric Corporation to use in its six planned nuclear plants. It seems the U.S. is more interested in selling to India than in investing in the country.

The ten countries shown in Figure 3 supply almost 87% of India's crude imports. Of the ten countries, U.S. crude imports have grown the most. As long as U.S. crude is discounted to Brent (Reuters 2019) and the volumes available justify the long journey times from the U.S. Gulf Coast to Indian east and west coast refineries, the share of U.S. crude in the Indian market will only increase.

U.S. oil exports are currently constrained due to infrastructural issues at its Gulf Coast loading ports. These constraints are likely to be resolved over the coming years, but whether India will continue to grow its imports of U.S. crude is an open question. The recent increase in U.S. imports into India is likely to be met with a response from legacy suppliers, who are more likely to buy into the vision offered by India's finance

Figure 3. The market shares of India's ten biggest crude suppliers.



Source: MoPNG

minister, Nirmala Sitharaman. Their ability to offer secure oil supplies and foreign direct investment is likely to be an attractive proposition for India, and the prospect of long-term returns is likely to be an attractive proposition for investors from resource-holding countries.

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