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Title : HOW TO GAIN FROM FALLING CRUDE PRICES

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While the decline in inflation will enhance your savings, a rate cut in the future will affect both stocks and debt funds positively.

Remember when crude prices had risen above \$140 a barrel in June 2008? In a happy reversal of fortune, the price of the Indian basket of crude has fallen below \$90. The decline in US dependence on imported crude owing to its shale gas revolution, and lower demand from the rest of the world, especially China, due to slow economic growth has led to this softening. We tell you how you can profit from this trend, both as a consumer and as an investor.

A caveat

Falling crude prices have already contributed to a lower consumer price index (CPI) as 'fuel, power and light' and 'transportation', two elements of the index, have considerable weight within it. Economist Abheek Barua, a consultant at ICRIER, says that there will also be a second round impact on the prices of food, and goods and services across the board as transportation costs fall.

However, inflation expectations have become firmly entrenched. The RBI's September survey of households shows that the latter expect double-digit inflation over the next one year. So it may be a while before inflation expectations moderate and providers of goods and services pass on the benefits of lower crude prices to consumers.

Another question arises over the sustainability of the latest low CPI--6.46% for September. "While lower fuel, food and core inflation have all contributed to the current low CPI, the favourable base effect has also played a part. This will reverse in a couple of months. So one needs to watch how sustainable the latest decline in inflation is," warns Santosh Kamath, MD, local asset management-fixed income, Franklin Templeton. Also, geopolitical developments could cause current low crude prices to reverse due to supply disruptions.

More money to invest and spend

The first impact of falling crude prices will be on your fuel bill. Take the case of an urban SUV owner who drives about 65 km per day, or about 20,000 km a year. His vehicle gives a mileage of 10 km per litre on city roads, so he uses up 2,000 litres each year. Over the past couple of months, petrol prices have already fallen by '4-6 per litre in different states. That translates into a saving of '8,000-12,000 per year. Double those numbers for households with two four-wheelers. "These are considerable savings. They will allow you to raise your SIP by anywhere between '1,300-2,000 per month," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Lower crude prices will also leave you with more money to spend. "As your nondiscretionary expenses go down, your discretionary spends can rise," says Barua. This will provide a leg-up to domestic consumption. Apoorva Shah, executive VP and fund manager, DSPBR Investment Managers, estimates that if the average cost of crude was \$105 per barrel last year and it falls to \$95 per barrel this year, it would mean a cumulative saving of \$10 billion or '61,000 crore for the economy. That money could either be saved and invested, or spent.

A boost for stocks

The biggest advantage of the decline in crude prices is that India's macro-economic climate has improved and will continue to get better. "The domestic India story will get a boost at a time when global growth is weakening," says Shah. The twin deficits--current account and fiscal--will moderate further. Inflation, as discussed, will decline, and liquidity within the banking system will improve. "All companies that use fuel and petroleum derivatives should do well because their input costs will go down," says Harsha Upadhyaya, CIO-equity, Kotak Mutual Fund.

Oil marketing companies (OMCs), according to Upadhyaya, will be the biggest direct beneficiaries. Now that they will have no under-recovery, they need not wait for the government to reimburse this money. Their cash flows will improve and interest burden will fall because of lower working capital requirement.

Another indirect beneficiary will be banking. "If crude continues to be soft, it will lead to significant moderation in inflation. That will provide room for the monetary authorities to cut rates when they deem fit, benefiting the banking and financial sector," says Upadhyaya. Other ratesensitive sectors like auto and capital goods will also benefit from a rate cut. Tyre companies stand to benefit as 25-35% of their raw material is derived from crude.

Raise allocation to long-term funds

Financial planners are of the view that debt fund investors should increase their allocation to longer-duration funds. "Over the last few years, Indian investors have not made money in debt funds for sustained periods, and have hence been content to stay in accrual funds. But for the past six months real interest rates have been positive. Investors can make more money by betting on longer-duration funds. They will also make capital gains when rates are cut," says Dhawan. He advises investors to put 25-33% of their fixed income portfolio in long-duration debt funds.

Kamath strikes a more cautious note. He fears that a strengthening dollar and a possible rate hike by the US Fed could put pressure on the rupee. A faster-than expected economic rebound in India would raise inflation concerns--the latest trade deficit number shows widening due to rising imports. All these factors would make the RBI cautious about cutting rates. Kamath expects no rate cut for the next six months. He expects the first cut in perhaps the second half of 2015. He also doubts if the quantum of cuts will be sharp. His advice to investors is to have the larger portion of their funds in corporate bond funds with low average maturity, and a smaller portion in an income fund that takes some duration risk.

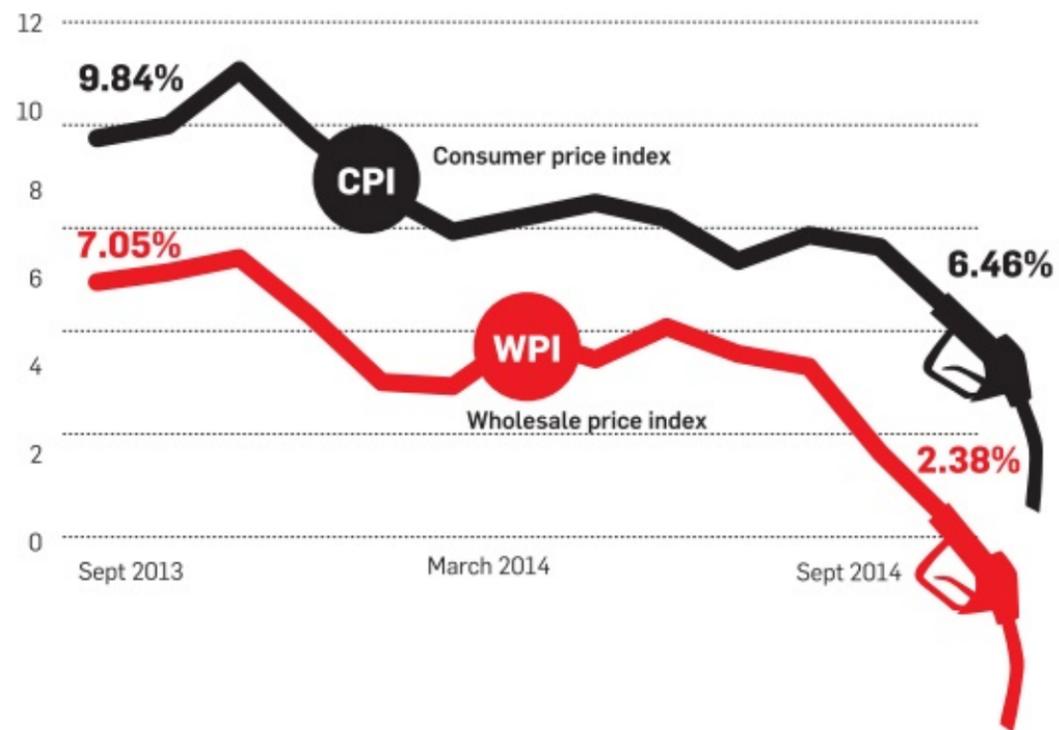
Gold may soften

Lower crude prices have contributed to the lowering of CAD and the rupee's stability. "If the CAD and the rupee continue to be stable, the government may reduce or remove the import duty on gold. That will cause its price to correct," says Dhawan.

For a country that imports almost 80% of its crude requirement and pays a massive import bill, the decline in its price is good news for its people. The benefits may not flow to you immediately, but they eventually will if crude prices continue to remain soft for some time.

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Declining inflation will put more money in your pocket



Beneficiaries of falling crude prices

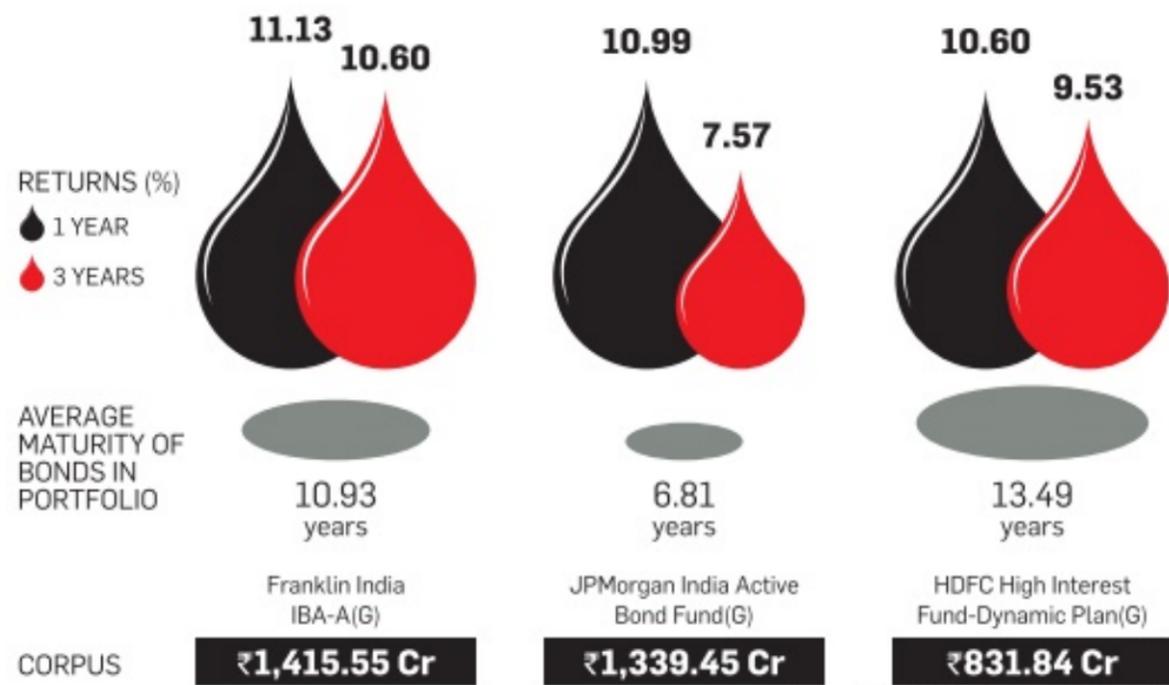
Here are a few stocks whose bottom lines will benefit if the trend of weak crude prices sustains.

Company	CMP (₹)	Revenue (₹)	Revenue-5-yr CAGR (%)	PAT (₹)	PAT-5 yr CAGR (%)
Bharat Petroleum	666	2,64,406.60	14.13	4,052.98	41.12
Hindustan Petroleum	495	2,34,159.44	12.65	1,079.62	7.35
Indian Oil Corporation	360	4,88,792.62	11.11	6,966.58	23.80
HDFC Bank	859	50,852.52	20.82	8,764.51	31.23
State Bank of India	2,465	2,26,944.57	14.95	14,489.47	5.34
Maruti Suzuki India	2,939	44,450.60	16.56	2,831.60	18.19
MRF	30,430	12,248.22	19.38	808.61	41.32

Source: Ace Equity. Revenue figure is total income in case of banks. Data as on 16 October, 2014

Is it time to bet on long-term funds?

Three long-term and dynamic bond funds that could prove rewarding if interest rates are cut.



Source: Ace MF. Data as on 16 October