Indian Edible Oil Sector

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Restriction on import of refined palm oil will safeguard the margins of domestic palm oil refiners while also improving their capacity utilisation

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HIGHLIGHTS

- More than ~70% of total edible oil consumed in India is imported. Palm oil is nearly entirely imported and constitutes ~40% of total edible oil consumption and ~60% of total imports in India.

- On January 8, 2020, the Director General of Foreign Trade (DGFT), Government of India (GoI), has imposed restrictions on imports of refined palm (RPO) oil through amending the import policy wherein import of RPO has been moved to "restricted" category from "free".

- This move comes a week after the scheduled reduction in import duty differential(IDD). From January 1, 2020, under the Association of Southeast Asian Nations (ASEAN) agreement and the Malaysia India Comprehensive Economic Cooperation Agreement (MICECA) the import duty on RPO was reduced to 45% from 50%, while that on crude palm oil (CPO) was reduced to 37.5% from 40% resulting in an IDD of 7.5% (compared to 10% earlier) between RPO and CPO. While the duty reduction is the final periodic revision under this agreement, ICRA believes that the change would have significantly impacted the margins of the domestic palm oil refining industry.

- India imports almost entire palm oil (~90%) from Indonesia (~65% for FY2019) and Malaysia (~27% for FY2019). Both the countries have higher export taxes on CPO and lower export taxes on RPO. As per ICRA analysis, the combined impact of Indian import duties and their export taxes results in an effective duty protection (EDP) for Indian refiners of ~1.7% (10% earlier) for Malaysia and ~4.0% (7% earlier) for Indonesia.

- The capacity utilisation for the domestic palm oil refiners remained low at around ~30-40%, since ~30% of palm oil consumption was being met through direct RPO imports. Hence, with the restriction on RPO imports, CPO import should increase, resulting in improved capacity utilisation levels for domestic refiners.

- Apart from improving the operating efficiency, it will remove the competition from imported RPO, further giving the players better pricing flexibility thereby supporting overall improvement in margins. While the step is a positive for the refiners, credit metrics of the edible oil industry to continue to remain subdued in the near to medium term, given the inherently modest profitability and high debt levels.

Impact analysis of restriction on import of refined palm oil

Restricting import of refined palm oil and palmolein will result in higher crude palm oil imports

The Director General of Foreign Trade (DGFT), Government of India (GoI), vide its notification dated January 8, 2020 has imposed restrictions on imports of RPO through amending the import policy wherein import of palm oil has been moved to “restricted” category from “free”. The import has been restricted and not prohibited, hence, an importer under license or permission would be able to import RPO.

Restriction comes after GOI’s move of reducing import duty on RPO and CPO which has reduced IDD

The Ministry of Finance, Government of India (GoI), vide its notification dated December 31, 2019 had reduced the import duty on RPO to 45% from 50%, while that on CPO to 37.5% from 40% with effect from January 1, 2020. The scheduled duty reduction was made under the ASEAN agreement and the MICECA to provide deeper tariff concessions in respect of goods imported from these countries and was the final periodic revision under this agreement. As seen above, in January 2019, the IDD of 10% had been maintained (except for imports from Malaysia) to safeguard the domestic palm oil refiners. The recent reduction in import duties has resulted in a lower IDD of 7.5% from 10% earlier which could have impacted the domestic palm oil refiners.

Trend of import duty on palm oil

Oil	Sep 2016	Aug 2017	Nov 2017	Feb 2018	Jun 2018	Jan 2019	Sep 2019	Jan 2020
CPO	7.5%	15%	30%	30%	44%	40%	40%	37.5%
RPO	15%	25%	40%	40%	54%	45%-50%*	50%#	45%

*Source: The Solvent Extractors Association of India, ICRA research; * import duty on Malaysia was 45%, 50% for other countries; # levy of 5% safeguard duty on import from Malaysia.*

The net impact on the EDP is a combined effect of Indian import and export taxes in Indonesia/Malaysia –

Current effective duty protection (EDP) (wef from January 1, 2020)

Exporting country	Particulars	Exporting country tax	India’s Import Duty	Net tax	Difference
		a	b	(1+a)*(1+b)	
Indonesia	CPO	6.85%#	37.50%	46.92%	
	RPO	4.11%@	45.00%	50.96%	4.04%
Malaysia	CPO	4.25%^	37.50%	43.34%	
	RPO	0.00%	45.00%	45.00%	1.66%

Source: ICRA research; CPO reference rate: 730$/mt; # $50/$730, @ $30/$730, ^$31/$730

In order to safeguard their industry, Indonesia has maintained an export duty differential of US$ 50 on CPO and US$ 30 on RPO whereas Malaysia has export duty on CPO of US$ 31 and nil on RPO. Considering these, the EDP for CPO and RPO works out to be only ~4% in case of import from Indonesia against the earlier EDP of ~7%. Further, the EDP for Malaysia stands substantially lower at ~1.7% against the earlier EDP of almost 10%.

Over ~70% of total edible oil consumption is imported; palm oil constitutes ~40% of consumption which is nearly fully imported from Indonesia/Malaysia

The total domestic palm oil consumption remains around ~9.5 million metric tonnes (MMT) with most of the demand being met through imports. Further, imports from Indonesia (~65% in FY2019) and Malaysia (~27% in FY2019) forms more than 90% of total imports.

Share of CPO and RPO in palm oil imports

Oil	FY2016	FY2017	FY2018	FY2019	8M FY2020*
CPO	73%	65%	71%	72%	64%
RPO	27%	35%	29%	28%	36%

*Source: Ministry of Commerce & Industry, ICRA research; * April 2019 to November 2019*

Historically, in most of the years the share of RPO has remained less than ~30% of total palm oil imports; however, for the period January 2019-September 2019, the IDD for imports from Malaysia was lower at 5% and hence, the import of RPO increased significantly to 1.8 MMT for 8M FY2020 from 0.7 MMT in FY2019 which resulted in higher share of RPO in total imports in YTD FY2020 exerting pressure on refining margins of domestic refiners.

Details of import from Indonesia and Malaysia

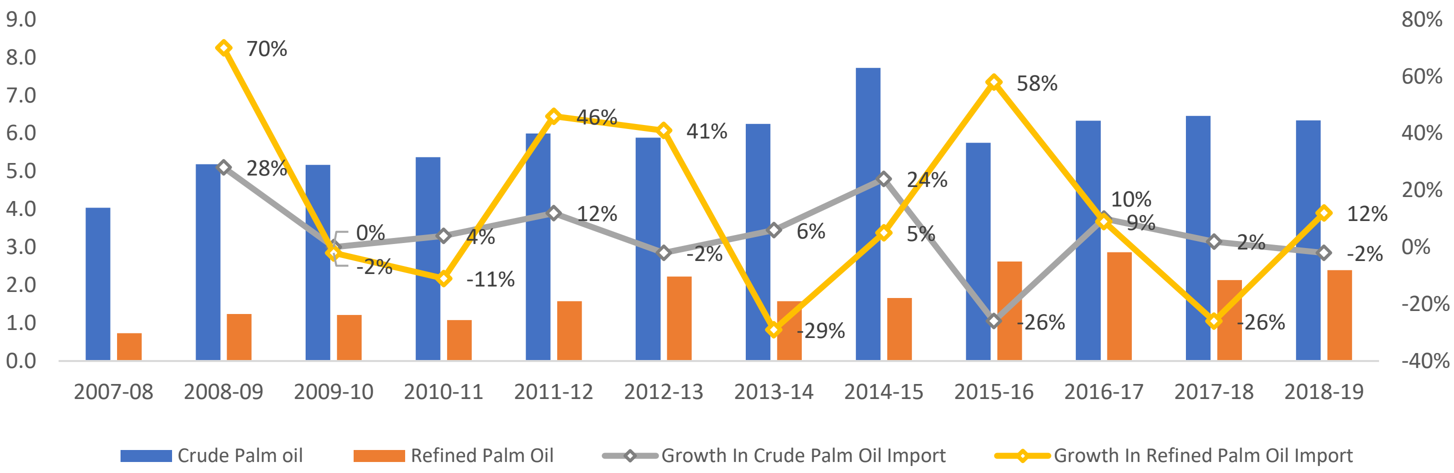
Oil (in MMT)	FY2016	FY2017	FY2018	FY2019	8M FY2020*
Indonesia - CPO	3.7	3.3	4.6	4.2	2.7
Indonesia - RPO	2.1	2.3	2.4	1.7	0.2
Total (A)	**5.9**	**5.7**	**6.9**	**5.8**	**2.9**
Malaysia - CPO	3.4	2.0	1.7	1.7	1.3
Malaysia - RPO	0.4	0.6	0.4	0.7	1.8
Total (B)	**3.8**	**2.6**	**2.1**	**2.4**	**3.0**
Total (A + B)	9.7	8.2	9.1	8.3	5.9
Total Palm oil import	**9.7**	**8.3**	**9.5**	**8.9**	**6.5**

*Source: Ministry of Commerce & Industry, ICRA research; * April 2019 to November 2019*

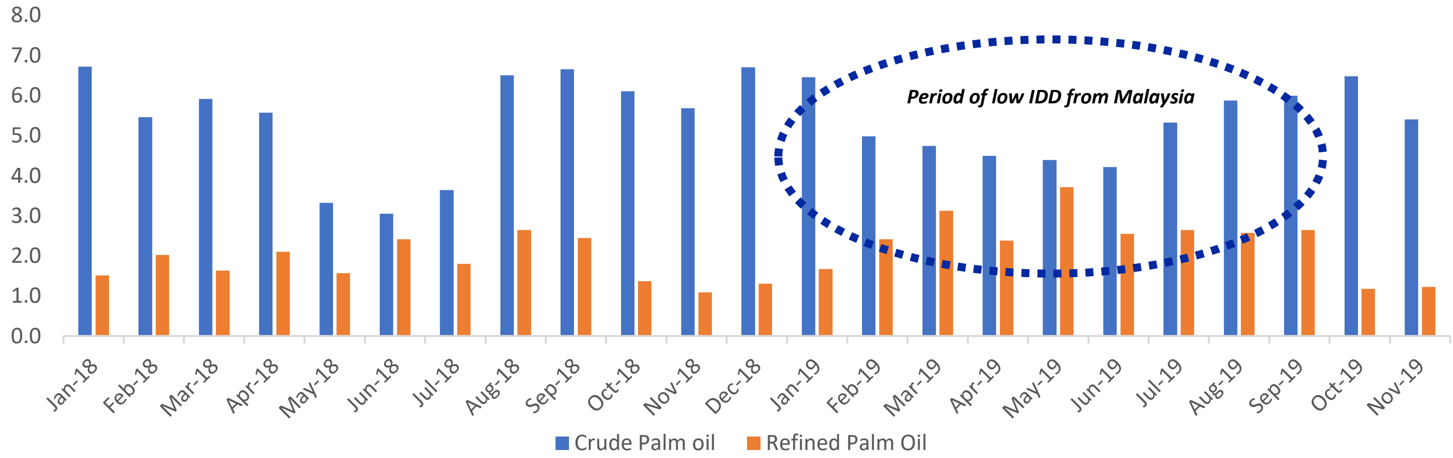
As seen in the charts below, the share of imports from Malaysia increased to ~47% in 8M FY2020 against ~27% in FY2019. However, a safeguard duty of 5% was imposed on RPO import from Malaysia in September 2019 (for a period of 180 days) to rectify the issue and increase the IDD from 5% to 10% in line with IDD for import from Indonesia. This had an instant impact and in November 2019, the RPO imports reduced significantly to 0.12 MMT against import of 0.26 MMT each in August 2019 and September 2019. Generally, the capacity utilisation for domestic palm oil refiners remains low at ~30%-40% due to significant import of RPO to the extent of ~30% of total palm oil imports. The capacity utilisation further declined during the period of lower IDD.

Moreover, GOI has planned to increase domestic oil production to reduce import dependency. It has also announced scheme for promoting palm oil plantations. Hence, the move to restrict RPO imports will safeguard the interests of domestic palm oil refiners as well as oil seed growers.

Palm oil imports (in MMT) and growth rates



CPO monthly imports in MMT

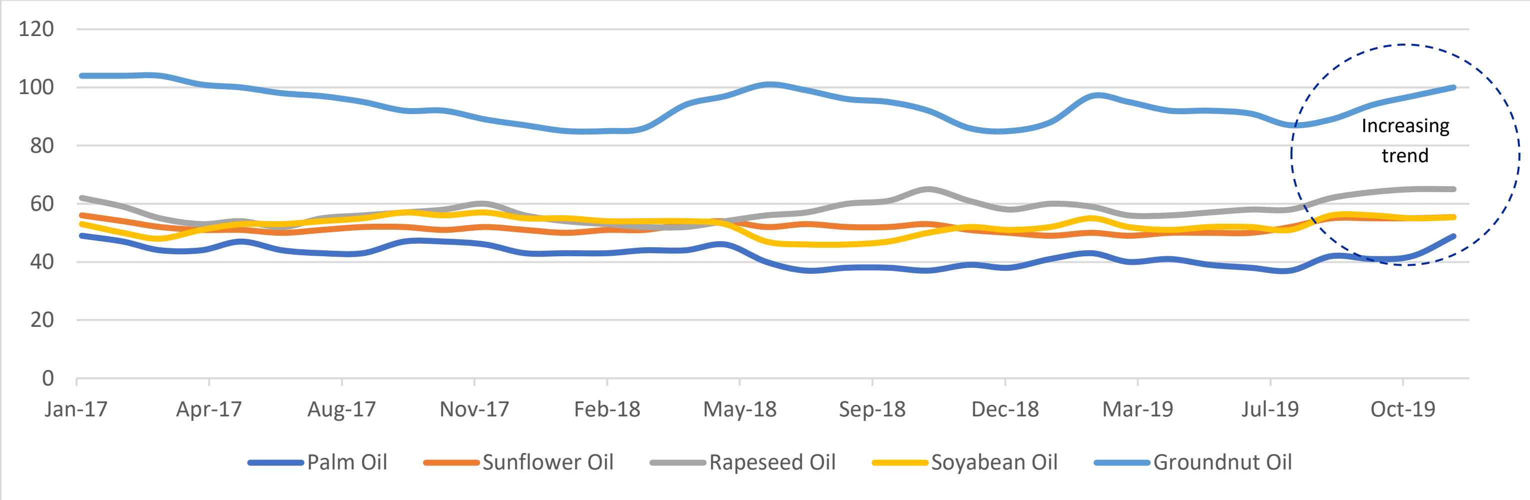


*(Source: Source: Ministry of Commerce & Industry, ICRA research; * April 2019 to November 2019)*

Indirect impact on the prices of all domestic edible oils on account of lower import duty

Palm oil constitutes a significant proportion of the total edible oil consumption. In terms of pricing, it is the cheapest and most neutral in its characteristics for usage. Its consumption tends to increase if consumers of other oils (which are all priced at a premium of ~15-100% in the retail market) see a higher price advantage. The lowering of duty on CPO will thus result in an indirect impact on the prices of oils extracted from domestically grown oilseeds. Thus, ICRA believes that the reduction in import duty could have a negative impact on the realisations of oilseed growers and lead to further reduction in overall oilseed acreage in the long term. The offsetting factor here is that in the recent past, palm oil prices have had a significant run-up and that has elevated the realisations of all domestic edible oils by 15-30%, so the net impact could be minimal or neutral.

Edible oil price trend (Rs./Kg)



(Source: Indexmundi

Conclusion

The capacity utilisation for the domestic palm oil refiners remained low at around ~30-40%, since ~30% of palm oil consumption was being met through direct RPO imports. Further, given the low value addition in the edible oil refining business, operating margins for palm oil refiners have inherently been thin. Hence, with the restriction on RPO imports, CPO import should increase, resulting in improved capacity utilisation levels for domestic refiners. Apart from improving the operating efficiency, it will remove the competition from imported RPO, further giving the players better pricing flexibility thereby supporting overall improvement in margins. While the step is a positive for the refiners, ICRA expects credit metrics of the edible oil industry to continue to remain subdued in the near to medium term, given the inherently modest profitability and high debt levels.

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