India will tread a delicate path on Iranian oil trade

Wednesday, March 28 2012

India may continue to pay for Iranian oil imports in foreign currencies until the latest round of US sanctions take effect in July, according to reports today. Thereafter, the two sides are likely to process transactions via a rupee account. These efforts signal India's continued unwillingness (and inability) to stop oil imports from Iran, as well as its desire to avert sanctions. However, striking a balance between relations with Iran and the United States is proving difficult given India's rapidly rising energy needs and foreign policy imperatives.

An Iranian crude oil supertanker. (REU

What next

Growing energy needs and awareness that Saudi Arabia cannot substitute for Iranian supplies entirely in the long term will lead India to continue importing oil from Iran. However, as doing business with Tehran becomes more difficult, the volume of Iranian oil imports is likely to be cut by up to 18% over 2012-13 -- sufficient to avert US sanctions.

Impact

- India will increase oil import year, but preserve its trade
- Delhi, like Beijing, will seek imports, a move that will be
- A need to demonstrate auto lead Delhi to maintain its as

Analysis

Iran is the second-largest oil supplier for India after Saudi Arabia, and currently accounts for around 11% of India's total oil imports. This trade has been fraught with payment problems since December 2010, when the Reserve Bank of India scrapped the Asian Clearing Union payment mechanism following tougher US sanctions on Iran's financial sector (see INDIA/IRAN: Sanctions put energy ties at risk - July 27, 2011).

Following this, Indian refiners channelled payments via Turkey's Halkbank. However, this option may not be viable for much longer. On December 31, 2011, US President Barack Obama signed the National Defense Authorization Act containing measures that for the first time sanction Iran's central bank. Under this Act, any foreign bank or financial institution that processes payments through Iran's central bank would be barred from operating in the US market from July 2012. Fear of reprisals could lead Turkey to block the payment route.

Rupee payments

To avert an oil supply crisis, India and Iran have agreed to process payments in rupees via West Bengal-based, public-sector UCO Bank, which has little exposure to US and EU markets. However, this arrangement is also fragile, and could collapse. It may also be unsustainable because India's balance of trade with Iran is heavily skewed in the latter's favour:

- For example, in 2010-11, Indian exports to Iran stood at around 2.7 billion dollars, whereas imports (the bulk of which were oil shipments) totalled around 10.9 billion dollars. Even after accounting for a possible increase in exports to Iran due to the refusal of other countries to trade with it, India will still find it difficult to settle the remaining oil bill.
- The Society for Worldwide Interbank Financial Telecommunication (SWIFT), which handles global electronic fund transfers, dropped Iran out of its network recently. This creates further payment obstacles for India.

Rupee p

International sanctions pressure

Washington is aware that energy-deficient countries such as India are unlikely to cut Iranian imports immediately. Hence, it is has sought to put pressure on importers to significantly reduce (by 15-22%) their take-up of Iran oil or risk sanctions. This pressure has intensified since US Secretary of State Hillary Clinton announced that Japan and ten European countries had qualified for exemptions by reducing imports.

Delhi is beginning to feel this pressure, but remains reluctant publicly to announce immediate cuts in Iranian imports for fear of alienating domestic public opinion. It also has serious economic concerns:

- Many of India's older refineries are geared to Iranian oil and cannot be adapted immediately to accept other varieties.
- Indian refiners are finding it difficult to secure shipping insurance for Iranian oil imports. In a foretaste of things to come, one of India's shipping companies was reportedly forced to cancel an Iranian crude oil shipment in February because its European insurers refused to provide coverage for the vessel on the grounds of tightening sanctions.

Reducing imports, avoiding sanctions

Nonetheless, the government has reportedly advised domestic refiners to reduce their dependence on Iranian oil by at least 15% and seek alternative supplies from Arab exporters, such as Saudi Arabia, Kuwait and the UAE. The government's thrust appears to be to find the right balance of cuts that will satisfy Washington without terminating Iran's supplies:

- Mangalore Refinery and Petrochemicals, Iran's largest Indian oil buyer, plans to cut Iranian annual imports by 44% to 80,000 barrels/day (b/d) in fiscal year 2012-13 (which starts in April). This would imply a reduction of more than 20% in India's total purchases of Iranian oil.
- Bharat Petroleum Corporation, India's second-largest state refiner, is seeking to increase oil imports from Saudi Arabia by nearly 27% from 120,000 b/d in 2011-12 to 152,000 b/d in 2012-13. The refiner also intends to reduce Iranian imports by about 50% to 10,000 b/d in 2012-13.
- Hindustan Petroleum Corporation has said it will cut Iranian imports by about 15% to 60,000 b/d in its annual contract. It plans to buy 40,000 b/d on a regular basis and keep 20,000 b/d as optional volumes.

Indian oil refiners will i

India's import reductions have not yet been demonstrable because refiners' annual crude term deals with Iran typically run from April to March. The planned reductions are most likely to start when new annual contracts begin in April.

Foreign policy dilemmas

Reduction of oil imports from Iran will not end Delhi's foreign policy dilemmas.

Politically, India does not endorse the military component of Iran's nuclear programme, putting its views in line with those of Western countries. Since its September 2005 decision to vote alongside Washington at the International Atomic Energy Agency, India has maintained that position. Moreover, India also does not look well upon Iran's threats to close down the Strait of Hormuz (see IRAN: Tehran will avoid blocking the Strait of Hormuz - December 30, 2011).

Nonetheless, India's important strategic interests are linked with Iran:

- Iran provides India with land access to Afghanistan and Central Asia, something Pakistan has been unwilling to do.
- India is cooperating with Iran to build a trade route from an Iranian port in the south to the Caspian Sea in the north, which will reduce by two-thirds the cargo transport distance from the Indian Ocean to northern and eastern Europe, compared to the route through the Suez Canal and the Mediterranean Sea. The two countries are also cooperating to secure Persian Gulf sea lanes.
- Several Indian public-sector companies (such as Gas Authority of India) are heavily invested in Iran's energy sector and do not wish to their deals to be stalled indefinitely.

Delhi will press for dipl

Moreover, given India's energy needs and the fact that over 6 million Indian nationals work in the Gulf region, Delhi does not want tensions over Iran escalating into a war. Therefore, it will continue to push for a diplomatic resolution of disputes concerning Iran.

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