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FIRST LIGHT

13 September 2019

RESEARCH

BOB Economics Research | Monthly Chartbook

Transmission of lower rates to drive recovery

BOB Economics Research | Inflation and IIP

Food accelerates, core stable

SUMMARY

India Economics: Monthly Chartbook

Consumption slowdown intensified in Aug'19 with further dip in auto demand. Exports too remained lukewarm. Government spending improved marginally, but is likely to be constrained by muted tax collections. With better than forecast monsoon and lower global oil prices, inflation will remain well anchored and opens up room for further easing by RBI in Oct'19. This along with measures announced by government for availability of liquidity to MSMEs/ NBFCs should lead to a revival in demand. Transmission of rates remains the most important tool in reviving India's consumption and investment cycle.

Click here for the full report.

India Economics: Inflation and IIP

Industrial activity surprised positively at 4.3% in Jul'19 led by mining and manufacturing. CPI inflation saw a mild acceleration to 3.2% in Aug'19 (3.1% in Jul'19) led by food at 3% (2.4% in Jul'19). Despite higher gold prices, core remained stable at 4.2% with a broad based decline. Given the economic slowdown, core inflation is expected to be benign in the year. So is the case with CPI which is estimated at 3.3% in FY20 (3.4% in FY19). This opens up room for further reduction in repo rate by 40bps by RBI as early as Oct'19.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	595
GAIL	Buy	175
ONGC	Buy	175
TCS	Add	2,360
HPCL	Sell	200

MID-CAP IDEAS

Company	Rating	Target
Balkrishna Ind	Buy	1,290
Future Supply	Buy	715
Greenply Industries	Buy	195
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.74	1bps	(1bps)	(122bps)
India 10Y yield (%)	6.68	10bps	18bps	(145bps)
USD/INR	71.67	0.1	(1.2)	0.7
Brent Crude (US$/bbl)	60.81	(2.5)	3.9	(23.7)
Dow	27,137	0.8	3.2	4.4
Shanghai	3,009	(0.4)	8.4	13.3
Sensex	37,271	0.3	(0.8)	(1.2)
India FII (US$ mn)	**9 Sep**	**MTD**	**CYTD**	**FYTD**
FII-D	38.0	461.7	4,708.9	4,164.2
FII-E	41.6	(803.8)	6,402.3	(442.9)

Source: Bank of Baroda Economics Research

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Transmission of lower rates to drive recovery

Consumption slowdown intensified in Aug'19 with further dip in auto demand. Exports too remained lukewarm. Government spending improved marginally, but is likely to be constrained by muted tax collections. With better than forecast monsoon and lower global oil prices, inflation will remain well anchored and opens up room for further easing by RBI in Oct'19. This along with measures announced by government for availability of liquidity to MSMEs/ NBFCs should lead to a revival in demand. Transmission of rates remains the most important tool in reviving India's consumption and investment cycle.

Slowdown intensifies: Led by declining non-oil-gold imports at (-) 2.2% in Jul'19 and the slump in auto sales (-41% for passenger cars, (-) 22% for 2-wheelers), consumption slowdown has intensified in Aug'19. With south-west monsoon moving above LPA, kharif sowing has improved (-0.6%). This coupled with measures for easing liquidity with MSMEs/ NBFCs announced by government should boost consumption demand.

Fiscal constraints remain: Centre's tax collections are behind budget estimates as growth slowdown has impacted revenues. On FYTD basis, centre's direct tax collections have risen by only 6% (BE: 19%) while indirect tax collections are up by 2% (BE: 17%). State government's tax revenue receipts are also down by (-) 1.5%. This has resulted in muted spending, with capex taking the maximum hit (Centre: -3.4%; States: -9.5%). In order to revive public spending, states are increasing their reliance on market borrowings (Rs 1161bn in Q2FY20 vs Rs 809bn last year and Rs 815bn in Q1FY20). In the coming months, we expect states to drive spending.

Yields have inched up slightly: India's 10Y yield has risen by 19bps in Aug'19 and by 12bps in Sep'19. This is on the back of an expected stimulus by government. The gap between short-term and long-term rates has increased in Aug'19 (steepening yield curve). With RBI expected to cut rates further in Oct'19 and a favourable macro backdrop in the form of low oil prices (~US$ 61/bbl in Sep'19), inflation well anchored below 4% target, falling global yields and muted global growth. 10Y yield is also likely to fall.

INR depreciates in Aug'19: Driven by both global and domestic factors, INR depreciated by (-) 3.6% in Aug'19. This was in line with a (-) 3.8% depreciation in CNY and (-) 3.3% fall seen in EM currencies. FII outflows in equity segment continued as growth concerns persisted. Government measures to address the growth slowdown such as liberalistaion of FDI in certain sectors and rollback of FPI surcharge will help INR recover its losses. In Sep'19, INR has risen for five straight sessions after falling to its lowest since Nov'18 at 72.39/$. Lower oil prices will also support INR, in our view.

INFLATION AND IIP

12 September 2019

Food accelerates, core stable

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Industrial activity surprised positively at 4.3% in Jul'19 led by mining and manufacturing. CPI inflation saw a mild acceleration to 3.2% in Aug'19 (3.1% in Jul'19) led by food at 3% (2.4% in Jul'19). Despite higher gold prices, core remained stable at 4.2% with a broad based decline. Given the economic slowdown, core inflation is expected to be benign in the year. So is the case with CPI which is estimated at 3.3% in FY20 (3.4% in FY19). This opens up room for further reduction in repo rate by 40bps by RBI as early as Oct'19.

IIP growth accelerates: Industrial output in Jul'19 increased by 4.3% compared with 1.2% in Jun'19 on the back of improvement in mining to 4.9% (1.5% in Jun'19) and manufacturing to 4.2% (0.2% in Jun'19). Within manufacturing, intermediate goods output accelerated to a high of 13.9% (12.6% in Jun'19) led by fragrances, MS slabs and copper bars. FMCG production too increased to 8.3% (7.1% in Jun'19). Primary goods output rose by 3.5% on the back of favourable base. On the other hand, capital and consumer durable output contracted by (-) 7.1% and (-) 2.7% respectively in Jul'19. Electricity production decelerated to 4.8% in Jul'19 (8.2% in Jun'19).

Food drove CPI higher: CPI inflation rose to 3.2% in Aug'19 from 3.1% in Jul'19 on account of 60bps jump in food inflation (3% in Aug'19 from 2.4% in Jul'19). Prices of vegetables increased by 6.9% in Aug'19 (2.8% in Jul'19), pulses by 6.9% (6.8% in Jul'19), spices by 2.4% (2% in Jul'19) and milk by 1.4% (1% in Jul'19). Cereal inflation remained stable at 1.3%. Despite an unfavourable base of 0.2% in FY19, muted global food prices and above normal monsoon will anchor food inflation at 3%-3.2% in FY20.

Core remains stable: Core inflation was stable at 4.2% in Aug'19. While personal care and effects index saw a jump due to higher gold prices to 6.4% (4.3% in Jul'19), all other core components saw a deceleration in inflation momentum. For instance, housing at 4.8% in Aug'19 (4.9% in Jul'19), clothing and footwear at 1.2% (1.4% in Jul'19), transport and communication at 1.2% (1.6% in Jul'19), household goods and services at 3.7% (4% in Jul'19) and education at 6.1% (6.4% in Jul'19). Outlook on core inflation is benign as the current economic slowdown will ensure that pricing power with producers is limited. Our projection for core inflation in FY20 is 4.2% (5.8% in FY19).

KEY HIGHLIGHTS

- CPI inflation rose by 3.2% in Aug'19 vs 3.1% in Jul'19.
- Core inflation stable at 4.2% in Aug'19.
- IIP growth improves to 4.3% in Jul'19 from 1.2% in Jun'19.

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BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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