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# FIRST LIGHT

14 July 2020

## RESEARCH

### BOB Economics Research | Weekly Wrap

Global macros improving despite rising cases

### BOB Economics Research | Inflation

CPI surprises negatively led by core

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Navigating uncertain waters

### Building Materials | Q1FY21 Preview

Operating performance to crumble amid lockdown

## SUMMARY

### India Economics: Weekly Wrap

Global equity markets continued upward momentum led by China as economic activity rebounds. However, apart from China bond yields were lower. DXY was under pressure on the back of rising COVID-19 cases in US and Fed comments of a protracted slowdown. Domestic economic activity is gaining traction as seen in higher electricity demand, digital payments and a normal monsoon implying rural demand will bounce back. India's 10Y yield closed lower on anticipation of bond purchases by RBI and softening inflation.

**Click here for the full report.**

### India Economics: Inflation

NSO released CPI inflation for Apr'20 and May'20 along with Jun'20 data. CPI inflation in Q1 is at 6.5% (6.7% in Q4) and in Jun'20 at 6.1%. The negative surprise came from core inflation at 5.1% in Q1 from 4.1% in Q4. While core and food inflation will moderate going ahead, the trajectory for H2 is now higher than earlier estimated. MPC members may still go for a 25bps rate cut to support growth but room is limited and most of policy rate cuts are behind us. Focus will be on transmission, financial stability and yield curve.

**Click here for the full report.**

## TOP PICKS

### LARGE-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Bajaj Finance | Buy | 3,000 |
| Cipla | Buy | 690 |
| GAIL | Buy | 150 |
| Petronet LNG | Buy | 305 |
| Tech Mahindra | Buy | 690 |

### MID-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Alkem Labs | Buy | 2,950 |
| Chola Investment | Buy | 200 |
| Laurus Labs | Buy | 630 |
| Transport Corp | Buy | 240 |
| Mahanagar Gas | Sell | 710 |

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

| Indicator | Current | 2D (%) | 1M (%) | 12M (%) |
|---|---|---|---|---|
| US 10Y yield (%) | 0.64 | 3bps | (2bps) | (148bps) |
| India 10Y yield (%) | 5.76 | (1bps) | (3bps) | (73bps) |
| USD/INR | 75.21 | (0.3) | 0.8 | (9.5) |
| Brent Crude (US$/bbl) | 43.24 | 2.1 | 12.2 | (35.2) |
| Dow | 26,075 | 1.4 | 3.8 | (4.6) |
| Shanghai | 3,383 | (1.9) | 15.8 | 15.5 |
| Sensex | 36,594 | (0.4) | 9.1 | (5.5) |
| **India FII (US$ mn)** | **09 Jul** | **MTD** | **CYTD** | **FYTD** |
| FII-D | (202.6) | (53.5) | (14,335.5) | (4,576.0) |
| FII-E | 450.3 | (33.5) | (2,475.0) | 4,128.0 |

Source: Bank of Baroda Economics Research

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## Banking: Q1FY21 Preview

We believe the true picture of banks' asset quality in Q1FY21 will be masked by the loan moratorium as this will rein in slippages. Credit costs are likely to stay elevated as banks build further contingent buffers to protect their balance sheets from Covid-19 downside risks. Considering the sluggish economic activity, we expect subdued loan growth for most of our coverage (ex-HDFCB), in the range of 4-12% YoY. NIMs are projected to decline 8-10bps on average despite deposit rate cuts, given the pressure on yields and increased risk aversion among banks.

**Click here for the full report.**

## Building Materials: Q1FY21 Preview

We expect building material companies under our coverage to post an anaemic Q1FY21 as the Covid-19 lockdown has exacted a severe toll on business. Revenues and volumes are forecast to slump ~50% YoY on average due to the absence of sales for most of the quarter. Resultant negative operating leverage will take a bite out of profitability. For building material players, pipes & adhesives are the only segments likely to post positive EBITDA. Management commentary on expected business pickup for the remainder of FY21 will be a key monitorable.

**Click here for the full report.**

WEEKLY WRAP

13 July 2020

## Global macros improving despite rising cases

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**Global equity markets continued upward momentum led by China as economic activity rebounds. However, apart from China bond yields were lower. DXY was under pressure on the back of rising COVID-19 cases in US and Fed comments of a protracted slowdown. Domestic economic activity is gaining traction as seen in higher electricity demand, digital payments and a normal monsoon implying rural demand will bounce back. India's 10Y yield closed lower on anticipation of bond purchases by RBI and softening inflation.**

## Markets

- **Bonds:** Yields rose in China as economic activity is showing signs of improvement. Despite US ISM-non manufacturing index surprising positively, its 10Y yield closed lower due to rising COVID-19 cases and concern of prolonged slowdown raised by Fed. Oil prices rose by 1% (US$ 43/bbl). India's 10Y yield fell by 9bps (5.76%). System liquidity surplus was lower at Rs 3.9tn as on 10 Jul 2020 compared with Rs 4.3tn in the previous week.

- **Currency:** Except INR, global currencies closed higher against the dollar as economic data such as European retail sales surprised positively. Comments by Fed on protracted slowdown and rising number of COVID-19 cases in US weighed against US$ and DXY fell by 0.5%. CNY appreciated by 0.9%. INR depreciated by 0.7% as oil prices inched up despite FII inflows of US$ 82.3mn.

- **Equity:** Global indices ended the week mixed due to surge in cases and hopes of global economic recovery amidst news of COVID-19 vaccine. Shanghai Comp (7.3%) gained the most on the back of improving economic fundamentals. Sensex too was up by 1.6% on the back of global cues, with metal and banking stocks advancing the most.

- **Upcoming key events:** Markets will closely watch host of data from the US (CPI, retail sales, housing starts and jobless claims) and China (GDP, trade, industrial production and FAI). Central Bank decisions and comments from ECB, Japan, Indonesia and Korea are also awaited. On the domestic front, CPI, WPI and trade data is scheduled for release. Local lockdowns too will have an impact on domestic markets.

## INFLATION

13 July 2020

# CPI surprises negatively led by core

**NSO released CPI inflation for Apr'20 and May'20 along with Jun'20 data. CPI inflation in Q1 is at 6.5% (6.7% in Q4) and in Jun'20 at 6.1%. The negative surprise came from core inflation at 5.1% in Q1 from 4.1% in Q4. While core and food inflation will moderate going ahead, the trajectory for H2 is now higher than earlier estimated. MPC members may still go for a 25bps rate cut to support growth but room is limited and most of policy rate cuts are behind us. Focus will be on transmission, financial stability and yield curve.**

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### KEY HIGHLIGHTS

- NSO has released headline CPI print for Apr, May & Jun'20.
- Food inflation has moderated to 7.9% in Jun'20 from 11.7% in Apr'20.
- Core inflation accelerated significantly to 5.3% in Jun'20 from 4% in Mar'20.

**CPI surprises negatively:** As against our forecast of 5.1% (consensus of 5.3%) for Jun'20, actual CPI inflation was 6.1%. Data released for Apr'20 and May'20 shows CPI inflation at 7.2% and 6.3% respectively. While food inflation has come down in the last three months from 11.7% in Apr'20 to 7.9% in Jun'20, core inflation has increased from 4.9% in Apr'20 to 5.3% in Jun'20. In Mar'20 core was 4.0% which shows a significant increase during the lockdown period.

**Food inflation falls:** Food inflation fell to 7.9% in Jun'20 from 9.2% in May'20 led by moderation in vegetable prices to 15-month low of 1.9% in Jun'20 (5.5% in May'20). CPI (ex-vegetables) moderated to 6.2% in Jun'20 from 6.4% in May'20. Given the abundant rainfall and sowing pattern, food inflation is expected to moderate in coming months.

**Core inflation rose:** NSO released core inflation for Apr'20 and May'20 along with Jun'20. Notably, core inflation has accelerated in lockdown period led by personal care (12.4% in Jun'20 vs 8.8% in Mar'20), education (5.5% vs 3.9%), and transport and communication (7.1% vs 4.3%). On the other hand, categories such as housing (3.7% vs 3.5%) and recreation (4.4% vs 3%) have seen a deceleration. Rising core inflation is due to higher gold prices, taxes on fuel and underlying change in consumer behaviour.

**RBI to focus on growth:** We now expect CPI inflation to average 3.4% in H2FY21 as against 5.7% in H1FY21. Our GDP growth forecast remains at (-) 4.7% for FY21. Given the growth inflation dynamics, MPC may focus on growth for now and deliver a 25bps rate cut in August policy. However, some MPC members may vote for a pause to see the impact of negative GDP growth on inflation before cutting rates further. RBI's focus is likely to be on financial stability and transmission as most of monetary easing is behind us.

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**BANKING** | Q1FY21 Preview | 13 July 2020

# Navigating uncertain waters

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**We believe the true picture of banks' asset quality in Q1FY21 will be masked by the loan moratorium as this will rein in slippages. Credit costs are likely to stay elevated as banks build further contingent buffers to protect their balance sheets from Covid-19 downside risks. Considering the sluggish economic activity, we expect subdued loan growth for most of our coverage (ex-HDFCB), in the range of 4-12% YoY. NIMs are projected to decline 8-10bps on average despite deposit rate cuts, given the pressure on yields and increased risk aversion among banks.**

**Moratorium to keep slippages in check:** In our view, slippages will remain muted in Q1 as stressed accounts continue to benefit from extension of the moratorium till August-end coupled with the absence of major account downgrades. The moratorium will remain the key area of discussion as the share of loans under its phase-2 extension (Jun-Aug) is likely to be lower than phase-1 (Mar-May). Stress recognition will begin once this relief measure ends but we believe credit costs will stay high due to improving provision coverage and building of contingency buffers against Covid-19.

**Subdued loan growth trends:** Overall loan growth trends are likely to remain muted for most banks under coverage, in the range of 4-12% YoY, due to the lockdown. Latest data on systemic credit released by RBI suggests growth remains sluggish at 6%. Proforma business updates point to softer loan growth by Federal Bank (8% YoY) and IndusInd Bank (4% YoY). However, HDFC Bank continues to exhibit strong growth at 21%.

**NIMs likely to decline marginally:** A sharp reduction in deposit rates, including savings rate, coupled with lower interest reversals is likely to cushion NIMs. But a bulk of the banking sector's loan portfolio is still linked to MCLR where both large/mid-sized private banks and public banks have cut rates by 15-90bps since Jan'20. Moreover, most banks have turned risk-averse to protect their balance sheets, dampening growth in high-yielding unsecured loans, which could drive down margins by an average of 8-10bps in Q1.

**Treasury income could cushion earnings to some extent:** State Bank of India and ICICI Bank should get a boost from gains on stake sales in their subsidiaries. G-sec yields have declined by ~25bps QoQ in Q1FY21 which should also help banks post strong treasury gains.

## RECOMMENDATION SNAPSHOT

| Ticker | Rating |
|---|---|
| AXSB IN | BUY |
| CBK IN | ADD |
| DCBB IN | SELL |
| FB IN | ADD |
| HDFCB IN | BUY |
| ICICIBC IN | BUY |
| IDFCFB IN | ADD |
| IIB IN | BUY |
| KMB IN | BUY |
| RBK IN | ADD |
| SBIN IN | ADD |

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**BUILDING MATERIALS** | Q1FY21 Preview | 13 July 2020

# Operating performance to crumble amid lockdown

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**We expect building material companies under our coverage to post an anaemic Q1FY21 as the Covid-19 lockdown has exacted a severe toll on business. Revenues and volumes are forecast to slump ~50% YoY on average due to the absence of sales for most of the quarter. Resultant negative operating leverage will take a bite out of profitability. For building material players, pipes & adhesives are the only segments likely to post positive EBITDA. Management commentary on expected business pickup for the remainder of FY21 will be a key monitorable.**

**Tiles & Sanitaryware – dull quarter all round:** Amid the lockdown and listless demand during the quarter, we expect sales to plummet ~60% YoY for coverage tile companies Kajaria Ceramics (KJC) and Somany Ceramics (SOMC). April was a washout month due to the Covid-led restrictions, with sales gradually resuming in May and then picking up in June. We forecast heavy EBITDA losses stemming from negative operating leverage on lower volumes. In sanitaryware, we expect Cera Sanitaryware (CRS) to report ~62% YoY revenue erosion as core category sales slump, inducing operating losses.

**Plywood & MDF – both segments to suffer:** We estimate a ~65% YoY plunge in plywood sales for both Greenply Industries (GIL) and Century Plyboards (CPBI) due to weak sales in April-May. Operating margins are likely to turn negative for both companies, resulting in EBITDA losses. In the MDF segment, Greenpanel Industries (GREENP) and CPBI are projected to post revenue declines of ~45% YoY accompanied by EBITDA losses.

**Pipes & Adhesives – only segments to report positive EBITDA:** As the lockdown coincided with the busy season, we forecast revenue declines of 45-50% YoY for pipe companies, with agriculture pipe demand being the only silver lining. Pipe companies will likely see softer operating margins, but for our building material coverage – Supreme Industries (SI), Astral Poly (ASTRA) and Finolex Industries (FNXP) – this is the only segment besides adhesives that is projected to report positive EBITDA. In adhesives, we model for 55% YoY topline shrinkage for Pidilite Industries (PIDI) and ASTRA, with lower operating margins but positive EBITDA.

**Watch for:** We await management commentary on demand trends expected for the remainder of FY21 in the wake of Covid-19.

### RECOMMENDATION SNAPSHOT

| Ticker | Rating |
|---|---|
| KJC IN | ADD |
| SOMC IN | ADD |
| CRS IN | ADD |
| PIDI IN | SELL |
| MTLM IN | BUY |
| CPBI IN | BUY |
| ASTRA IN | REDUCE |
| FNXP IN | ADD |
| SI IN | ADD |
| GREENP IN | BUY |

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**Recommendations and Absolute returns (%) over 12 months**

**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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