FIRST LIGHT

02 June 2022

RESEARCH

BOB Economics Research | Currency Outlook

Pressure on INR

India Strategy | Monthly Wrap

Mixed outlook

Consumer Durables

FY22 Review – Margin gains elusive

SUMMARY

India Economics: Currency Outlook

With easing lockdown restrictions in China and stimulus measures announced by UK and China, global growth concerns abated. As a result, DXY eased and other global currencies edged up. Investors have also pared back expectations of aggressive rate hikes by Fed, while ECB is expected to kick-start the rate-hike cycle sooner than expected amidst record-high inflation. In India, INR depreciated to a record-low of 77.73/$ in the last fortnight but has since found support at the 77.5/$ level. However, higher domestic inflation, FPI outflows, risks to domestic growth outlook and a widening trade deficit continue to weigh on the Rupee. We expect INR to trade in the range of 77.5-78/$ in the next fortnight with a depreciating bias.

Click here for the full report.

India Strategy: Monthly Wrap

- Indian benchmarks underperformed their global peers in May; locally, autos, consumers and financials outperformed
- Commodity prices appear to have largely peaked, though oil & gas may remain elevated near term; India better placed to absorb volatility
- Global clean energy initiatives remain at the fore despite the Russia-Ukraine war; we continue to prefer domestic sectors

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Daily macro indicators

Indicator	30-May	31-May	Chg (%)
US 10Y yield (%)	2.74	2.84	11bps
India 10Y yield (%)	7.41	7.42	1bps
USD/INR	77.54	77.64	(0.1)
Brent Crude (US$/bbl)	121.7	122.8	1.0
Dow	33,213	32,990	(0.7)
Hang Seng	21,124	21,415	1.4
Sensex	55,926	55,566	(0.6)
India FII (US$ mn)	**27-May**	**30-May**	**Chg ($ mn)**
FII-D	(37.0)	48.4	85.3
FII-E	(403.9)	294.3	698.2

Source: Bank of Baroda Economics Research

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Consumer Durables

- War, inflation, supply chain disruptions and Covid all dented consumer durable margins, but likely to be transient
- Management commentary cautious as companies walk a fine line between raising prices to combat RM inflation and preserving demand
- Pricing power and cost control vital in an inflationary climate; prefer leaders with a demonstrable record – VOLT, HAVL, POLYCAB

Click here for the full report.

CURRENCY OUTLOOK

01 June 2022

Pressure on INR

Aditi Gupta
Economist

With easing lockdown restrictions in China and stimulus measures announced by UK and China, global growth concerns abated. As a result, DXY eased and other global currencies edged up. Investors have also pared back expectations of aggressive rate hikes by Fed, while ECB is expected to kick-start the rate-hike cycle sooner than expected amidst record-high inflation. In India, INR depreciated to a record-low of 77.73/$ in the last fortnight but has since found support at the 77.5/$ level. However, higher domestic inflation, FPI outflows, risks to domestic growth outlook and a widening trade deficit continue to weigh on the Rupee. We expect INR to trade in the range of 77.5-78/$ in the next fortnight with a depreciating bias.

How have currencies fared?

Improvement in global risk-appetite drove global currencies higher in the last fortnight. Fears of global growth slowdown eased as China ended lockdown restrictions in Shanghai and also announced several measures aimed at supporting the economic recovery. DXY fell by 2.7% as safe-haven demand waned. Further, investors also pared back expectations of aggressive rate hikes by Fed. This was consistent with a decline in US treasury yields.

EM currencies rose sharply by 2.3%. Chinese Yuan (CNY) also rose by 1.8%, after declining by 2.7% in the fortnight before. Brazilian Real (BRL) was the highest gainer, appreciating by 6.9% supported by higher global commodity prices. Expectations of further rate hikes by Brazil's central bank also supported gains in the currency. On the other hand, Turkish Lira (TRY) depreciated sharply by 5.6% amidst surging inflation and widening current account deficit. Even so, Turkey's central bank has kept interest rate steady at 14% for the fifth straight month. It must be noted that inflation in Turkey surged to ~70% in Apr'22, much above the central bank's target of 5%.

New Zealand dollar (NZD) too gained by 3.8% as Reserve Bank of New Zealand (RBNZ) raised its official cash rate by 50bps to 2%. This was the second consecutive rate hike by RBNZ. Further, it is estimated that the cash rate is likely to double to 4% over the coming year and stay at that level until CY24. EUR gained by 3.1% as surging inflation in the Euro Area (Euro Zone's inflation soared to a record-high of 8.1% in May'22), led to expectations that the ECB may hike rates sooner than expected. GBP too gained by 2.8% as UK announced a slew of fiscal measures to tide over the cost-of-living crisis.

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Mixed outlook

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- **Commodity prices appear to have largely peaked, though oil & gas may remain elevated near term; India better placed to absorb volatility**
- **Global clean energy initiatives remain at the fore despite the Russia-Ukraine war; we continue to prefer domestic sectors**

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Nifty remains southbound: Indian equities underperformed major global benchmarks. RBI's surprise 40bps rate hike raised the cost of equity for Indian borrowers and put further pressure on the market. Amongst sectoral indices, auto, consumer and financials outperformed while commodities, realty and IT lagged. Our analysis of market behaviour during volatile phases indicates that auto, private banks and commodities typically beat the index when the market is emerging from a bottom (see our note: **Navigating index peaks and troughs**).

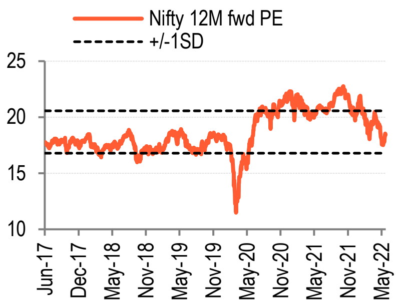
Centre announces measures to ease inflation: Excise duty was cut on petrol/diesel by Rs 8/Rs 6 and subsidies were raised on fertiliser and LPG. Export duty was imposed on iron ore and steel products and import duty was lowered on coal and coke. We maintain that commodity prices largely peaked in March this year. The run-up was clearly a result of supply still anchored to the pandemic while demand started returning to pre-pandemic levels. A better alignment of supply chains coupled with slowdown in China and rate hikes in the US have put downward pressure on commodity prices. Nevertheless, we believe oil & gas prices could remain elevated through to the winter, more so when the EU is now banning seaborne Russian oil imports in six months.

RBI's FY22 annual report optimistic on economy: The central bank believes the Indian economy is relatively better placed to sustain recovery post Covid. It cited strong domestic demand, robust reserve buffers, a buoyant FDI pipeline and proactive policies as factors that will help the economy withstand adverse global spillovers.

EU doubling down on climate targets: Contrary to market expectations that the ongoing Russia-Ukraine war would force the EU to go slow on its transition to clean energy, the region has doubled down on its green targets. The European Commission has announced a US$ 220bn plan to wean the EU away from Russian energy – only 5% of this fund is allocated for fossil fuel while the balance is for clean energy.

Outlook: We believe the Indian economy is poised for a resurgence as a favourable macro environment and key building blocks are in place (see our note: **India at takeoff point**). However, the trigger is likely to be a capex upcycle that is still a few quarters away. We continue to favour sectors linked to domestic as opposed to export demand.

Valuation now closer to 5Y average



Source: Bloomberg, BOBCAPS Research

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CONSUMER DURABLES

01 June 2022

FY22 Review: Margin gains elusive

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Multiple pressure points on margins: FY22 will be remembered as a year when margin gains proved elusive for consumer durable players as they grappled with the impacts of war, inflation, supply chain hurdles and the pandemic. If the first half of the year was marred by Covid-related stress, the second half saw raw material headwinds. The Russia-Ukraine conflict, supply shortages and logistical issues as well as the shutdown of key business and transportation hubs in China due to the Omicron wave all contributed to higher input costs for companies. Inflation, which has a direct impact on discretionary spending, topped this heady cocktail.

Commoditised businesses did better: Our analysis of subsegments within consumer durables shows that relatively commoditised businesses such as cables and wires have outperformed the brand- and distribution-led segments of appliances and light electricals. For the former, copper is a key input and players were able to pass on the rising prices, as evidenced by strong sales growth for companies such as HAVL and POLYCAB About 70-80% of the sales growth comes from pricing and the rest from volumes. In contrast, appliances players faced challenges – for example, in the AC space, BLSTR and Lloyd outpaced VOLT but only by sacrificing margins.

Pricing to pose a key challenge in FY23: The biggest challenge ahead for the consumer durables sector is striking the delicate balance of raising prices to combat raw material inflation without upsetting demand. Most managements are cautious on pricing. While some like VOLT and BLSTR have alluded to a small 3-5% range, others like Lloyd may refrain from hikes in order to sustain volume growth.

Prefer leaders in an inflationary scenario: Pricing power and cost management are crucial in a high-inflation environment as these factors will determine cash flow yields. We prefer leaders that have a demonstrable track record, viz. VOLT (BUY, TP Rs 1,250) and HAVL (BUY, TP Rs 1,500) among the durable names. POLYCAB (BUY, TP Rs 3,000) is our pick among cables and wires where pass-through is easier. In the contract manufacturing business, we like DIXON (BUY, Rs 4,600) for its business model.

Recommendation snapshot

Ticker	Price	Target	Rating
AMBER IN	2,633	3,500	HOLD
BLSTR IN	1,024	1,200	HOLD
CROMPTON IN	361	500	BUY
DIXON IN	3,859	4,600	BUY
HAVL IN	1,202	1,500	BUY
ORIENTEL IN	280	350	HOLD
POLYCAB IN	2,442	3,000	BUY
VGRD IN	234	250	HOLD
VOLT IN	1,018	1,250	BUY

Price & Target in Rupees | Price as of 31 May 2022

Consumer durables: Q4 result reviews

Company	Result review link
VOLT IN	Structural story intact
HAVL IN	Plenty of positives – BUY
DIXON IN	A play on PLI
POLYCAB IN	Wired for growth
CROMPTON IN	Prudent cost management aids Q4
BLSTR IN	Gunning for market share
ORIENTEL IN	Premiumisation is key
VGRD IN	Margin pressure continues
AMBER IN	Components business remains in focus

Source: BOBCAPS Research

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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