RESEARCH

BOB Economics Research | Policy Rates

Is there a link between Indian and US interest rates?

Tata Steel | Target: Rs 140 | +31% | BUY

Preferred pick as we look beyond volatility

SUMMARY

India Economics: Policy Rates

It has been observed that global monetary policy rates tend to move in tandem, with the US Fed generally leading the global rate cycle. In the present context of a synchronized global policy tightening effort in response to surging inflation, a regular talking point has been the magnitude of rate hikes. A similar sentiment also exists in the domestic market with investors/analysts alike assessing the possibility of rate hikes by the RBI, and more importantly the extent to which RBI might hike policy rates. Often it tends to get linked with the Fed even though it has been stated that the MPC looks at the global environment but takes decisions based on domestic considerations surrounding inflation.

Click here for the full report.

Tata Steel

- TATA exposed to slower pickup in China but we expect Chinese demand to stabilise over H2, providing support to regional margins
- Stock currently discounting EBITDA/t of Rs 127k-13.7k based on 5Y/10Y EV/EBITDA multiples – below mid-cycle levels
- Retain BUY with TP of Rs 140 (vs. Rs 170) based on reduced forecasts and cut in target EV/EBITDA to 5.5x (vs. 6x) to reflect economic uncertainty

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Daily macro indicators

Indicator	01-Aug	02-Aug	Chg (%)
US 10Y yield (%)	2.57	2.75	18bps
India 10Y yield (%)	7.24	7.20	(4bps)
USD/INR	79.03	78.71	0.4
Brent Crude (US$/bbl)	100	100.5	0.5
Dow	32,798	32,396	(1.2)
Hang Seng	20,166	19,689	(2.4)
Sensex	58,116	58,136	0.0
India FII (US$ mn)	**29-Jul**	**01-Aug**	**Chg ($ mn)**
FII-D	(56.4)	49.1	105.5
FII-E	185.1	675.4	490.3

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

POLICY RATES

03 August 2022

Is there a link between Indian and US interest rates?

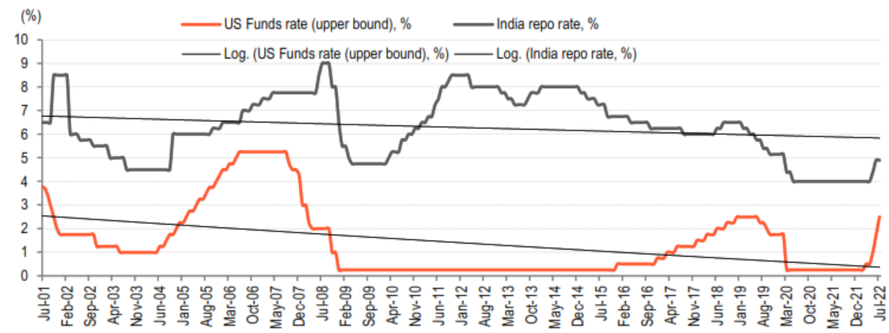
Aditi Gupta
Economist

It has been observed that global monetary policy rates tend to move in tandem, with the US Fed generally leading the global rate cycle. In the present context of a synchronized global policy tightening effort in response to surging inflation, a regular talking point has been the magnitude of rate hikes. A similar sentiment also exists in the domestic market with investors/analysts alike assessing the possibility of rate hikes by the RBI, and more importantly the extent to which RBI might hike policy rates. Often it tends to get linked with the Fed even though it has been stated that the MPC looks at the global environment but takes decisions based on domestic considerations surrounding inflation.

In this context, we assess the movement of Fed funds rate (upper bound) and RBI repo rate in the past two decades and attempt to draw patterns in the relationship between the two. If such a relation does exist, it can be extended to make conjectures on how the path of repo rate could shape up as the Fed's position becomes clearer.

Figure 1 below charts Fed policy rate with repo rate. Barring a few exceptions, repo rate closely follows the movement in the Fed policy rate. Further, while the magnitude of rate hike/cut may be different in the US and India, the general direction of monetary policy remains the same.

Figure 1: Fed fund rate versus RBI repo rate



Source: Bloomberg, Bank of Baroda Research | Note: Monthly figures are end-period

The table below provides the difference between Fed policy rate (upper bound) and RBI's policy rate since May 2001. We may exclude the period of post global financial crisis when the Fed rate was close to zero while there was a wide variation in the RBI policy rate during this period. The QE which was enforced in the US was not pursued in India as our economy was not buffeted by the financial crisis. This was the case with most of the emerging markets. Some observations are:

- Starting 2001 till the time when the Fed rate peaked at 5.25% in 2006-07, the average variation of our repo rate was around 325 bps.

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BUY
TP: Rs 140 | ⮝ 31%

TATA STEEL

| Metals & Mining | 03 August 2022

Preferred pick as we look beyond volatility

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Kirtan Mehta, CFA
research@bobcaps.in

Exposed to slowdown in China…: India's steel sector is directly exposed to developments in China which has a strong influence on regional pricing. With the latter's July PMI entering into a contraction zone, there is a possibility that demand pickup could take longer in China. This could put pressure on regional margins and pricing over the next quarter.

…but China to eventually provide support: We believe the Chinese government's efforts to accelerate infrastructure projects to offset economic weakness will yield results. While the real estate situation is difficult, a decline is likely to be arrested if the government succeeds in completing unfinished projects. With the election of the Chinese premier due in Mar'23, we believe the government has a strong incentive to stabilise the economy over H2CY22. This could help steady regional margins.

TATA also expects recovery in H2FY23: Management expects margin improvement from Q3FY23 as the benefit of lower coking coal costs would feed through the cost base. Demand growth will also be underpinned by a rebound in the auto segment given the easing of chip shortages and post monsoon pick-up in infrastructure projects.

Estimates cut on conservative basis: We now assume FY23/FY24 EBITDA/t of Rs 15.4k/Rs 16.9k for standalone operations including BPSL. With the ability to earn a premium via its integrated operations and strong B2C network, the company can deliver better margins than the US$ 200/t possible for the Indian industry, assuming China's gross margin settles at US$ 250, a 10Y historical average. The stock is currently discounting EBITDA/t of Rs 12.7k-13.7k based on 5Y/10Y multiples.

Maintain BUY: We cut our FY23/FY24 EBITDA estimates for TATA by 16%/5% and lower our target 1Y forward EV/EBITDA multiple to 5.5x (from 6.0x) to reflect global economic uncertainty. Our TP thus reduces to Rs 140 (from Rs 170). We maintain our rating at BUY given the company's healthy growth and margin profile. TATA is trading at 4.5x FY24E EV/EBITDA compared to its 5Y/10Y mean of 5.5x/5.7x.

Key changes

Target	Rating
▼	◄►

Ticker/Price	TATA IN/Rs 107
Market cap	US$ 16.4bn
Free float	66%
3M ADV	US$ 15.4mn
52wk high/low	Rs 153/Rs 83
Promoter/FPI/DII	34%/22%/20%

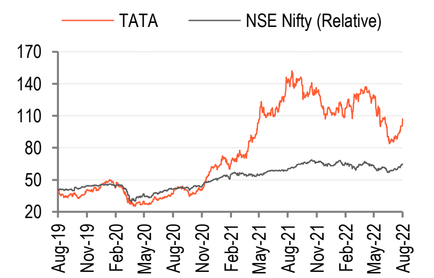
Source: NSE | Price as of 3 Aug 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	2,423	2,278	1,975
EBITDA (Rs mn)	635	432	400
Adj. net profit (Rs mn)	402	221	190
Adj. EPS (Rs)	33.2	18.3	15.7
Consensus EPS (Rs)	33.3	17.6	14.5
Adj. ROAE (%)	42.6	17.8	13.3
Adj. P/E (x)	3.2	5.8	6.8
EV/EBITDA (x)	3.4	4.5	4.5
Adj. EPS growth (%)	436.1	(44.9)	(14.2)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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