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FIRST LIGHT

04 September 2023

RESEARCH

BAJAJ FINANCE | TARGET: Rs 9,105 | +29% | BUY

From strength to strength – initiate with BUY

INDIA STRATEGY | MONTHLY CHARTBOOK

A month of consolidation but outlook remains positive

BOB ECONOMICS RESEARCH | BONDS WRAP

Fortnightly review

BOB ECONOMICS RESEARCH | CROP PRODUCTION

BoB Forecasts of kharif production

BOB ECONOMICS RESEARCH | CURRENCY OUTLOOK

Fortnightly forex review

BOB ECONOMICS RESEARCH | MONTHLY ECONOMIC BUFFET

Economic Round-up: August 2023

Daily macro indicators

Indicator	30-Aug	31-Aug	Chg (%)
US 10Y yield (%)	4.11	4.11	(1bps)
India 10Y yield (%)	7.19	7.16	(2bps)
USD/INR	82.73	82.79	(0.1)
Brent Crude (US$/bbl)	85.9	86.9	1.2
Dow	34,890	34,722	(0.5)
Hang Seng	18,483	18,382	(0.5)
Sensex	65,087	64,831	(0.4)
India FII (US$ mn)	**29-Aug**	**30-Aug**	**Chg ($ mn)**
FII-D	167.0	3.4	(163.6)
FII-E	95.9	1.2	(94.7)

Source: Bank of Baroda Economics Research

SUMMARY

BAJAJ FINANCE

- Momentum across consumer, commercial, SME and mortgage lending to propel a 28% AUM CAGR over FY23-FY25E
- Stellar record on asset quality (10Y GNPA at 1.1-1.8%); expect comfortable GNPA of 1.3%, credit cost of 1.7% over 2Y
- Seasoned management, solid execution to help fend off rivals; valuations have moderated as well – initiate with BUY, TP Rs 9,105

Click here for the full report.

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INDIA STRATEGY: MONTHLY CHARTBOOK

- Nifty 50 fell 2.5% in August, largely in line with other major global indices; Chinese Indices were the worst performers
- As we transition from Q1FY24 earnings, our analysis suggests results linked market momentum – positive or negative – is usually short lived
- We continue to prefer consumption and capital goods sectors, with a neutral stance on others, including IT

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INDIA ECONOMICS: BONDS WRAP

US 10Y yield has pared most of its increase in Aug'23 as major growth indicators remained patchy. Fed Chair's speech though remained hawkish, market is anticipating higher probability of a hawkish pause in the Sep'23 policy meet. Domestic 10Y yield remained stable. Some comfort came from slower pace of increase in high frequency data on prices in Aug'23 coupled with government's supply side measures. However, short end part of the curve reacted spontaneously to the underlying liquidity conditions. Mandate of incremental CRR together with monthly GST outgo have resulted in liquidity moving into deficit for the time this fiscal.

Click here for the full report.

INDIA ECONOMICS: CROP PRODUCTION

Past data indicates that over 90% of kharif sowing is completed by August end. Based on this data point we have estimated the kharif production for this year under certain assumptions, and the picture emerging from this analysis is mixed. A pickup in rice sowing has ensured that rice output is likely to improve marginally this year. This will be a relief as cereals inflation has been a concern in the last few months. On the other hand, production of pulses is estimated to fall as it looks unlikely that the sowing area will change significantly going ahead. In case of oilseeds and cash crops such as sugarcane, production is estimated to be only slightly higher than last year.

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INDIA ECONOMICS: CURRENCY OUTLOOK

After depreciating to a record-low during the month, INR made a smart recovery to end the month only marginally lower. Pressure on the currency has come from worsening global backdrop of a strengthening dollar and elevated oil prices. RBI intervention helped the currency pair to limit losses. Unsurprisingly, INR was amongst the best performing Asian currency in Aug'23, despite a 1.7% increase in DXY. Elevated oil prices and a moderation in FPI inflows are likely to weigh on INR in the near-term. Fed rate trajectory will be contingent on incoming data and the US jobs report due later in the day will shed more light on the same. Against this backdrop, we expect INR to trade in the range of 82.5-83/$ in the next fortnight.

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INDIA ECONOMICS: MONTHLY ECONOMIC BUFFET

Macro data points from the US, Europe and China and are showing that weakness in manufacturing and services activity still persists. Further conditions in Europe (Eurozone and UK) seem to be deteriorating faster than that in the US. German economy stagnated in Q2, and PMIs have hit rock bottom. To reignite growth, federal government has even announced €32bn tax cut program spread over 4 years. In the US, while initial jobless claims data suggests tightness in labour market still persists, new job openings have reduced.

Click here for the full report.

BUY
TP: Rs 9,105 | ⮝ 29%

BAJAJ FINANCE | NBFC | 01 September 2023

From strength to strength – initiate with BUY

- **Momentum across consumer, commercial, SME and mortgage lending to propel a 28% AUM CAGR over FY23-FY25E**
- **Stellar record on asset quality (10Y GNPA at 1.1-1.8%); expect comfortable GNPA of 1.3%, credit cost of 1.7% over 2Y**
- **Seasoned management, solid execution to help fend off rivals; valuations have moderated as well – initiate with BUY, TP Rs 9,105**

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Diverse, high-growth portfolio: BAF has delivered a robust 25% AUM CAGR to Rs 2.5tn over FY18-FY23, scaling up to 69mn customer accounts from 26mn. In line with guidance of 29-31% growth in FY24 and 25-27% long term, we forecast a 28% AUM CAGR to Rs 4tn over FY23-FY25, lifted by buoyancy across consumer loans (42% of AUM), mortgage (31%), SME (14%) and commercial lending (13%). Mortgages, having risen 28% on average over five quarters, will be a key factor to growth. BAF continues to enrich its slate, entering new car financing in Q1FY24 and aiming for microfinance in Q4FY24 and tractor financing the following year.

Best-in-class asset quality: For the past decade, BAF has contained GNPA between 1.1% and 1.8%, achieving sub-1% levels in FY23. Considering its seasoned management team and disciplined record, we expect comfortable GNPA at 1%/1.3% and NNPA at 0.4%/0.5% for FY24/FY25 despite the planned entry into higher risk segments. Credit cost too has held below peers at 1.5% on average for FY13-FY19, though the Covid years were outliers before the company returned to form in FY23. We conservatively bake in a creeping rise in cost to 1.6%/1.7% for FY24/FY25.

Return ratios buoyant despite slim margins: Barring the turbulent Covid period, the company has delivered a consistent step up in return ratios over the past 10 years. Accounting for a rising cost of funds in a high rate environment, we project a 40bps fall in NIM from 10.6% in FY23 to 10.2% in FY25. Even so, ROAE is forecast to rise from 23.5% to 24.8% over the same period as rapid business expansion and cost control likely improve operating leverage and lower C/I ratio from 35.1% to 33.1%.

Valuations have moderated; BUY: BAF's veteran leadership team, diversified business model and effective execution should enable it to weather rising competition and fend off asset quality risks in proposed businesses such as microfinance. We, therefore, value the standalone business at 6.6x FY25E ABV – a 20% premium to the long-term average – for a value of Rs 8,619/sh. The addition of Rs 482/sh for housing arm BHFL (2x FY25E BV) and Rs 4/sh for securities subsidiary BFSL (15x FY25E EPS) yields an SOTP-based TP of Rs 9,105. We initiate coverage on BAF with a BUY rating for 29% upside from the current price.

Ticker/Price	BAF IN/Rs 7,163
Market cap	US$ 16.5bn
Free float	44%
3M ADV	US$ 84.3mn
52wk high/low	Rs 8,000/Rs 5,486
Promoter/FPI/DII	56%/20%/13%

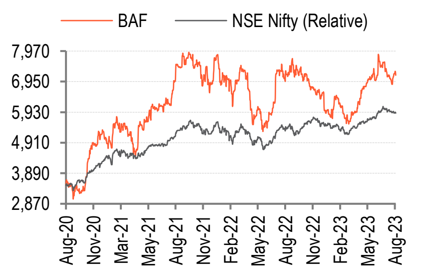
Source: NSE | Price as of 31 Aug 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
NII (Rs mn)	2,29,903	2,85,451	3,63,124
NII growth (%)	31.2	24.2	27.2
Adj. net profit (Rs mn)	1,15,077	1,44,966	1,85,079
EPS (Rs)	189.6	238.7	304.8
Consensus EPS (Rs)	189.6	233.0	290.0
P/E (x)	37.8	30.0	23.5
P/BV (x)	8.0	6.5	5.3
ROA (%)	4.7	4.6	4.6
ROE (%)	23.5	23.9	24.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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MONTHLY CHARTBOOK | Volume #13 | 01 September 2023

A month of consolidation but outlook remains positive

- **Nifty 50 fell 2.5% in August, largely in line with other major global indices; Chinese Indices were the worst performers**
- **As we transition from Q1FY24 earnings, our analysis suggests results linked market momentum – positive or negative – is usually short lived**
- **We continue to prefer consumption and capital goods sectors, with a neutral stance on others, including IT**

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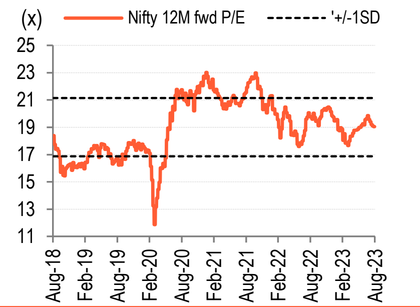
Nifty50 largely in line with global indices in August, but remains a laggard YTD: Most major global indices were under pressure during August with Chinese indices among the worst performing indices. Hang Seng and Shenzhen were down 8% and 6.5% respectively. S&P500 was down 1.6% while Nifty50 was down 2.5%. With this correction, now the one year forward PE multiple for Nifty50 is in line with its 5y average, which implies a fair valuation. Nfty50, up 6.3% YTD, has lagged the double-digit returns of other major indices.

Mid & small caps maintained momentum but most sectoral indices in red: Nifty mid & small cap indices were up ~4% during August. Nifty IT had a 3% recovery indicating bottoming out of the sector. Pharma sector also had a modest recovery given expectation of a milder pricing pressure in generic medicines in USA. That said, weakening INR also played part in the two sectors' recovery. Most other major sectors had negative return over the month though. Mid & Small cap funds continue to see disproportionately higher inflow which has created its own cycle of outperformance and resultant inflow.

Result-led market momentum short-lived: We further analysed the change in Nifty 50 P/E from start to finish of each quarterly result season for the past five years (Chart 1) and evaluated its correlation with market movement in each subsequent non-result period. We found 10 instances of expansion in one-year forward P/E multiple and 10 of contraction during earnings. However, the absolute index movement in the following non-result periods showed no correlation with earnings season valuation momentum (correlation coefficient of less than 0.11). Moreover, the valuation change during the Q1FY24 results (increase of 0.027 from 1-Jul to 15-Aug) was the lowest in five years.

Investment view: We remain constructive on the consumer and capital good sectors given their domestic focus, while staying largely neutral on other sectors. The Nifty 50's fair valuation in our view will likely mean that market will largely move in line with its nominal earnings growth for rest of CY23.

Nifty valuation close to 5Y average



Source: Refinitiv, BOBCAPS Research

BONDS WRAP

01 September 2023

Fortnightly review

Dipanwita Mazumdar
Economist

US 10Y yield has pared most of its increase in Aug'23 as major growth indicators remained patchy. Fed Chair's speech though remained hawkish, market is anticipating higher probability of a hawkish pause in the Sep'23 policy meet. Domestic 10Y yield remained stable. Some comfort came from slower pace of increase in high frequency data on prices in Aug'23 coupled with government's supply side measures. However, short end part of the curve reacted spontaneously to the underlying liquidity conditions. Mandate of incremental CRR together with monthly GST outgo have resulted in liquidity moving into deficit for the time this fiscal.

We expect India's 10Y yield to remain in the range of 7.15-7.25% in the current month. Liquidity would continue to remain under pressure till RBI reviews the position on maintaining incremental CRR by banks. If RBI continues to extend the decision beyond 8th Sep, we might see some sell off in the short part of the curve.

Broadly sell off in global bond market continued in Aug'23:

- US 10Y yield has pared most of the increase seen post release of Fed minutes. Till 17 Aug'23, US 10Y yield have risen by 32bps when compared to 31 Jul'23. However, it ended only 15bps higher for the full month of Aug'23. This was on account of a moderate GDP data in Q2 (2.1%, annualized QoQ against estimate of 2.4%), core PCE data also remained in line with expectations. However, labour market data is giving mixed signals with private payroll and jobless claims showing different picture albeit remaining tighter. The probability of a pause under these conditions have been raised to 89% by market participants which was 80% a week earlier.
- Bond sell off was witnessed in emerging economies with Thailand 10Y yield rising at the sharpest pace by 16bps. This was on account of policy rate being raised to its 9-year high of 2.25%.
- In Germany, deterioration in business conditions, flat growth in Q2 and in line CPI led to its 10Y yield close a tad bit lower. Even moderation in Eurozone core inflation has resurfaced the debate of whether rate hike cycle is nearing its end or not.
- China's 10Y yield fell by 8bps as more stimulus is expected on the back of weakening growth indicators (manufacturing PMI, exports, retail sales).

CROP PRODUCTION

01 September 2023

BoB Forecasts of kharif production

Dipanwita Mazumdar | Aditi Gupta
Economist

Past data indicates that over 90% of kharif sowing is completed by August end. Based on this data point we have estimated the kharif production for this year under certain assumptions, and the picture emerging from this analysis is mixed. A pickup in rice sowing has ensured that rice output is likely to improve marginally this year. This will be a relief as cereals inflation has been a concern in the last few months. On the other hand, production of pulses is estimated to fall as it looks unlikely that the sowing area will change significantly going ahead. In case of oilseeds and cash crops such as sugarcane, production is estimated to be only slightly higher than last year.

This has also been reflected in domestic prices, with prices of almost all major commodities witnessing upward momentum. Swift supply side interventions from the government have helped in keeping price pressures from spiraling, but risks remain from de-anchoring of inflation expectations. We continue to maintain our inflation forecast for FY24 at 5.5%, but do see upside risks.

The foregoing analysis first looks at the state of the monsoon which is a major factor driving agricultural production. Next, the stocks of rice with the government is analyzed as it has a bearing on the price sentiment in the market which in turn gets reflected in the cereals inflation picture. At the third stage, the price movements are analyzed with focus on changes over May, which is just before the monsoon arrives. This is important as the market provides some signals on the state of the output for various crops. When there are expectations of shortfalls, it gets reflected in the spot prices even though the present stock levels are comfortable. In a way, the market prices signal expected output on most occasions given that production was normal/higher last year. Last, we provide our forecasts of kharif crops this year based on certain assumptions.

Rainfall deficit increasing which is a concern and adds to negative sentiment:

The monsoon this year has played truant and after a rather satisfying month in July dropped off in August with the overall cumulative deficit now being at around 10% of LPA. The monsoon pattern has been quite erratic and while 10 met divisions have recorded deficient rainfall so far, the spread across districts has been uneven. Heavy rains in Jul'23 have been followed by arid conditions in Aug'23, and hence the crop prospects could have been affected. It is assumed here that there has been no adverse effects as that can be known only after a survey is undertaken.

Stocks of rice with the FCI steady, but lower than in the past:

What poses a concern is that though rice stocks are comfortably above the buffer norms, it is still the lowest in past 5 years (Figure 2.). The level of 24.3 mn tonnes though higher than the buffer stock norms is the lowest in the last 5 years as of August 2023.

CURRENCY OUTLOOK

01 September 2023

Fortnightly forex review

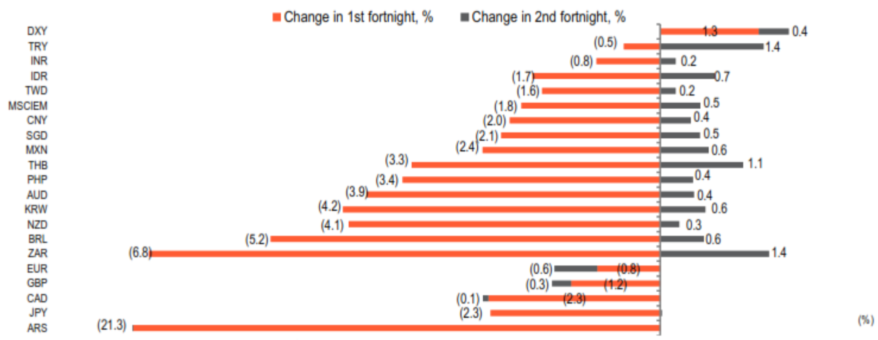
Aditi Gupta
Economist

After depreciating to a record-low during the month, INR made a smart recovery to end the month only marginally lower. Pressure on the currency has come from worsening global backdrop of a strengthening dollar and elevated oil prices. RBI intervention helped the currency pair to limit losses. Unsurprisingly, INR was amongst the best performing Asian currency in Aug'23, despite a 1.7% increase in DXY. Elevated oil prices and a moderation in FPI inflows are likely to weigh on INR in the near-term. Fed rate trajectory will be contingent on incoming data and the US jobs report due later in the day will shed more light on the same. Against this backdrop, we expect INR to trade in the range of 82.5-83/$ in the next fortnight.

Movement in global currencies

After a tumultuous start to the month, the second half was marked by relative calmness in the global forex market. The sudden and unexpected wave of dollar rally pushed global currencies lower in the first fortnight of the month. Stronger than expected US macro data has reinforced views of possibly more rate hike(s) by the Fed. This was also reiterated by the Fed Chair and other Fed officials. However, data released since then has shown that claims about the resilience of the US economic strength may have been exaggerated. Downward revision to Q2 growth estimates, weak private payrolls, sluggishness in housing sector etc. have reinforced views that previous rate hikes may have percolated into the real economy. With incoming data painting a mixed picture, the future trajectory of Fed has become uncertain. While DXY gained 1.3% in the first fortnight of Aug'23, its gains in the second half of the month were more modest at 0.4%.

Figure 1: Fortnightly currency movement in Aug'23



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 31 Aug 2023

Despite some reversal in the second fortnight, most global currencies ended the month lower against the dollar. Amongst major currencies, JPY continued to be the worst hit as the policy divergence between Fed and BoJ is unlikely to correct anytime soon.

MONTHLY ECONOMIC BUFFET

01 September 2023

Economic Round-up: August 2023

Sonal Badhan
Economist

Macro data points from the US, Europe and China and are showing that weakness in manufacturing and services activity still persists. Further conditions in Europe (Eurozone and UK) seem to be deteriorating faster than that in the US. German economy stagnated in Q2, and PMIs have hit rock bottom. To reignite growth, federal government has even announced €32bn tax cut program spread over 4 years. In the US, while initial jobless claims data suggests tightness in labour market still persists, new job openings have reduced.

As a result consumer confidence has also taken a hit. Further, weakness in global demand is hampering China's export growth as it fell sharply (most since Covid-19 period) in Jul '23. This is also trickling down to moderation in industrial activity and investment growth. Going ahead, major central banks are likely to take faltering growth into account and slowdown the pace of rate hikes/pause. However, revival in inflationary pressures and Europe, and elevated levels of prices in UK, may push BoE and ECB to hike rates further this month.

Global growth: Global growth continues to remain on shaky grounds as more and more indicators are signalling that real activity is getting dented. While pace of contraction of manufacturing activity seems to have slowed in Eurozone and China, it continues to deteriorate at a faster pace in US and UK. Despite this, Eurozone's manufacturing sector remains worse hit and now services activity has also begun to contract. In UK, real data points (PMIs, mortgage approvals, retail sales) are faltering while nominal data points (tax collections) continue to show a better picture owing to higher levels of inflation. For quarter ending Jun'23, while Germany was the worst performing major economy, India was the fastest growing major economy.

Global Central Banks: In Jul'23, BoE, Fed, and ECB hiked rates by 25bps each. RBA decided to hold rates unchanged in Aug'23 as well. All major central banks are due to announce their decisions in Sep'23. Fed is likely to stand pat in both Sep'23 and Nov'23, as core PCE price index is following Fed's desired trajectory and labour market is also showing signs of cooling down. In case of BoE and ECB, uncertainties persists. In Eurozone, inflation has begun to inch up again in Aug'23 and in UK prices still remain elevated and risks from wage increase persists. However, slowdown in economic activity is exerting pressure on them to opt for a hawkish pause. Analysts expect ECB to hike rates one more time in CY23 (Sep or later) and BoE will have a longer road ahead before it can pause.

Key macro data releases: India's GDP rose by 7.8% in Q1FY24, following 6.1% growth in Q4FY23, thus remaining the fastest growing major economy. Support to growth was provided by private consumption and investment. Sector-wise, financial & real estate sector, trade, transport etc, and public administration and defence spending provided major boost to GDP in Q1.

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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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