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12 June 2023

RESEARCH

BOB ECONOMICS | MONTHLY CHARTBOOK

Hawkish pause; monsoon to hold key

OIL & GAS

Ceramics expert call: Expect Morbi gas volume recovery in H2

IT SERVICES | Q4FY23 REVIEW

Macro headwinds prompt us to stay selective

SUMMARY

INDIA ECONOMICS: MONTHLY CHARTBOOK

India's GDP data confirmed that economic growth remains on firm ground. RBI in its latest policy also reaffirmed its bullish outlook on growth and expects the strength to continue in Q1FY24 as well. High frequency data for May'23 (port cargo, vehicle registration, toll collections, PMIs, air passenger traffic) supports this. RBI also cautioned that it will closely monitor the price trajectory, as it aims to bring back inflation to targeted 4%. This slightly hawkish stance led to marginal increase in 10Y yield. Globally as well, central banks are sounding hawkish alarm bells (RBA, Central Bank of Canada). All eyes are now on Fed, which is likely to pause in Jun'23. Oil prices remain range bound as concerns of slowing global demand outweigh benefits from production cut by OPEC+ members.

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OIL & GAS

- Slow start for the ceramics sector in FY24 but export traction, big projects and demand for large tiles to support revenue growth
- Morbi gas demand remains under pressure from lower utilisation in the ceramics industry and strong competition from propane
- Medium-term outlook for Morbi gas demand still healthy given a likely doubling of tile exports over the next 3-4 years

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Daily macro indicators

Ticker	07-Jun	08-Jun	Chg (%)
US 10Y yield (%)	3.80	3.72	(8bps)
India 10Y yield (%)	6.98	7.02	4bps
USD/INR	82.55	82.57	0.0
Brent Crude (US$/bbl)	77.0	76.0	(1.3)
Dow	33,665	33,834	0.5
Hang Seng	19,252	19,299	0.2
Sensex	63,143	62,849	(0.5)
India FII (US$ mn)	**06-Jun**	**07-Jun**	**Chg ($ mn)**
FII-D	1.5	18.1	16.5
FII-E	134.5	175.0	40.5

Source: Bank of Baroda Economics Research

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IT SERVICES: Q4FY23 REVIEW

- Demand remains affected by slower decision-making, caution around spending and project ramp-downs
- Focus on cost optimisation projects to continue until clients see a better economic turnaround
- Retain our preference for INFO within large-caps and PSYS & COFORGE within mid-cap IT

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Hawkish pause; monsoon to hold key

India's GDP data confirmed that economic growth remains on firm ground. RBI in its latest policy also reaffirmed its bullish outlook on growth and expects the strength to continue in Q1FY24 as well. High frequency data for May'23 (port cargo, vehicle registration, toll collections, PMIs, air passenger traffic) supports this. RBI also cautioned that it will closely monitor the price trajectory, as it aims to bring back inflation to targeted 4%. This slightly hawkish stance led to marginal increase in 10Y yield. Globally as well, central banks are sounding hawkish alarm bells (RBA, Central Bank of Canada). All eyes are now on Fed, which is likely to pause in Jun'23. Oil prices remain range bound as concerns of slowing global demand outweigh benefits from production cut by OPEC+ members.

Demand continues to showcase resilience: Robust consumption demand was registered in Q1FY24 as reflected by high frequency indicators including, auto sales, manufacturing PMI (31-month high) and domestic air passenger traffic. UPI payments remained steady, though deceleration in electricity demand and non-oil-non-gold imports will be monitored. RBI's consumers confidence index signalled optimism. On rural front, two wheeler sales recorded double digit growth (MoM). Government hiked MSP of all the crops, in the range of 5-10%, with the exception of cotton. With the arrival of monsoon, focus is expected to shift towards distribution of rainfall.

Centre's finances: Union government managed to meet its fiscal deficit (% of GDP) target of 6.4% for FY23, supported by better than expected revenue growth, and despite miss in disinvestment target. Overshooting of expenditure by certain ministries (subsidy bill, finance), was met by cuts in other ministries (agri, rural development.). In FY24, statistical base is at play, resulting in negative revenue growth in Apr'23 Gross tax revenues are down by (-) 6.1% versus 36.5% increase in Apr'22 and net revenue is down by (-) 13.9% versus 41.1% increase in Apr'22. For the same reason, expenditure growth is also showing moderation (10.6% in Apr'23 versus 21.2% in Apr'22). Capex is down by (-) 0.6% versus 67.5% jump recorded in Apr'22. On the other hand, revenue spending seems to be holding ground, registering 15.2% increase following 9.1% rise in Apr'22.

India's 10Y yield to remain rangebound: India's 10Y yield fell by 13bps in May'23, whereas global yields were on an upswing especially UK and US as macro signals gave confusing view on rate trajectory. In Jun'23, India's 10Y yield rose by 3bps, especially post policy increase was seen as Governor's tone reflected a hawkish pause. Cautiousness reined over inflation while bullishness on growth prevailed. We no longer foresee rate cut in Q3FY24. The earliest possibility of cut has now shifted to Feb'24. We expect India's 10Y yield to remain in the range of 6.95-7.05% in the current month. Downside risk may persist from a comfortable CPI print in May'23 (our est.: 4.5%).

INR likely to remain range-bound: In May'23, INR was under pressure amidst uncertainty around the Fed policy. This was despite lower oil prices and resurgent FPI inflows. Support also came from likely FX intervention by the RBI, which helped keep INR in a tight range, even as DXY rose by 2.6% in May'23. In Jun'23, with investors paring back expectations of a rate hike by Fed, dollar strength has once again come under question. Oil prices have also remained stable despite output cut by OPEC+. FPI inflows have also continued. Hence, we expect INR to continue to trade in the range of 82-83/$ in the near-term.

Note: The source for all exhibits is 'CEIC and Bank of Baroda' unless otherwise specified

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OIL & GAS

09 June 2023

Ceramics expert call: Expect Morbi gas volume recovery in H2

- **Slow start for the ceramics sector in FY24 but export traction, big projects and demand for large tiles to support revenue growth**
- **Morbi gas demand remains under pressure from lower utilisation in the ceramics industry and strong competition from propane**
- **Medium-term outlook for Morbi gas demand still healthy given a likely doubling of tile exports over the next 3-4 years**

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We interacted with Tapan Jena, founder of SANVT Ceramics, to gain a perspective on the ceramic industry and natural gas outlook for Morbi (Gujarat). Key takeaways:

Domestic market seeing short-term slowdown but will deliver growth: The domestic ceramic market has begun on a slow note in FY24 with below-expected volume growth in April-May and continuing price reduction in larger tiles. The market is expected to turn around with support from big-ticket projects in FY24 and a pickup in exports.

Branded players at an advantage: The reduction in branded-to-unbranded price differential with the easing of costs has helped level the playing field with the unorganised Morbi ceramics industry. Branded players are less affected by price reduction and are still likely to deliver value growth from higher sale volumes of bigger size tiles.

Exports have started improving: The past 15-20 days have seen export traction, but price pressure continues. The export market is still likely to deliver double-digit revenue growth for FY24 and is expected to double over 3-4 years.

Morbi industry needs 3-4 months to recover: Morbi players are yet to regain dealers' trust after multiple price cuts last year. Plant utilisation remains below 70% and competition is still high with 35-40 units newly commissioned in FY23 attempting to gain market share. The Morbi industry should also recover in 3-4 months with support from big-ticket domestic projects and export revival.

Morbi propane usage still high: Despite the sharp fall in natural gas prices since April, propane remains competitive and usage remains high. Propane prices will act as a cap on natural gas with nearly 70% of the Morbi ceramics cluster by volume having the ability to switch between propane and natural gas.

Read-across for Gujarat natural gas players: Recovery in Morbi gas demand is more likely in H2FY24 as the ceramic industry is still working to regain domestic market share. Though natural gas demand has come off Q4 lows, propane still poses stiff competition. The medium-term outlook remains strong with exports expected to accelerate.

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IT SERVICES | Q4FY23 Review | 09 June 2023

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Weak Q4: Tier-1 IT services companies reported poor Q4FY23 revenue growth of -3.2% to 0.6% QoQ CC, impacted by a sequential decline in the communication and tech verticals. Revenues from the Americas and Europe fell, indicating weakness in both regions. Despite a disappointing Q4, aggregate growth for mid-sized firms was marginally higher than that of large IT firms. TCS and COFORGE disappointed the least while INFO underperformed the most.

Headwinds to continue; retail & CPG only bright spots: Earnings commentary from IT companies confirmed the dull demand environment and cuts in discretionary IT spends. While deal bookings were supported by cost takeout, efficiency and maintenance contracts, revenue growth was hit by project deferrals, delayed ramp-ups and project cancellations. IT firms have turned comparatively more cautious on the pricing environment. In Q4, Europe performed better than the US as sentiment worsened in America (~60% of aggregate revenue). IT firms highlighted weakness in the communication, tech, BFSI and manufacturing verticals, but outperformance in retail & CPG.

Muted growth guidance: IT firms expect a soft H1FY24 as evident from WPRO's Q1FY24 guidance of -3 to -1% QoQ CC revenue growth. A declining headcount and cautious pricing outlook suggest sharp moderation in FY24 – also evident from the full-year revenue growth guidance of 4-7%/6-8% from INFO/HCLT and -3% to -1% from WPRO. A weak exit from FY23 and soft H1 portend a comparatively subdued H2, in line with consensus dollar revenue growth expectations of 7% in FY24, which can be bettered only in the event of large deal wins/ramp-ups.

Prefer select tier-I and mid-cap players: We expect INFO and HCLT to deliver on the midpoint of their topline guidance band and anticipate greater downside risk in the near term rather than the medium term. We maintain our preference for INFO (Rs 1,760, BUY) within large-caps and PSYS (TP Rs 5,330, BUY) & COFORGE (Rs 4,830, BUY) within mid-cap IT.

Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	1,002	1,110	BUY
COFORGE IN	4,386	4,830	BUY
HCLT IN	1,127	1,240	BUY
INFO IN	1,283	1,760	BUY
MPHL IN	1,864	2,541	BUY
PSYS IN	4,926	5,330	BUY
TCS IN	3,236	3,580	HOLD
TECHM IN	1,071	1,130	HOLD
WPRO IN	400	420	HOLD

Price & Target in Rupees | Price as of 8 Jun 2023

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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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