FIRST LIGHT

21 January 2022

RESEARCH

Automobiles

2Ws - Pent-up demand push but electrification a challenge

India Strategy | FY23 Budget Preview

Trade-off between growth and consolidation

BOB Economics Research | FY22 Fiscal Review

Fiscal consolidation to take a hit

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.86	(1bps)	46bps	78bps
India 10Y yield (%)	6.60	(3bps)	18.9bps	68bps
USD/INR	74.43	0.2	2.2	(1.9)
Brent Crude (US$/bbl)	88.44	1.1	20.3	57.7
Dow	35,029	(1.0)	(1.0)	12.3
Shanghai	3,558	(0.3)	(2.0)	(0.7)
Sensex	60,099	(1.1)	5.4	20.7
India FII (US$ mn)	**18-Jan**	**MTD**	**CYTD**	**FYTD**
FII-D	50.3	420.7	420.7	923.0
FII-E	(80.2)	(297.4)	(297.4)	(3,862.6)

Source: Bank of Baroda Economics Research

SUMMARY

Automobiles

- Pent-up demand to buoy 2W volumes in FY23E but sales likely to peak within the next decade going by trends in other emerging markets
- Electrification set to become pervasive, fanning competition from new players; scooters to be harder hit than motorcycles
- Prefer motorcycle players BJAUT and HMCL which we upgrade to BUY; raise EIM and TVSL to HOLD from SELL

Click here **for the full report.**

India Strategy: FY23 Budget Preview

- Given an improving Covid-19 situation, expect a path towards normalisation of deficit targets
- Focus likely to be on manufacturing, rural and urban infrastructure, agriculture, healthcare and digital education
- FY23 Union Budget, though important for the economy, is unlikely to be a significant market-moving event near term, in our view

Click here **for the full report.**

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India Economics: FY22 Fiscal Review

Despite a higher than projected nominal GDP growth and pick up in revenues, we except fiscal deficit in FY22 to come at 7%. This will be 0.2% higher than BE of 6.8%, mainly owing to shortfall in disinvestment receipts and higher than projected spending. We expect net and gross borrowing to remain unchanged from FY22BE and deficit will be financed through higher short-term borrowings/dip into NSSF funds. Budget for FY23 will also be significant keeping in view of upcoming major state elections.

Click here for the full report.

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AUTOMOBILES

20 January 2022

2Ws: Pent-up demand push but electrification a challenge

- **Pent-up demand to buoy 2W volumes in FY23E but sales likely to peak within the next decade going by trends in other emerging markets**
- **Electrification set to become pervasive, fanning competition from new players; scooters to be harder hit than motorcycles**
- **Prefer motorcycle players BJAUT and HMCL which we upgrade to BUY; raise EIM and TVSL to HOLD from SELL**

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Recommendation snapshot

Ticker	Price	Target	Rating
BJAUT IN	3,309	4,231	BUY
EIM IN	2,734	2,981	HOLD
HMCL IN	2,709	3,191	BUY
TVSL IN	636	681	HOLD

Price & Target in Rupees | Price as of 20 Jan 2022

2W sales to recover but may peak within the next decade: We expect domestic two-wheeler sales growth to rebound to ~10% YoY in FY23 and FY24, after two years of weakness owing to regulatory shifts that drove price inflation coupled with the Covid-led economic slowdown. However, as India's per capita income rises, we believe 2W traction could slow. India's East Asian neighbours crossed peak 2W sales a decade ago when their GDP per capita stood at US$ 1,500-3,800. India (US$ 2,100) may near the top end of this range within the next 10 years, translating to muted 2W volume growth of sub-5% per year, in our view.

Electrification inevitable: Electrification is likely to take off strongly in 2Ws, in line with trends seen in other developing countries such as China. EV cost economics have improved significantly, helped by government subsidies and high petrol prices. New business models such as the use of rented batteries could also bring down upfront costs. Existing 2W OEMs need to embrace electrification or risk losing share to new players. In the case of three-wheelers, electrification has reached 30% in recent months but competitors are fewer, giving existing players more time to electrify.

Motorcycle electrification moving slower: Motorcycle players are better protected against the EV transition vs. scooters in the near term as there are only a handful of electric models in this category. Globally as well, motorcycle electrification has moved at a relatively slower pace.

Export markets remain robust: The market for 2W exports remains robust and we expect sustained demand from key geographies for the foreseeable future.

Upgrade BJAUT & HMCL to BUY: We upgrade BJAUT (from SELL) and HMCL (from HOLD) to BUY as both players have higher exposure to motorcycles (less impacted by electrification) and are also the cheapest stocks in our auto OEM coverage. We raise TVSL from SELL to HOLD as it will benefit from recovery, but its higher scooter sales put it at relatively higher risk from electrification. TVSL is also among the most expensive OEMs in our coverage. We raise EIM from SELL to HOLD as we expect its sales to rebound. EIM is likely to be the least affected by electrification in our 2W coverage but the stock is at its peak valuation.

FY23 BUDGET PREVIEW

20 January 2022

Trade-off between growth and consolidation

- **Given an improving Covid-19 situation, expect a path towards normalisation of deficit targets**
- **Focus likely to be on manufacturing, rural and urban infrastructure, agriculture, healthcare and digital education**
- **FY23 Union Budget, though important for the economy, is unlikely to be a significant market-moving event near term, in our view**

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Last two budgets were growth-oriented: Last year's union budget had a twin focus on kick-starting the capex cycle and improving health infrastructure amid a slowdown in private capex. The large capex outlay during the FY21 and FY22 budgets pegged fiscal deficits at 9.5% and 6.8% respectively. We also observed recurring underlying themes related to infrastructure, local manufacturing, ease of doing business, and ease of living as envisioned in the 'minimum government, maximum governance' strategy.

FY23 budget likely to juggle growth and consolidation: Given the low incidence of hospitalisation in the third Covid wave, we believe the government will likely feel more confident in normalising deficit targets. However, the focus on ease of doing business, improving healthcare, reforming agriculture and augmenting digitisation will likely continue. We provide a list of industry expectations from the FY23 budget (fig 1) – we also expect allocation of resources for online rural education, further rationalisation of customs duty framework as also indicated in the FY22 budget and more sops for affordable housing (vs. the industry's demand for a blanket increase in tax deduction on home loan interest from Rs 200,000 to Rs 500,000).

Sectors likely to attract the spotlight: We expect a sustained spotlight on infrastructure, including roads. Given the government's emphasis on ease of living, we anticipate further greenfield and brownfield expansion of the metro network. Healthcare and agriculture will remain at the fore. We see an increasing thrust on clean energy and renewables but with the underlying intention of increasing domestic capacity. Given impending state elections, an increase in personal tax rate looks unlikely, which will be neutral-to-positive for consumption sectors.

Short-term market reaction unpredictable: We analysed Nifty returns over the last 10 years for a period starting a week before budget day and ending a week after (Fig 2). There were just three instances of movement greater than 5% during this period (two upmoves and one decline), but in all three cases, we noted directionally similar movements in the S&P500 index too. We, therefore, believe a short-term speculative position on the basis of a likely budget outcome is best avoided.

Returns from 1W pre- to 1W post-budget date

Budget date	Nifty returns (%)	S&P500 returns (%)
01-Feb-21	6.85	3.63
01-Feb-20	(0.17)	2.59
05-Jul-19	(2.38)	1.20
01-Feb-19	3.83	2.35
01-Feb-18	(5.87)	(6.02)
01-Feb-17	1.47	(0.16)
29-Feb-16	5.29	4.10
28-Feb-15	2.09	(0.41)
10-Jul-14	(1.64)	(0.42)
17-Feb-14	1.53	0.91
28-Feb-13	(0.54)	1.71
16-Mar-12	(2.45)	1.58
28-Feb-11	1.27	0.43

Source: BOBCAPS Research, Bloomberg

FY22 FISCAL REVIEW

20 January 2022

Fiscal consolidation to take a hit

Despite a higher than projected nominal GDP growth and pick up in revenues, we except fiscal deficit in FY22 to come at 7%. This will be 0.2% higher than BE of 6.8%, mainly owing to shortfall in disinvestment receipts and higher than projected spending. We expect net and gross borrowing to remain unchanged from FY22BE and deficit will be financed through higher short-term borrowings/dip into NSSF funds. Budget for FY23 will also be significant keeping in view of upcoming major state elections.

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FY22 fiscal deficit at 7%: With a 17.6% increase in nominal GDP, Centre's net revenues are estimated to rise by 18.4% to Rs 19.3tn (8.3% of GDP) instead of BE of Rs 17.9tn (8% of GDP). Spending is also likely to increase by 4.7% in FY22 to Rs 36.8tn (15.8% of GDP). The gap between revenue and spending will be met by an increase in fiscal deficit to 7% of GDP from BE of 6.8%. Most of the fiscal deficit will be financed through market borrowings (short-term and long-term; 67% of FD).

Indirect taxes to shine: Centre's gross tax collection is likely to be Rs 1tn higher than the budgeted target of Rs 22.2tn. Of this Rs 1tn, Rs 0.7tn additional gains will be seen under indirect tax collections. Within this too, customs and GST collections are estimated to pick up faster than budgeted projections. On the other hand, direct taxes are likely to overshoot the budgeted target only marginally, by Rs 0.3tn to Rs 11.4tn. In case of non-tax revenues, higher than estimated revenue will be on account of higher dividend paid by the RBI and better than expected corporate results of PSUs.

Revenue spending to soar: In the wake of second and third wave of Covid-19, government spending is estimated to increase more than budgeted on account of food and fertilizer subsidy bill and health and social sector spending. Recently, government had announced extension of its food grain distribution program (PM-GKAY) into its fifth phase till Mar'22. In addition, covering the cost of vaccination of eligible adults, higher MGNREGA spending, clearing dues of Air India, and payment of export incentives is expected to add considerable burden on the exchequer. Government has received approval for additional Rs 3.7tn spending in FY22, with net cash outgo of ~Rs 3tn. While we do not expect this entire amount will be spent in FY22, we estimate additional spending to the tune of Rs 1.9tn in FY22. We expect capital spending to be in line with budgeted projection and revenue spending to exceed the target.

Key highlights

- Reviving private capex, infrastructure spending, and asset monetisation to be key focus areas of FY23 Budget.
- Fiscal deficit for FY22 estimated at 7% of GDP.
- Gross/net borrowings to remain unchanged from BE in FY22.

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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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