FIRST LIGHT

14 March 2023

RESEARCH

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Expert calls – Steel recovering; aluminium price range-bound

SUMMARY

INDIA ECONOMICS: SOUTH ASIA ECONOMICS

The recent economic crisis in Pakistan is vividly reminiscent of a similar crisis in Sri Lanka just last year. Even more alarming is the fact that many of India's neighbors are facing a similar set of economic challenges. Apart from Pakistan and Sri Lanka, even Bangladesh and to a lesser extent Nepal have been grappling with increased economic instability in recent times, in the form of weak external buffers and high domestic inflation. In fact, the similarities are eerie. The dual shock of the Covid-19 pandemic and the Russia-Ukraine war brought the external vulnerabilities of these countries to the fore, which was compounded by short-sighted, and sometimes politically motivated government policies. Consequently, several of these countries are now scrambling for forex resources to 1) fund imports, 2) boost forex reserves, and 3) avoid debt default. All of these countries are in advance stages of talk with the IMF for securing the same.

Click here for the full report.

INDIA ECONOMICS: CPI

Headline inflation came in marginally above our expectation, though elevated print continues to add discomfort. Food inflation remained high, with over 5 out of 12 sub-groups within food and beverage composition registering above 6% inflation. Acceleration in housing prices, kept considerable risk on Core. Stickiness in core inflation alludes to higher discretionary spending and pass through of input costs to output prices. A number of firms are yet to pass on these high prices, which will lift their selling prices further. RBI would be highly cautious of this print and be in a wait and watch mode. It expects CPI to edge up by 5.7% in Q4 and 6.5% for FY23.

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Daily macro indicators

Ticker	09-Mar	10-Mar	Chg (%)
US 10Y yield (%)	3.90	3.70	(20bps)
India 10Y yield (%)	7.43	7.42	(1bps)
USD/INR	81.98	82.05	(0.1)
Brent Crude (US$/bbl)	81.6	82.8	1.5
Dow	32,255	31,910	(1.1)
Hang Seng	19,926	19,320	(3.0)
Sensex	59,806	59,135	(1.1)
India FII (US$ mn)	**08-Mar**	**09-Mar**	**Chg ($ mn)**
FII-D	(152.1)	(142.9)	9.3
FII-E	481.3	(55.4)	(536.7)

Source: Bank of Baroda Economics Research

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METALS & MINING

- We summarise key takeaways from our interactions with ArcelorMittal (MT NA) and Alcoa (AA US)
- Our interactions suggest near-term range-bound aluminium prices but the possibility of upside over the medium term
- MT reaffirmed our view of continuing recovery in steel margin through FY24; prefer TATA and JSP

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SOUTH ASIA ECONOMICS

13 March 2023

Is South Asia on the brink of a crisis?

Aditi Gupta | Jahnavi Prabhakar
Economist

The recent economic crisis in Pakistan is vividly reminiscent of a similar crisis in Sri Lanka just last year. Even more alarming is the fact that many of India's neighbors are facing a similar set of economic challenges. Apart from Pakistan and Sri Lanka, even Bangladesh and to a lesser extent Nepal have been grappling with increased economic instability in recent times, in the form of weak external buffers and high domestic inflation. In fact, the similarities are eerie. The dual shock of the Covid-19 pandemic and the Russia-Ukraine war brought the external vulnerabilities of these countries to the fore, which was compounded by short-sighted, and sometimes politically motivated government policies. Consequently, several of these countries are now scrambling for forex resources to 1) fund imports, 2) boost forex reserves, and 3) avoid debt default. All of these countries are in advance stages of talk with the IMF for securing the same.

Major macro-economic indicators

Fig 1 – Snapshot of key macroeconomic indicators

Country	GDP growth		Inflation rate		Forex reserves (US$ bn)		Exchange rate		Interest rates	
	2021	2022	2022	2023	2022	2023	2022	2023	2022	2023
Bangladesh	6.9	7.1	7.7	8.7	33.7	32.3	93.5	105.6	4.0	4.0
Nepal	3.8	5.5	7.6	7.3	9.5	10.3	125.8	131.5	8.5	8.5
Pakistan	5.7	6.0	19.7	29.6	5.6	4.3	202.3	256.2	16.0	20.0
Sri Lanka	3.3	(11.0)	45.9	51.2	1.9	2.1	325.3	359.9	14.5/15.5	15.5/16.5

Source: CEIC, Central Bank of Sri Lanka, State Bank of Pakistan, Nepal Rastra Bank, Bank of Baroda Reserach | Note: For 2023, latest data as available from source is taken

Pakistan's economic crisis: Years in making?

The economy has been suffering with ballooning of trade deficit and rising import bills, while exports remain stagnant. Foreign exchange reserves have shrunk. Pakistan largely imports commodities for its domestic consumption. ADB back in Feb'22 had noted that Pakistan had the lowest trade to GDP ratio in the World, a valid cause of concern. PKR has crashed and has been trading at 283/dollar. A large number of industries have halted production and even supply chain movement has stopped. Floods added a bigger blow to this ongoing economic meltdown with the destruction of cotton crop-biggest commodity that the country exports.

Geo-political background: The crisis in Pakistan is attributed to multiple factors starting with the political inability to break off from the group of powerful vested interest groups. The country also lacked political will and gave undue privileges to a few elite group in the form of tax breaks and access to easier capital. Heightened polarization, coupled with political instability and catastrophic floods in 2022 added to an already precarious economic situation. This, in addition to piling up of debt and short sightedness of policy makers and accelerating inflation has pushed Pakistan on the brink of the worst economic crisis that it has ever seen.

CPI

13 March 2023

CPI remains above RBI's upper band

Jahnavi Prabhakar
Economist

Headline inflation came in marginally above our expectation, though elevated print continues to add discomfort. Food inflation remained high, with over 5 out of 12 sub-groups within food and beverage composition registering above 6% inflation. Acceleration in housing prices, kept considerable risk on Core. Stickiness in core inflation alludes to higher discretionary spending and pass through of input costs to output prices. A number of firms are yet to pass on these high prices, which will lift their selling prices further. RBI would be highly cautious of this print and be in a wait and watch mode. It expects CPI to edge up by 5.7% in Q4 and 6.5% for FY23.

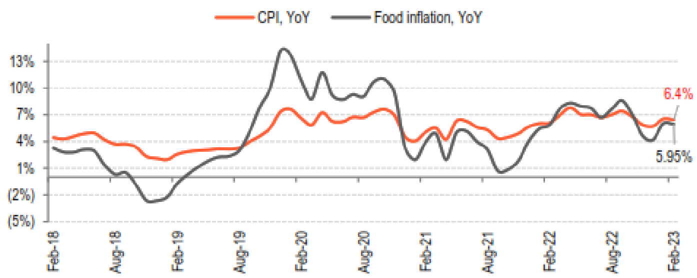
Any large deviation from this forecast will be viewed with caution. Given the ongoing challenges as well as the formation of EL NINO conditions and greater chance of heat wave, puts an upside risk to inflation in the coming months. We expect CPI to average around 6.5% in FY23 and 5-5.5% in FY24. The overshoot of CPI, mandates RBI to hike rate by another 25bps in Apr'23 meet and will push RBI to remain data dependent for the future course of action.

CPI inflation moderates a tad bit

CPI inflation eases marginally: CPI inflation data edged down modestly to 6.4% in Feb'23 after moving up to 6.5% in Jan'23. For the second-month in a row, CPI data came in above RBI's upper tolerance band. Food inflation virtually remained steady at 5.9% in Feb'23. Stickiness of core inflation persists.

Modest changes in Food inflation: CPI food index continued to remain elevated at 5.95% in Feb'23 against 6% in Jan'23, on YoY basis. Amongst major food items, sharpest pace of increase was led by fruit prices which moved up to 6-month high at 6.4% in Feb'23 from 3% in Jan'23. Cereals continued to clock double digit inflation (highest in this series) in line with expectation at 16.7% from 16.3% in Jan'23. Even milk prices also rose to 9.6% (8-year high) in Feb'23 from 8.8% in Jan'23. Pace of disinflation in vegetable prices went down from -11.7% in Jan'23 to -11.6% in Feb'23. Notably, 5 out of 12 broad group of food and beverage noticed inflation above 6%. However, inflation of eggs, meat & fish, spices and pulses registered a fall in Feb'23.

Figure 1: CPI inflation



Source: CEIC, Bank of Baroda Research

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METALS & MINING

13 March 2023

Expert calls: Steel recovering; aluminium price range-bound

- **We summarise key takeaways from our interactions with ArcelorMittal (MT NA) and Alcoa (AA US)**
- **Our interactions suggest near-term range-bound aluminium prices but the possibility of upside over the medium term**
- **MT reaffirmed our view of continuing recovery in steel margin through FY24; prefer TATA and JSP**

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MT on steel recovery: MT flagged improving market sentiment amid reduced fears of recession and anticipates double-digit HoH improvement in apparent demand over Jan-Jun'23. The company confirmed the restart of most of its shut-in European capacity (20% of total) given lengthening of the order book. It expects margins to improve in the March quarter as higher volumes and absorption of fixed costs offset weaker prices, and in the June quarter as better prices make up for raw material costs. Refer our note **Steel cycle recovery underway – AMNS**, 10 February, for added colour.

AA on near-term range-bound aluminium price: AA attributed the 9% correction in aluminium prices since Jan'23 to a pullback in sentiment. Though it flagged cautious buying behaviour, it is seeing the end of destocking. Management does not expect Yunnan supply cuts to move the needle and believes European/US restarts look difficult due to high energy costs. However, lower coal pricing could pose a risk if it accelerates restarts in China. The company raised the possibility of medium-term upsides in aluminium price as supply could lag a demand revival. See **Aluminium outlook healthy but limited price upside in FY24E**, 8 March, and **Constructive outlook despite uncertainty – Alcoa**, 19 January.

China soft but will support recovery: Both MT and AA find China's 5% GDP growth target for CY23 to be soft. While MT believes its base case for steel demand recovery still holds, AA indicated that the government's focus on improving the economy will support recovery and that the continued thrust on infrastructure spend, renewables and grid development is positive for the aluminium sector.

Read-across for Indian steel: Our interactions with the two global majors affirm our view of continuing recovery despite slower CY23 growth in China and higher interest rates in the western world. We retain our constructive outlook on Indian steel sector and continue to prefer **TATA** (BUY, TP Rs 140) and **JSP** (BUY, TP Rs 670).

Read-across for Indian aluminium: Aluminium pricing is likely to remain range-bound in the near term but see an upside over the medium term. Margins for Indian players will depend upon domestic coal availability and international coal prices.

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	575	670	BUY
JSTL IN	676	715	HOLD
SAIL IN	87	95	HOLD
TATA IN	107	140	BUY

Price & Target in Rupees | Price as of 13 Mar 2023

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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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