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FIRST LIGHT

13 July 2021

RESEARCH

BOB Economics Research | Weekly Wrap

Eye on CPI

BOB Economics Research | Inflation and IIP

Industrial activity slows, inflation eases

Automobiles | Q1FY22 Preview

Rising input cost and lower dispatches to depress earnings

Building Materials | Q1FY22 Preview

Tepid base to enable strong growth YoY

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.37	8bps	(28bps)	68bps
India 10Y yield (%)	6.19	7bps	10bps	35bps
USD/INR	74.64	0.1	(2.6)	0.4
Brent Crude (US$/bbl)	75.55	1.9	3.7	75.0
Dow	34,870	1.3	(0.6)	33.9
Shanghai	3,524	0.0	(2.1)	2.2
Sensex	52,386	(0.3)	0.5	43.1
India FII (US$ mn)	**08-Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	13.6	(15.1)	(3,181.9)	(1,154.7)
FII-E	(85.8)	(150.0)	7,934.2	607.8

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: Weekly Wrap

Global yields fell this week on the back of concerns over delta variant. Fed signalled that change in QE will hinge upon economic recovery. China's PBOC did cut reserve ratio by 50bps to boost liquidity and growth. DXY closed lower as US jobless claims inched up and PMI disappointed. On the domestic front, RBI introduced a new benchmark security. Indian 10Y went up by 12bps ahead of CPI data today. We expect CPI at 6.6%. Our weekly economic activity tracker (WET index) was stable at 93, signalling revival in economic activity. Slew of data is awaited from US and China this week.

Click here **for the full report.**

India Economics: Inflation and IIP

India's industrial output slowed down to 29.3% in May'21, led by manufacturing and electricity. Over a 2-year horizon, it has contracted by 13.9% led by capital goods and durables. CPI inflation for Jun'21 eased to 6.26% in Jun'21 with core inflation moderating to 6.2% from 6.5% in May'21. However, food inflation increased to 5.1%, up by 10bps MoM. The supply side pressure on core is likely to continue. Food inflation is expected to be soft, but below normal monsoon is a risk.

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Automobiles: Q1FY22 Preview

- Weaker QoQ dispatches in PVs, CVs, 2Ws and 3Ws to impact topline; rising input cost pressure and supply issues to compound woes
- Strong YoY volume growth in tractors off a low base but steel and tyre cost inflation to hurt earnings
- Tyre companies face challenges from high base effect in aftermarket sales, lower OEM dispatches and rising input prices

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Building Materials: Q1FY22 Preview

- Expect QoQ decline but robust YoY growth from our building materials coverage in Q1FY22 aided by lockdown-hit base quarter
- Operating margins set for YoY expansion across the board aided by better volumes (MDF, plywood, tiles, sanitaryware) and inventory gains (pipes)
- Management commentary on post-unlock demand and margin outlook key monitorables

Click here **for the full report.**

WEEKLY WRAP

12 July 2021

Eye on CPI

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Global yields fell this week on the back of concerns over delta variant. Fed signalled that change in QE will hinge upon economic recovery. China's PBOC did cut reserve ratio by 50bps to boost liquidity and growth. DXY closed lower as US jobless claims inched up and PMI disappointed. On the domestic front, RBI introduced a new benchmark security. Indian 10Y went up by 12bps ahead of CPI data today. We expect CPI at 6.6%. Our weekly economic activity tracker (WET index) was stable at 93, signalling revival in economic activity. Slew of data is awaited from US and China this week.

Markets

- **Bonds:** US 10Y yield fell by 5bps (1.42%) as Fed minutes pointed out that "substantial further progress" is needed before scaling back monetary stimulus. Germany's 10Y yield also fell by 5bps (-0.29%) as ECB changed its inflation target from close to or below 2% to allowing temporary movement beyond this point, giving room for more stimulus. Crude prices fell by 0.8% (US$ 76/bbl) on demand concerns. India's 10Y yield rose by 12bps (6.19%) due to higher than expected cut off price set by RBI for the new benchmark security. System liquidity surplus was at Rs 5.6tn as on 9 Jul 2021 (Rs 5.7tn last week).

- **Currency:** DXY fell by 0.1% this week as US jobless claims rose unexpectedly. AUD depreciated by 0.5% amidst rising Covid-19 cases and lockdown. EUR rose by 0.1% as Eurozone composite PMI surged to a 15-year high in Jun'21. INR appreciated by 0.1% led by FII inflows (US$ 199mn) and lower oil prices.

- **Equity:** Global indices closed mixed, with Nikkei and Sensex closing lower and Dow, Dax and Shanghai Comp each rising by 0.2%. FTSE closed flat. Recent surge in Covid-19 cases globally is a risk to equity markets. Sensex closed 0.2% lower, dragged by auto, IT, energy and banking stocks.

- **Covid-19 tracker:** Global Covid-19 cases rose by 3mn this week versus 2.7mn last week. Cases increased in Japan, South Korea and UK. In India, cases rose at a slower pace. Our weekly economic activity tracker index was stable at 93 (100=Feb'20). Israel has fully vaccinated 60% of its population, UK at 51% and US at 48%. India is at 5.3% now.

- **Upcoming key events:** Major events this week include rate decisions of BoJ and BoK, US CPI, PPI and retail sales and China's industrial production, retail sales and trade data. In India, IIP and CPI data will be released later in the day followed by WPI. An area of concern is delay in monsoon which is now 8% below LPA (13% above normal last year) because of which sowing is lower.

INFLATION AND IIP

12 July 2021

Industrial activity slows, inflation eases

India's industrial output slowed down to 29.3% in May'21, led by manufacturing and electricity. Over a 2-year horizon, it has contracted by 13.9% led by capital goods and durables. CPI inflation for Jun'21 eased to 6.26% in Jun'21 with core inflation moderating to 6.2% from 6.5% in May'21. However, food inflation increased to 5.1%, up by 10bps MoM. The supply side pressure on core is likely to continue. Food inflation is expected to be soft, but below normal monsoon is a risk.

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IIP growth eases: Industrial output increased by 29.3% in May'21 from 134.4% in Apr'21. Over a 2-year horizon, IIP has fallen by 13.9% led by 16.4% decline in manufacturing and 8.5% dip in electricity output. This is in sharp contrast to Apr'21 when over a 2-year horizon, IIP was resilient. The decline in production in May'21 is attributable to restrictions imposed in the wake of the second wave. The decline in industrial activity over a 2-year horizon is driven by capital goods (-37% over May'19) and consumer durables (-41% over May'19). This is in sharp contrast to non-oil-non-gold imports which increased by 11.3% over a 2-year horizon in Jun'21 thus indicating a pick-up in domestic demand.

Food inflation inches up slightly: CPI inflation moderated slightly to 6.26% in Jun'21 from 6.3% in May'21. However, food inflation edged up to 5.1% from 5% led by eggs (19.4% from 15.2%), milk (1.9% from 0.6%), oils and fats (34.8% from 30.9%), vegetables (-0.7% from -1.9%) and pulses (10% from 9.4%). On the other hand, cereals (-1.9% from -1.4%) and meat and fish (4.8% from 9.1%) moderated. While government has reduced custom duty on edible oils, the lull in monsoon rain is a cause of worry which may push food prices higher.

Core inflation falls: Core inflation softened to 6.2% in Jun'21 from 6.5% in May'21. This was led by housing (3.7% from 3.9%), health (7.7% from 8.4%), transport and communication (11.6% from 12.4%), recreation and amusement (5% from 6.1%) and personal care and effects (4.8% from 7.4%). A part of the decline is also attributable to base effect as last year, core inflation increased by 40bps MoM. Even so, the cost push in core inflation is likely to continue with pass-through of international crude prices being visible in domestic prices. Higher domestic retail oil prices imply increase in logistics costs a well. In addition, domestic manufacturing firms are yet to accomplish complete pass-through of higher raw material costs.

We continue to expect retail inflation at 5.5% in FY22 led by higher core inflation at 6.1%. Monsoon is now below normal and poses an upward risk to our inflation estimate. We expect RBI to normalize monetary policy in Q4FY22 by reducing wedge between reverse repo and repo rate and changing its liquidity stance.

Key highlights

- CPI inflation edged down to 6.26% in Jun'21 from 6.3% in May'21.
- Food inflation edged up to 5.1%. Core inflation moderated to 6.2%.
- IIP moderates to 29.3% in May'21. It has fallen by 13.9% over a 2-year horizon.

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AUTOMOBILES | Q1FY22 Preview | 12 July 2021

Rising input cost and lower dispatches to depress earnings

- **Weaker QoQ dispatches in PVs, CVs, 2Ws and 3Ws to impact topline; rising input cost pressure and supply issues to compound woes**
- **Strong YoY volume growth in tractors off a low base but steel and tyre cost inflation to hurt earnings**
- **Tyre companies face challenges from high base effect in aftermarket sales, lower OEM dispatches and rising input prices**

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OEMs: We expect a 27% QoQ decrease in Maruti's (MSIL) Q1FY22 revenue led by the 28% QoQ decline in its sale volumes. The sharp upswing in commodity prices also makes us skeptical on margins. Volumes are down 35% QoQ for Hero (HMCL), 14% for Bajaj Auto (BJAUT), 29% for TVS Motor (TVSL) and 40% for Eicher Motor (EIM – RE). Despite some respite from exports for MSIL, BJAUT and TVSL, we forecast a sharp sequential decline in EBITDA margins and PAT for all three due to rising commodity prices. Inventories remain normal-to-high for 2W players in the domestic market, indicating that any fall in retail sales may have a direct impact on production.

In the CV segment, MHCV sales have declined over 50% QoQ in Q1 owing to partial lockdowns during the quarter. With the pandemic spread, recovery could be delayed. We expect Ashok Leyland (AL) to report a 60% QoQ drop in Q1 revenue. The sharp increase in metal and tyre costs and the company's inability to take corresponding price hikes will continue to erode its margins and earnings.

Tractors & Tillers: Tractors continued their growth trajectory in Q1FY22 as well. YoY, volumes surged 52% for M&M (MM) and 38% for Escorts (ESC). VST Tillers (VSTT) also reported YoY growth of 26%. However, we expect margins for all these agri-related players to contract QoQ as higher raw material cost, both steel and tyres, takes a toll.

Tyres: OEMs have posted a sequential decline of over 50% in Q1 MHCV tyre sales. While replacement demand for truck tyres (radials) remains steady, it is important to note that the high base of FY21 will limit upside growth YoY. The farm subsegment (tractors) has clocked decent growth. We expect steady capacity utilisation in bias tyres and project an overall revenue decline of 5-6% QoQ from the tyre pack in Q1. In our view, the jump in rubber prices (from ~Rs 155/kg to Rs 170/kg) and higher crude derivative costs (up ~13% QoQ) would shave 250-300bps of Q1 gross margins QoQ. We recommend a strong SELL on the entire tyre pack.

Recommendation snapshot

Ticker	Price	Target	Rating
AL IN	125	80	SELL
BJAUT IN	3,996	3,200	SELL
HMCL IN*	2,897	2,900	HOLD
MSIL IN	7,426	8,000	BUY
TVSL IN	600	480	SELL
EIM IN	2,712	2,200	SELL
MM IN	772	630	SELL
CEAT IN	1,318	840	SELL
APTY IN	228	140	SELL
BIL IN	2,280	1,550	SELL
MRF IN	79,995	67,000	SELL
MDA IN	127	140	BUY
JKI IN	142	90	SELL
SRTY IN	2,234	1,200	SELL
ESC IN	1,200	1,350	BUY
VSTT IN	1,976	2,300	HOLD
GNA IN*	457	450	HOLD

Price & Target in Rupees | Price as of 9 Jul 2021 | *HMCL and GNA realigned to HOLD from REDUCE and ADD respectively as per our new rating scale

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BUILDING MATERIALS

12 July 2021

Tepid base to enable strong growth YoY

- **Expect QoQ decline but robust YoY growth from our building materials coverage in Q1FY22 aided by lockdown-hit base quarter**
- **Operating margins set for YoY expansion across the board aided by better volumes (MDF, plywood, tiles, sanitaryware) and inventory gains (pipes)**
- **Management commentary on post-unlock demand and margin outlook key monitorables**

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Tiles & Sanitaryware to see better demand traction YoY: Sales in the tiles and sanitaryware business faltered due to lockdowns during Q1FY22 and the spread of Covid-19 in tier-2-and-below markets, but are still expected to be higher YoY due to a greater number of operational days. We expect Kajaria Ceramics (KJC) to post robust revenue growth YoY due to a low base and increased volumes from a revival in housing demand. Cera Sanitaryware (CRS) is also likely to witness strong growth YoY aided by ramp-up in its sanitaryware production facility following resolution of labour issues. Operating margins are likely to improve for all players aided by cost control and operating leverage

Plywood – demand revival; MDF – robust growth YoY: We expect plywood sales to grow handsomely YoY for Century Plyboards (CPBI) and Greenply Industries (GIL) due to continued demand momentum. Plywood margins for both companies are forecast to improve on the back of operating leverage and price hikes. In MDF, we project revenue growth of 365% YoY (-19% QoQ) for Greenpanel Industries (GREENP) and 323% YoY (-18% QoQ) for CPBI due to better capacity utilisation and price hikes. Both players should also deliver higher MDF margins YoY.

Pipes & Adhesives – strong YoY uptick: Demand from the housing sector has been relatively strong during the quarter but higher PVC prices have dented agriculture sector consumption in peak season. We expect higher PVC resin prices (+90% YoY) to aid revenue growth in the pipe segment. Operating margins are forecast to expand for all players under our coverage – Supreme Industries (SI), Astral Poly (ASTRA) and Finolex Industries (FNXP) – due to operating leverage and inventory gains on account of rising PVC resin prices. In adhesives, we anticipate strong topline growth for Pidilite Industries (PIDI) and ASTRA aided by a tepid base YoY along with margin expansion from operating leverage.

Key monitorables: Management commentary with regards to demand pick-up post unlocking and outlook on margins amid raw material cost pressure will be key monitorables going ahead.

Recommendation snapshot

Ticker	Price	Target	Rating
KJC IN*	996	950	HOLD
MTLM IN*	197	230	HOLD
CPBI IN	408	370	SELL
CRS IN	4,447	4,145	HOLD
GREENP IN	241	295	BUY
PIDI IN	2,278	1,365	SELL
ASTRA IN	2,034	1,210	SELL
FNXP IN	180	175	HOLD
SI IN	2,166	1,805	SELL

Price & Target in Rupees | Price as of 9 Jul 2021\ *KJC and MTLM realigned to HOLD from REDUCE and ADD respectively as per our new rating scale

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

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