FIRST LIGHT

12 October 2020

RESEARCH

BOB Economics Research | Monthly Chartbook

Green shoots emerging

BOB Economics Research | Monetary Policy Review

Lender of last resort

SUMMARY

India Economics: Monthly Chartbook

A silver lining seems to be emerging with positive growth visible in exports, auto and electricity output, rural wages, GST collections and rail freight. However, government revenues continue to be constrained due to lower tax and non-tax collections, thus impacting capex spending. State government borrowings are rising to bridge the gap between revenue and expenditure which is pushing spread over 10Y benchmark. Supply driven inflationary pressures are also not relenting for now. H2 will be better with a base effect playing out. However, negative policy rates and an estimate of more than 4% inflation in FY22 make us believe that room for further rate cuts is not there. A more supportive fiscal policy will push growth.

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India Economics: Monetary Policy Review

MPC members unanimously voted to keep policy rate unchanged. With a 5-1 vote, members decided to maintain accommodative stance into current and next financial year. RBI now expects GDP to contract by 9.5% in FY21 with positive growth in Q4. Inflation too is likely to ease in the range of 4.1-4.4% in FY22 which is higher than target of 4%. Thus we believe liquidity measures will be the bulwark of supporting growth. Today, RBI announced on tap TLTROs, SDL OMOs, extension of HTM limits and lower risk weight for housing.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	155
Petronet LNG	Buy	310
Tech Mahindra	Buy	910

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	270
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.79	0bps	7bps	(88bps)
India 10Y yield (%)	6.02	0bps	2bps	(45bps)
USD/INR	73.24	0.1	0.1	(3.1)
Brent Crude (US$/bbl)	43.34	3.2	3.2	(26.7)
Dow	28,426	0.4	1.0	7.3
Shanghai	3,218	(0.2)	(2.3)	9.2
Sensex	40,183	0.8	4.6	6.1
India FII (US$ mn)	**7 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	(91.0)	(427.4)	(15,107.1)	(5,347.6)
FII-E	139.0	584.0	4,624.1	11,227.0

Source: Bank of Baroda Economics Research

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Green shoots emerging

A silver lining seems to be emerging with positive growth visible in exports, auto and electricity output, rural wages, GST collections and rail freight. However, government revenues continue to be constrained due to lower tax and non-tax collections, thus impacting capex spending. State government borrowings are rising to bridge the gap between revenue and expenditure which is pushing spread over 10Y benchmark. Supply driven inflationary pressures are also not relenting for now. H2 will be better with a base effect playing out. However, negative policy rates and an estimate of more than 4% inflation in FY22 make us believe that room for further rate cuts is not there. A more supportive fiscal policy will push growth.

Silver lining emerging: Higher electricity demand (+2.5%), GST collections (+3.9%), E-Way bills (+9.6%), 4-wheeler (+14.1%), 2-wheeler (+3%) output, tractor sales (+64.8%) along with pick-up in rural wages (3-year high) show economy is returning to some level of normalisation. However, there are significant local restrictions impacting the services sector which imply economy will not be operating at full potential in the near-term. Rural India continues to remain a bright spot with kharif sowing rising by 4.8% compared with last year and sharp jump in procurement. The government has passed three significant agriculture bills to spur investments in farm infrastructure, a long-term positive.

Fiscal deficit still elevated: General government fiscal deficit (12M sum basis) has inched up further to 10.7% of GDP in Aug'20 from 10.3% in Jul'20 on the back of muted revenue growth. Centre's net tax revenue growth slipped to (-) 38.6% from (-) 30.6% in Jul'20. Centre's direct tax collections remain weak (decline of 34.1% as of Aug'20). Higher excise duties have led to recovery in indirect tax collections. Tax revenues of states have fallen by 21.1% in FYTD21. As a result, capex of both centre (-1.3%) and states (-21.1%) has taken a hit. However, revenue spending remains relatively bouyant. To meet the expenses, market borrowings of states have risen by ~43% on FYTD basis (till Oct'20). Centre's dated and T-bill borrowings are up.

Inflation not relenting: Underlying inflationary pressures are visible in Sep'20 with vegetable prices rising by 14% MoM. Inflation in Sep'20 is estimated at 7.15%. While demand side inflation is muted because of lack of demand, supply side factors continue to induce significant inflationary pressures. 10Y yield which had increased by 28bps in Aug'20, fell by 11bps in Sep'20 on the back of RBI's special OMOs and hike in HTM limits for banks. Notably, SDL spreads have again inched up to 25bps due to elevated state borrowings.

Lower trade deficit, positive for INR: After appreciating by 1.6% in Aug'20, INR depreciated by 0.2% in Sep'20 on the back of FII outflows and a rebound in US$. In Oct'20, INR has appreciated by 0.7% on the back of FII inflows, lower trade deficit and a record high current account surplus. We expect INR to remain rangebound with an appreciating bias.

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09 October 2020

Lender of last resort

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KEY HIGHLIGHTS

- Policy rate kept unchanged at 4%.
- GDP to contract by 9.5% in FY21 before increasing to 10.1% in FY22.
- CPI inflation to moderate to 4.5% in Q4 but to remain above target of 4% in FY22.

Focus on liquidity: MPC members unanimously voted to keep key policy rates unchanged. With a 5-1 vote, MPC decided to maintain accommodative stance at least during current and next financial year. On the liquidity front, RBI introduced on tap TLTRO of Rs 1tn for providing additional liquidity to sectors with backward and forward linkages to growth; extended SLR holding limits under HTM till Mar'22; announced OMOs for SDLs to compress the rising spreads; increasing banks' exposure to retail and small business borrowers from Rs 50mn to Rs 75mn; and rationalising risk weights on fresh retail housing loans *(Details in the Regulatory Announcements section).*

CPI to ease in H2: CPI inflation is projected at 6.8% in Q2FY21, 5.4% in Q3 and 4.5% in Q4. MPC members will look through current inflation as a 'transient hump'. In FY22, CPI inflation is projected in the range of 4.1-4.4%. The underlying assumption is normalisation of supply chains and availability of vaccine against COVID-19. Our projections are similar with inflation estimated to come down to 4.3% in FY22.

GDP to contract by 9.5% in FY21: MPC expects GDP growth to contract by 9.2% in Q2FY21 and by 5.6% in Q3. Growth is expected to be marginally positive at 0.5% in Q4. For FY21, it estimates GDP to contract by 9.5% in FY21 with downside risks. MPC noted that weak urban demand, hit to the services sector, subdued exports and muted investment growth are likely to impinge on growth. GDP growth is expected to inch up to 20.6% in Q1FY22.

Forward guidance: MPC is awaiting easing of inflationary pressures to use the space available for supporting growth. However, inflation is unlikely to come down below RBI's target of 4% even next year. Thus we believe liquidity and focus on transmission will be the focus areas for RBI rather than easing of policy rates to support growth.

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ADD – Expected return from >+5% to +15%

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SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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