JUNE 2019

BWR drishtikone

www.brickworkratings.com

SEBI Registered
RBI Accredited
Credit Rating Agency

Expected Revival in GDP Growth with Political Stability and Monetary Stimulus

June 2019

Contacts
Rajat Bahl
Chief Analytical Officer
+91 22 1234 5678
rajat.b@brickworkratings.com

Anita Shetty
Research Editor
+91 22 1234 5678
anitashetty@brickworkratings.com

Ria Matwani
Research Editor
+91 22 1234 5678
ria.m@brickworkratings.com

Praveen Pardeshi
Research Analyst
+91 22 1234 5678
praveen.p@brickworkratings.com

IN THIS ISSUE…

Growth concerns driven by low consumer demand

GDP growth slowed down to 5.8% in Q4 2018-19, thus dragging down the estimates of FY 2018-19 growth at 6.8%. However, the domestic economy expected to improve in 2019-20 on the back of monetary easing, benefiting from benign inflation coupled with relatively lower oil prices than expected. Political continuity ensured by the outcome of the general elections also helped to improved growth prospects in 2019-20, since the new government's decisive measures to increase investment is critical to the development of the economy. The government should continue its focus on resolving the twin balance sheet crisis which is also equally important.

Negative growth in the farm sector have already pulled down the Q4 GDP growth whereas, uncertainty clouding over the monsoon forecast enhances this trouble. Domestic investment activity has weakened in Q4 2018-19 and overall demand has been weighed down partly by slowing exports. Escalation in trade wars may further impact India's exports and investment activity. On the other hand, benevolent inflation provide room for RBI MPC to cut repo rates. MPC had already changed its monetary stance from neutral to accommodative and reduced repo rates to revive sagging growth, investments and consumption demand.

India's consumption fuelled growth remained subdued recently, evident in terms of declining auto sales and falling steel and cement prices. All three segments i.e. cars, two-wheelers and commercial vehicles witnessed a slowdown owing to multiple reasons like increasing cost of ownership, revised axle norms and funding issues due to NBFC crisis. This slowdown has dragged down the overall IIP numbers.

The fortunes of the auto sector are unlikely to change and the slowdown is expected to continue for the next couple of months.

After showing some narrowing trend recently, trade deficit widened again on account of increase in crude oil prices from its lows since January 2019 as major trade tensions have raised trade policy uncertainty. This lead to fall in global trade as well. Volatile oil prices continued to pose risks to India's growth story, as contraction in import bill in 2018-19 was largely attributed to fall in oil prices. Despite uncertain global conditions, Rupee managed to remain stable during the recent months.

Debt market indicators suggest mixed sentiments reflecting uncertain economic and market scenario.

Liquidity is the major driving factor for the debt market instruments. Also, global cues like crude oil prices, US treasury yields direct the market.

Bond markets have witnessed a sharp rally of late assisted by a steady Rupee and favourable election outcome despite volatile crude prices. This comes on the back of the election outcome and a sharp drop in US treasury yields which have further buoyed gilts. The 10Y benchmark yield traded between 7.25-7.45% prior to 23-May'19 as against 7.35% during the Apr'19 MPC meet. Looking ahead, bond markets will continue to mirror the Rupee & oil trajectory, the new Government's fiscal target & borrowing plan and the global Central Bank's policy regime.

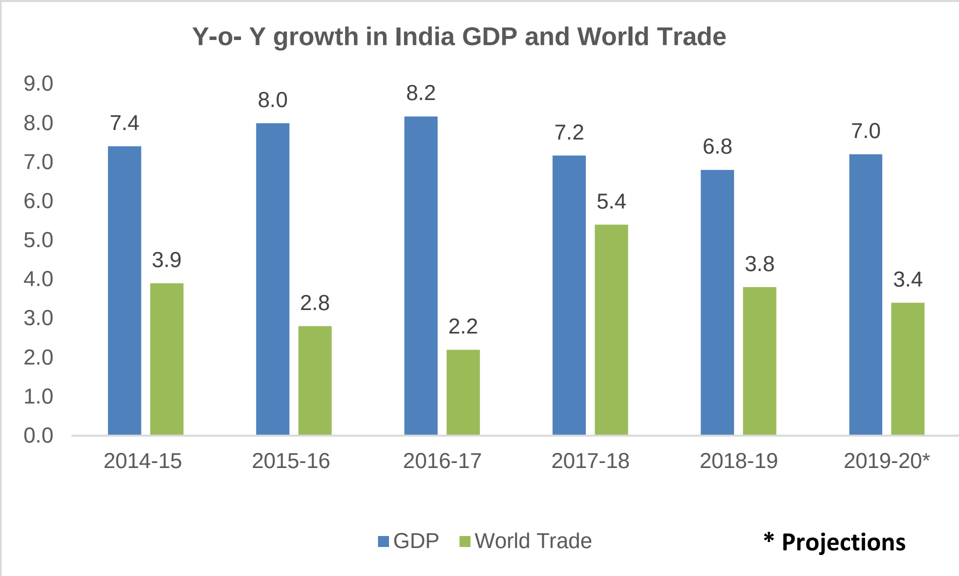
Macro-Economic Indicators

View

India's (GDP) growth is expected to improve in 2019-20 supported by the recovery of investment and consumption amid accommodative stance of monetary policy and some expected impetus from the fiscal policy. However, rising trade tensions and increased global economic uncertainty prone to deteriorate global trade in 2019-20.

Domestic Growth and Global Trade

The relative importance of international trade to the economy of a country captured in the below chart. The slowdown in the domestic economy and international trade moved in tandem in the last 2 years; world trade growth declined to 3.8% in 2018-19 from 5.4% in 2017-18, similarly domestic GDP growth also slowed down to 6.8% from 7.2%.



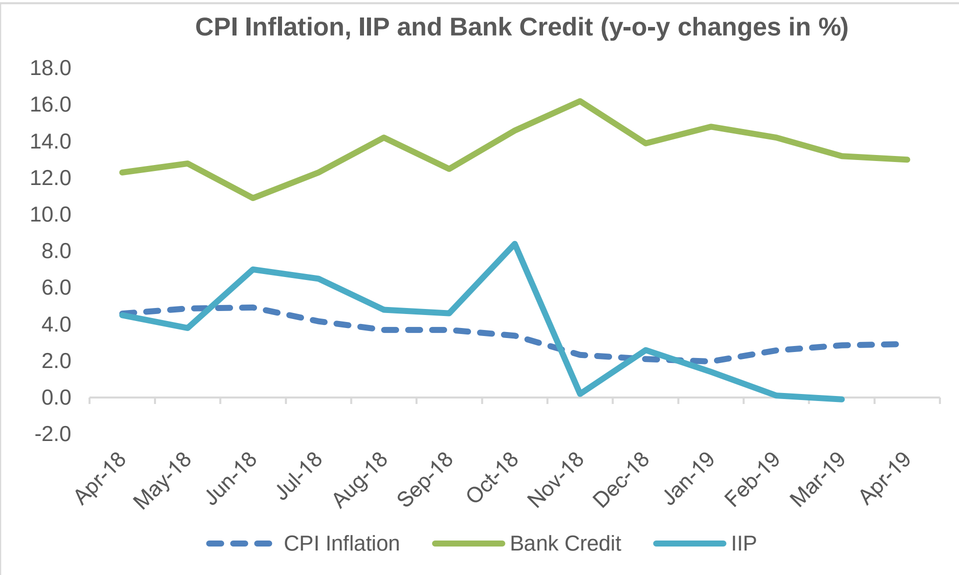
Source: MOSPI, IMF, RBI, BWR Research

View

CPI inflation is expected to remain benign in 2019-20 and within the targeted level of RBI at 4%. However, it may cross 3 to 3.2% in Q2 2019-20, in the advent of rising food prices. The credit growth also expected to pick-up in FY 2019-20 on the back of monetary easing by MPC and RBI's liquidity improving measures.

Inflation and Bank Credit

CPI inflation remained within the targeted level of RBI at 4% (+/-2%) which helped the RBI MPC to reduce repo rate three times in 2019 so far. Consequently, the credit growth also picked up.



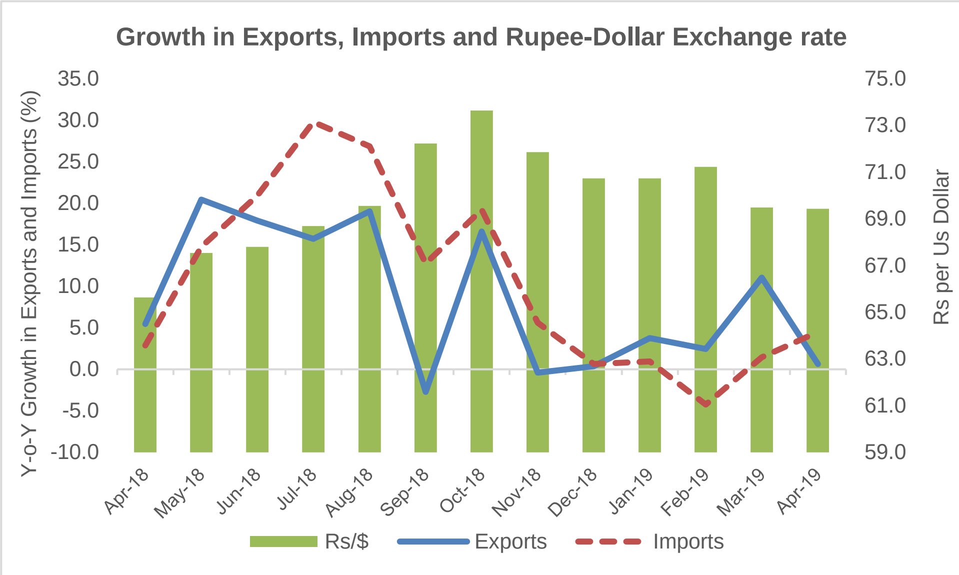
Source: MOSPI, RBI, BWR Research

Trade and INR USD Exchange Rate

View

In the short run, trade balance responds to change in exchange rate. In October 2018, both imports and exports witnessed double-digit growth and the rupee depreciated significantly against US dollar. Appreciation of Rupee from its lows recently helped the exports to grow.

In the recent period, rupee depreciated responding to both global and domestic factors and exports witnessed sharp improvement in March 2019. In stark contrast to 11% growth in March exports grew by just 0.6% in April 2019. Shortage of liquidity and constraints on the domestic front in addition to global challenges including trade war, protectionism, fragile global conditions altogether making the situation worse for domestic trade.



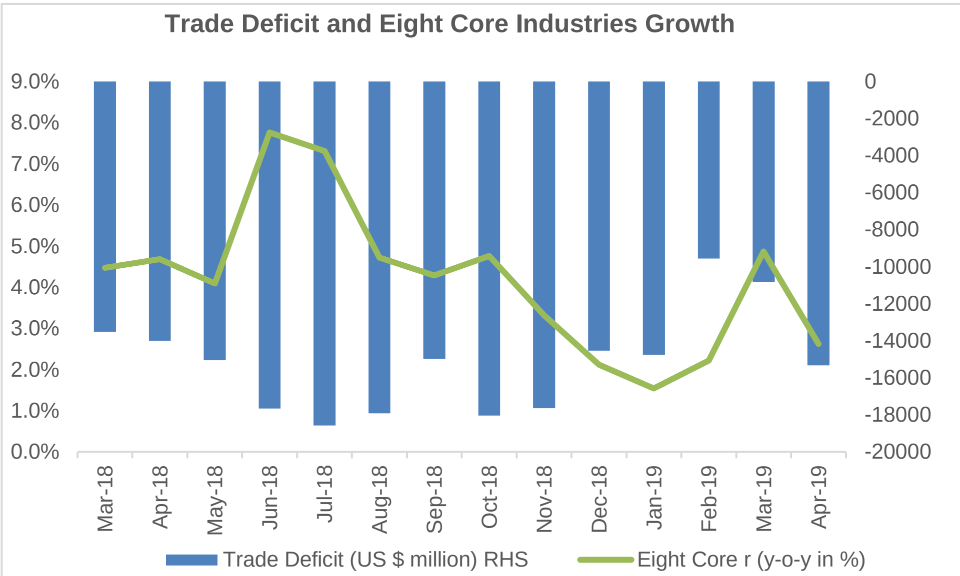
Source: Ministry of Commerce, RBI, BWR Research

Performance of Core Industries and Trade

View

Declining signs of IIP and core sectors suggest muted demand. Going forward, industrial sector is expected to rebound amid improvement in investments as increase in output will critically depend on new investments.

Phenomenal growth in exports during March 2019 is not consistent with growth in industries. Eight core industries witnessed marginal growth recently, whereas trade deficit widened further.



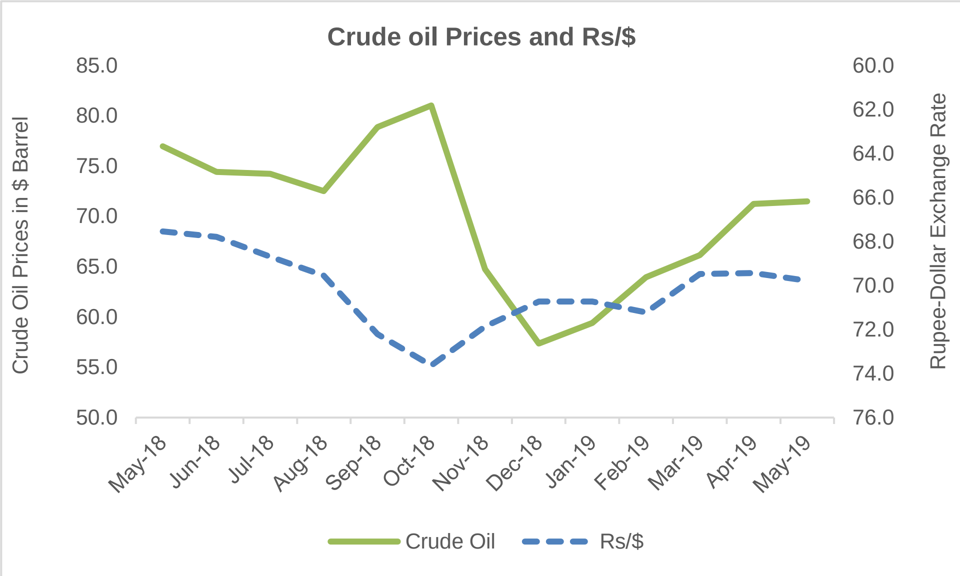
Source: Ministry of Commerce, MOSPI, BWR Research

View

Prevailing uncertainty over crude oil prices continue to remain a major trouble for Indian rupee as well as on the trade front. Risks arising from the US sanctions on Iran impacting the oil prices, rupee -dollar exchange rate may witness significant volatility in 2019-20.

Fluctuation in Crude oil Prices and its Impact on INR/USD

Rupee depreciated in the first half of FY 2018-19 on account of rising crude oil prices. Fall in oil prices since October 2018 helped the rupee to recover against the US dollar. The inverse relationship was evident during mid-2018. However, in the recent period, crude oil prices inched upwards, but rupee remained comparatively stable.



Source: RBI, U.S Energy Information Administration, BWR Research

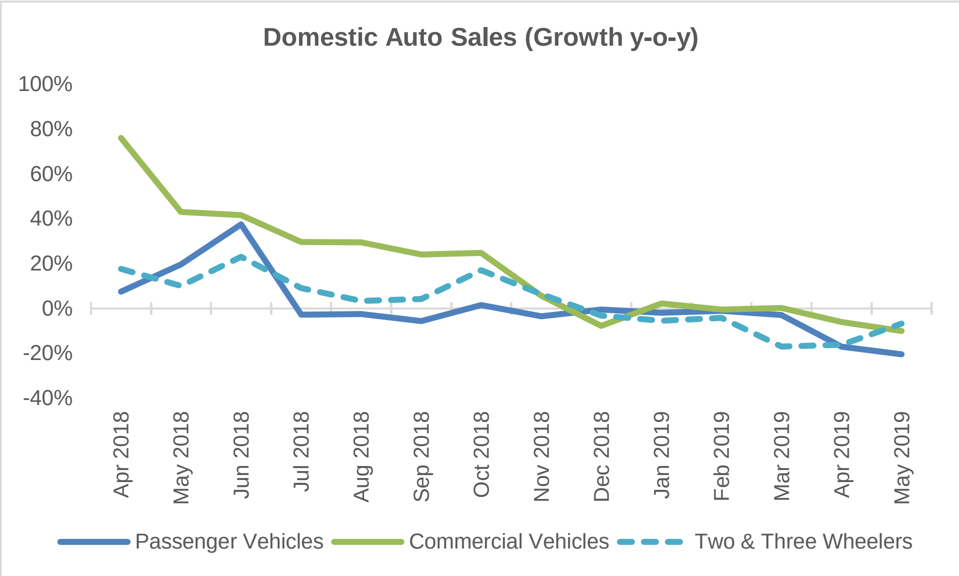
SECTORAL INDICATORS

Automobiles

View

Vehicle sales is expected to remain under pressure till H1 FY20, post which commercial vehicles might see an uptick in purchases by fleet owners before the BS-VI norms kick in from FY21.

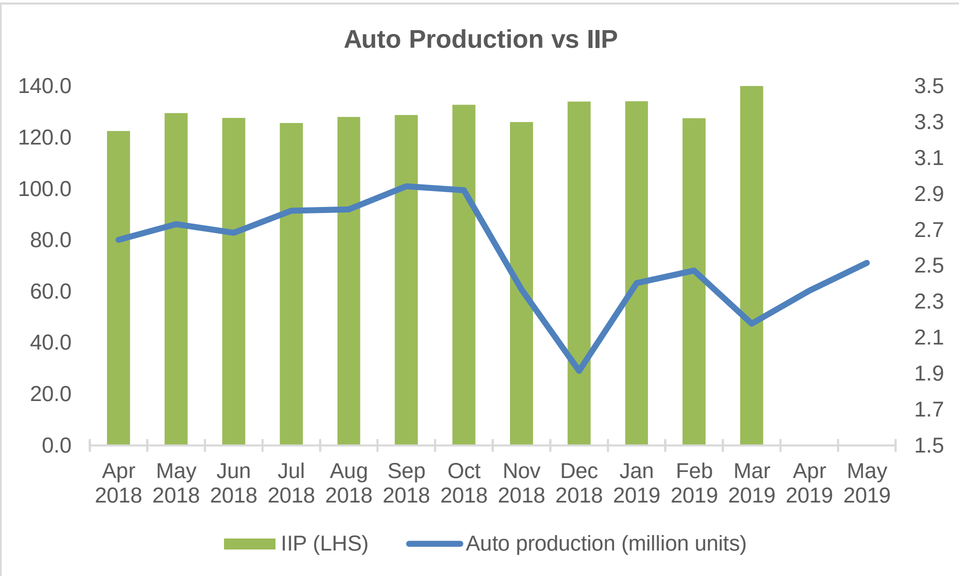
Overall automobile sales fell by 8.6% in May 2019 driven by weak sales in passenger vehicles segment. High cost of ownership due to increased insurance cost has hampered the passenger vehicles and two-wheeler sales. On the other hand, revised axle norms and financing issues due to NBFC crisis have hit the commercial vehicle sales.



Source: CMIE, BWR Research

IIP and Automobiles

Slowdown in auto production is in line with overall decline in IIP growth. Slowdown in manufacturing activity is a proxy for falling consumer demand which is evident in the flat growth in IIP.



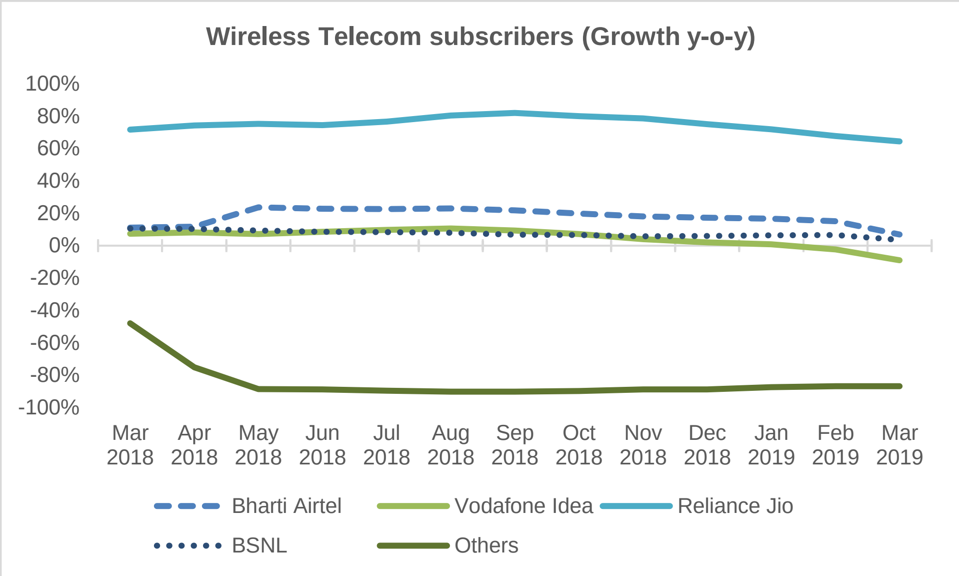
Source: MOSPI, CMIE, BWR Research

View

Competitive intensity is expected to ease as pricing by players are now on the same lines. Reliance Jio may see slower rate of subscriber additions going forward.

Telecom

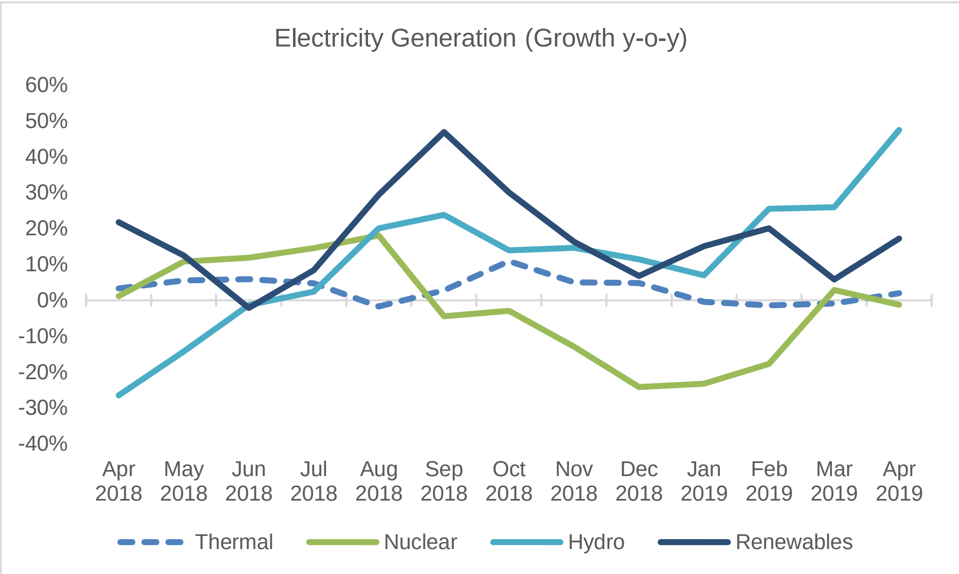
Consolidation of the market continues with Jio increasing its market share and driving the overall subscriber additions in the sector. Players other than the top 4 are now completely out of the market.



Source: TRAI, BWR Research

Power

Power generation in Hydro and renewables show a healthy growth this year compared to thermal and nuclear.

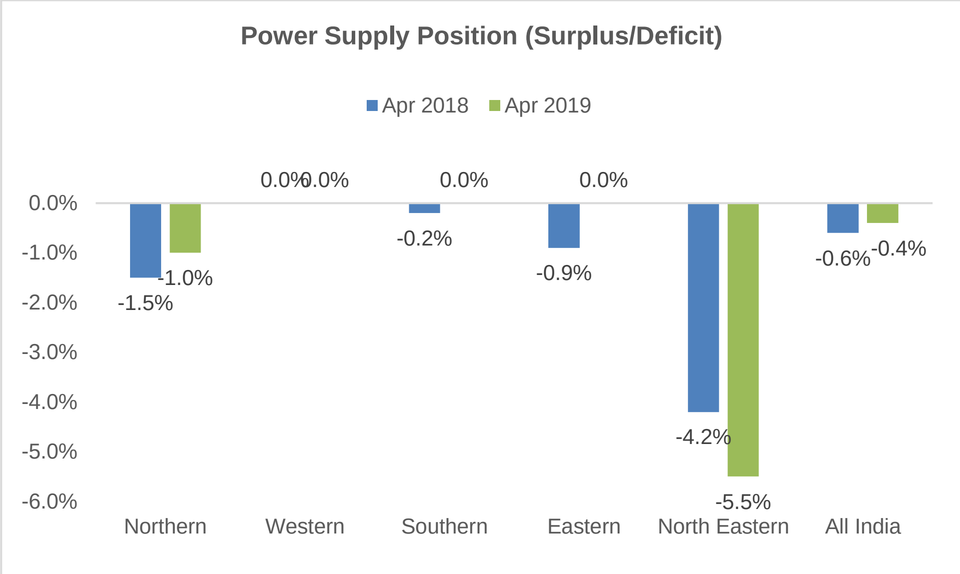


Source: Central Electricity Authority, BWR Research

View

Power sector may continue to witness stress due to stalled projects.

India's power supply position improved in March 2019, but country is still not a power-surplus nation.



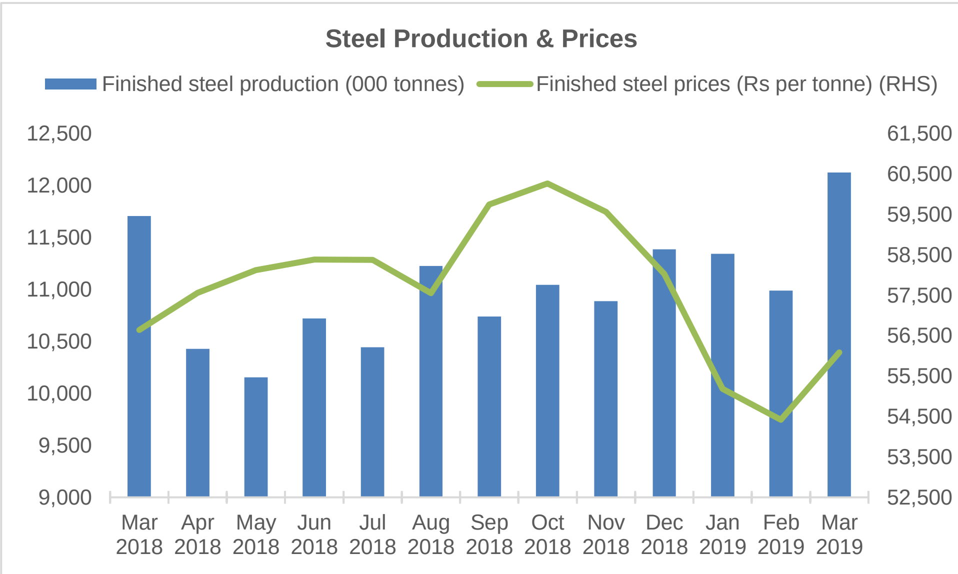
Source: CEA, BWR Research

Steel

View

Steel prices are expected to remain firm for the next couple of months as demand revival will be slow until the new government takes steps to boost the industrial sector and infrastructure sector.

Steel prices witnessed a decline after October 2018, owing to subdued industrial activity in the country visible in declining infrastructure & construction activity and lower automobile sales. However, in March 2019, domestic steel prices increased on the back of increased raw material prices, particularly coking coal and iron ore.



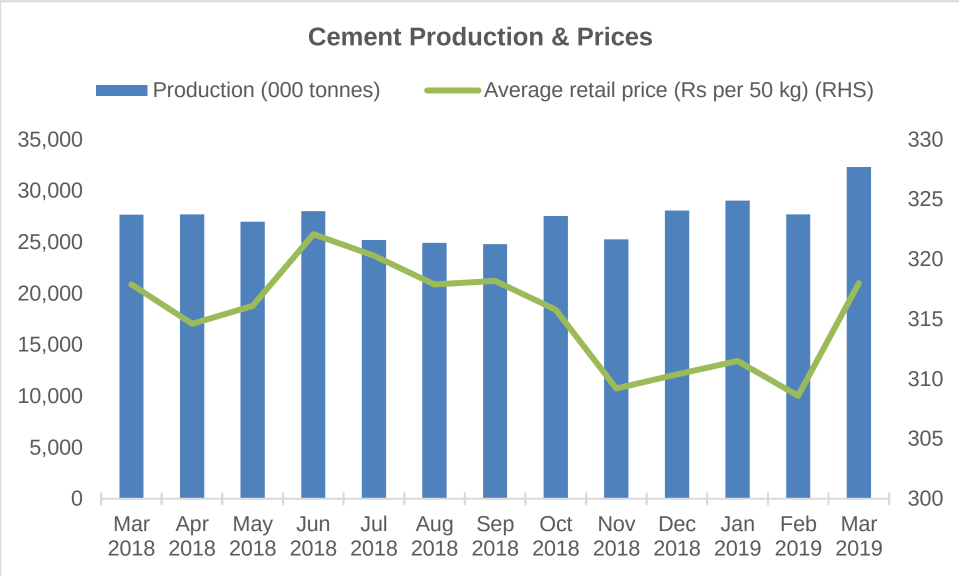
Source: CMIE, BWR Research

Cement

View

Cement prices are expected to remain firm in the next couple of months owing to disruptions in demand due to slowdown in government projects.

Cement prices have remained range bound in 2018-19. Despite demand remaining low, players increased the prices in March 2019.



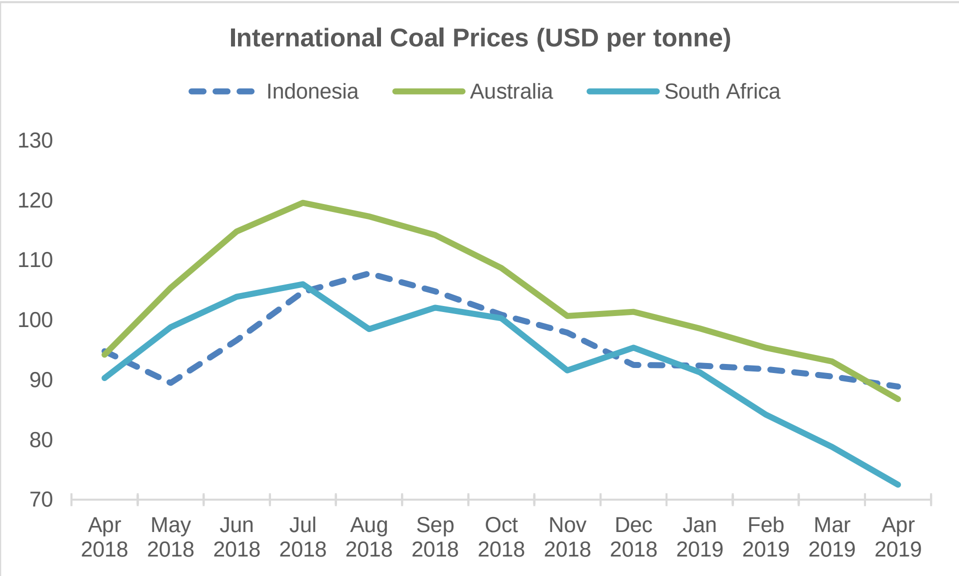
Source: CMIE, BWR Research

Coal

View

International coal prices may continue to soften on the back of expected lower demand from markets like China and India.

Coal prices have been declining since July 2018, due to weak global growth and lower demand. Also, record increase in coal production in China and its plans to open new mines put further pressure on the price.



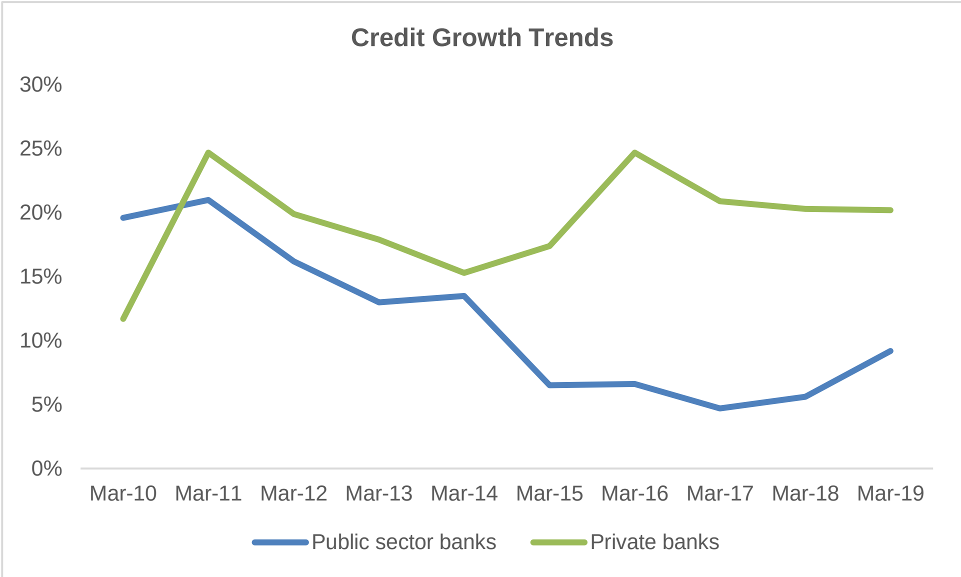
Source: CMIE, BWR Research

Banking

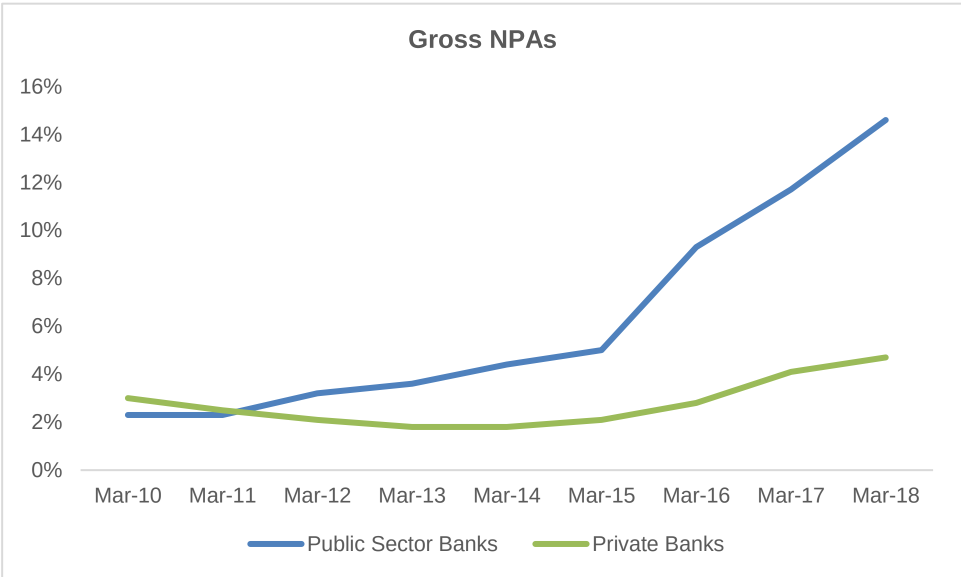
View

Bank credit is expected to accelerate further owing to a continued healthy demand for credit from the retail and services sectors as well as revival in bank credit to industries

After subdued growth in the past couple of years partly due to lower credit off take in the economy and slowdown in private investments, the Bank credit growth revived in FY19.



Source: RBI, BWR Research



Source: RBI, BWR Research

DEBT MARKET INDICATORS

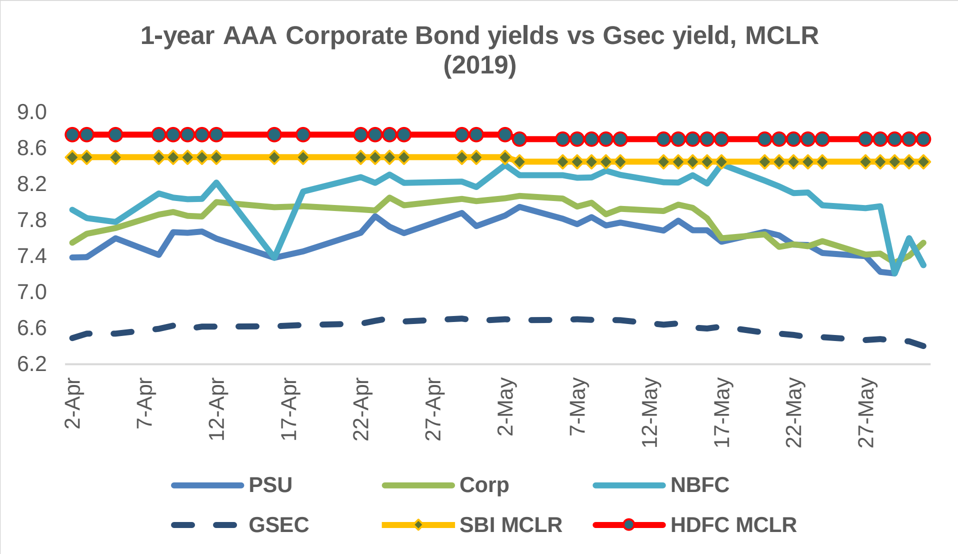
Movements in Bond Yields

View

Yields of shorter tenor corporate bond will further ease on improving liquidity backed by the hopes of Central Bank cutting the key policy rates again.

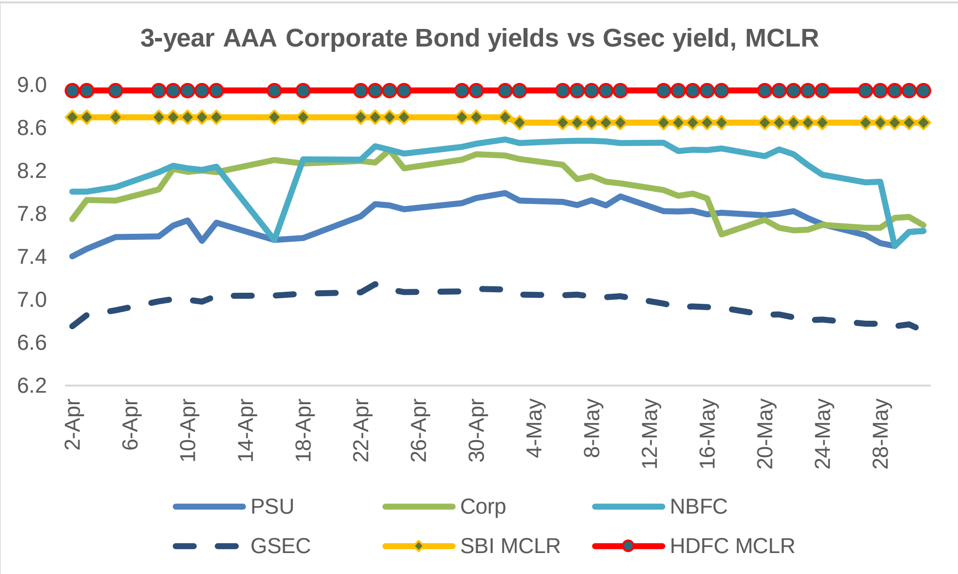
Below is the comparison of all bond yields (annualised) of Public Sector Units (PSUs), Corporates and Non-Banking Finance Companies (NBFCs) maturing in 1-year, 3-year and 5-year with corresponding Government Securities and Bank MCLR.

The AAA rated corporate bonds (NBFCs) maturing in 1-year have been trading more than 100 bps higher than G-sec due to recent liquidity crisis faced by the sector as a result of frequent defaults.



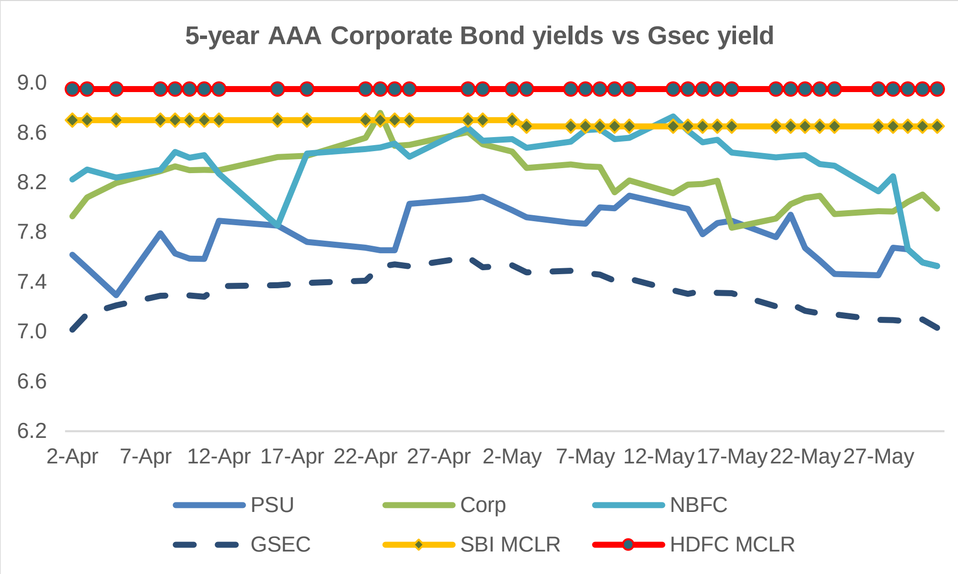
Source: FIMMDA, BWR Research

The transmission of rate cut is not evident in the HDFC Bank's 3-year MCLR, whereas SBI's 3-year MCLR witness the transmission of barely 5 basis points.



Source: FIMMDA, BWR Research

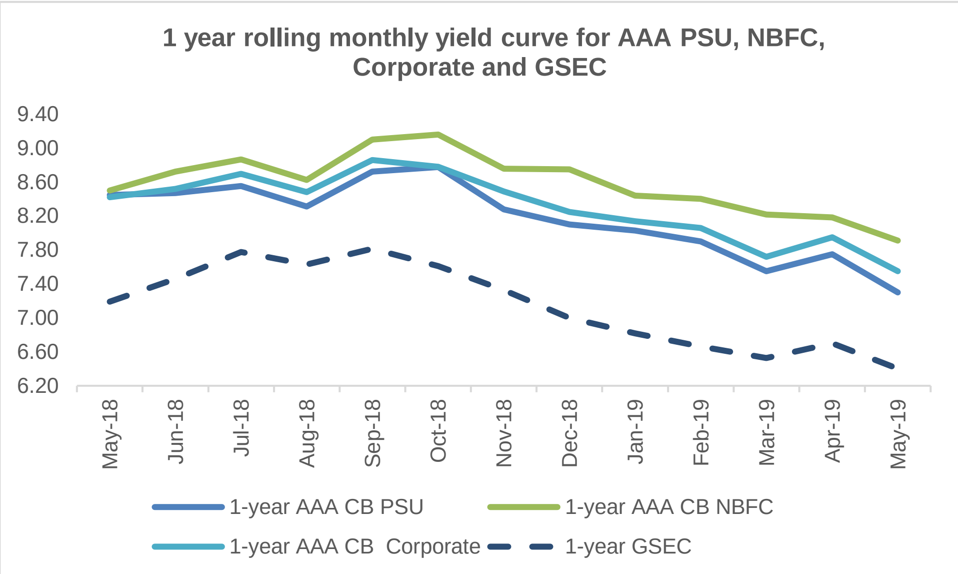
The bonds across sectors also shows improving investor sentiments owing to anticipation of RBI easing key policy rates and a sharp fall in crude oil prices.



Source: FIMMDA, BWR Research

The AA rated corporate bonds across sectors have traded in the range of 8-9% compared to benchmark Gsec yield of around 7%. So, it's offering 100-200 bps more returns compared to the benchmark yield. Yields of A rated corporate bond offer returns in the range of 9-11.50%, giving more risk reward of up to 450 basis points over the benchmark Government Securities.

Rolling maturity of Government Security maturing in 1 year along with similar trend reflected by Corporate bonds of PSUs, NBFCs and Corporates has witnessed easing trend due to softening of interest rates (RBI-MPC repo rate cuts) amid infusion of huge liquidity by Central Bank through Open Market Operations (OMOs) and FX swaps.



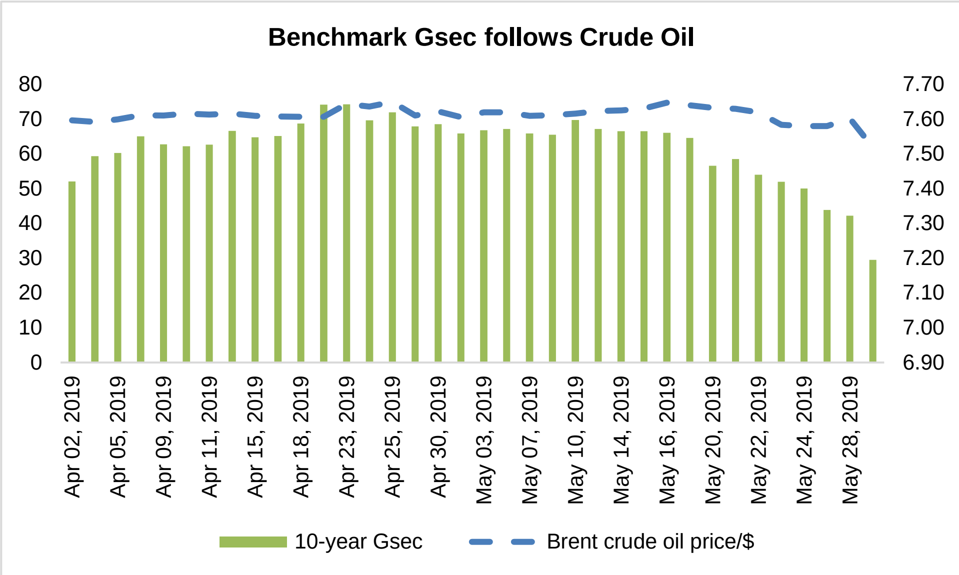
Source: FIMMDA, Brickwork Research

Lower Brent Crude Oil directs the Indian Government Securities

The recent fall in Brent Crude oil prices has reflected in the easing of yields, thereby, boosting positivity in the bond market.

View

Recent sharp fall in the crude oil prices amid drop in US treasury yields helped easing domestic yields. Global cues may continue to influence the Indian bond market.



Source: U.S Energy Information Administration, BWR Research

BRICKWORK RATINGS (BWR) IS INDIA'S HOME GROWN CREDIT RATING AGENCY BUILT WITH SUPERIOR ANALYTICAL PROWESS FROM INDUSTRY'S MOST EXPERIENCED CREDIT ANALYSTS, BANKERS AND REGULATORS. ESTABLISHED IN 2007, BRICKWORK RATINGS AIMS TO PROVIDE RELIABLE CREDIT RATINGS BY CREATING NEW STANDARDS FOR ASSESSING RISK AND BY OFFERING ACCURATE AND TRANSPARENT RATINGS. BRICKWORK RATINGS PROVIDES INVESTORS AND LENDERS TIMELY AND IN-DEPTH RESEARCH ACROSS THE STRUCTURED FINANCE, PUBLIC FINANCE, FINANCIAL INSTITUTIONS, PROJECT FINANCE AND CORPORATE SECTORS. BRICKWORK RATINGS HAS EMPLOYED OVER 350 CREDIT ANALYSTS AND CREDIT MARKET PROFESSIONALS ACROSS 8 OFFICES IN INDIA. OUR EXPERIENCED ANALYSTS HAVE PUBLISHED OVER 12,000 RATINGS ACROSS ASSET CLASSES. BRICKWORK RATINGS IS COMMITTED TO PROVIDE THE INVESTMENT COMMUNITY WITH THE PRODUCTS AND SERVICES NEEDED TO MAKE INFORMED INVESTMENT DECISIONS. BRICKWORK RATINGS IS A REGISTERED CREDIT RATING AGENCY BY SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI) AND A RECOGNISED EXTERNAL CREDIT ASSESSMENT AGENCY (ECAI) BY RESERVE BANK OF INDIA (RBI) TO CARRY OUT CREDIT RATINGS IN INDIA. BRICKWORK RATINGS IS PROMOTED BY CANARA BANK, INDIA'S LEADING PUBLIC SECTOR BANK. MORE ON CANARA BANK AVAILABLE AT WWW.CANARABANK.CO.IN

BWR RATING CRITERIA IS AVAILABLE AT HTTPS://WWW.BRICKWORKRATINGS.COM/RATINGSCRITERIA.ASPX