SBI ECOWRAP

भारतीय स्टेट बैंक
STATE BANK OF INDIA

'Be the Bank of Choice for a Transforming India'

MARCH 28, 2019
ISSUE NO:101, FY19

GLOBAL AND DOMESTIC GROWTH PROSPECTS LOOK INCREASINGLY WORRISOME: IS 50 BPS CUT THE NEW BENCHMARK?

Global growth prospects now look increasingly weaker across China, Europe and USA. Trade growth, a key artery in the global economy, has also slowed markedly, to around 4% in 2018 from 5.25% in 2017. Crude markets have remained broadly supported, but purely by supply cuts led by producer group OPEC and by aggressive sanctions by the US against Iran and Venezuela.

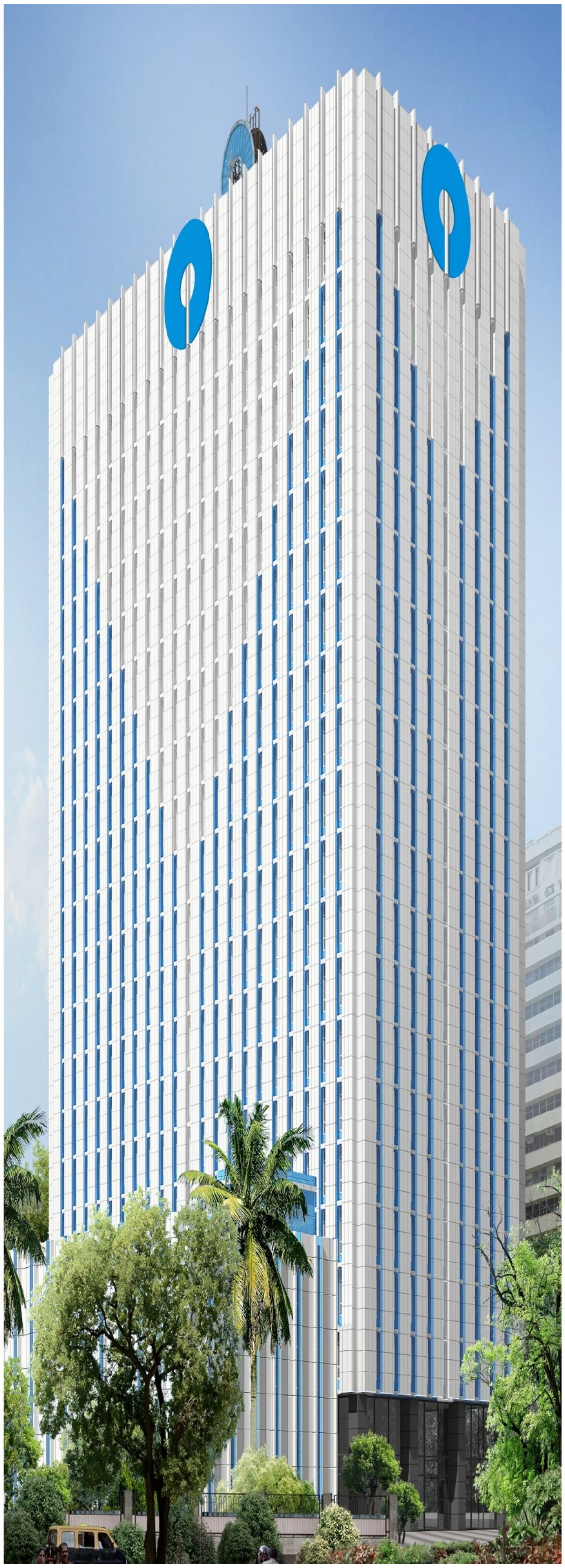
A consensus is yet to emerge when US could turn into a slowdown mode following the yield curve inversion last week. The average duration of lead months of inverted yield curve and US economy slipping into recession is 14 months and average duration of recession is 12 months. By this logic, US might plunge into recession by the end of 2019 or early 2020! Interestingly, a plot of Fed Fund Futures and Market clearly indicates US markets are pricing in a rate cut in second half of 2019.

Back home, rural demand continues to look increasingly weak and fragile. Additionally, latest global forecasts indicate that El Nino weather phenomenon is gaining strength. Procurement data published by NAFED suggests procurement agencies could not procure even half of the quantity sanctioned at MSP, thereby the impact on food prices will continue to remain low. The cash transfer will not impact inflation. Even if we assume that the food prices increases by as much as @10%, the CPI inflation will still be decisively below 4% for most of FY20.

Urban demand is also worrying. Even February sales for the auto industry declined to a new low as weak consumer demand continues into sixth straight month. A deceleration in global trade growth is also impacting export outlook through the trade channel.

Investment scenario, as can be referred from orders inflows has declined in Q3FY19 by 20%. NBFCs with higher exposure to SMEs/ Loan against shares and developer loans are likely to see pain in FY20 also. Credit growth is not broad based and is in selective areas only. Capex led growth from listed companies will remain muted and working capital will remain key to credit growth.

We thus expect at least a 25 bps rate cut in April policy (cumulative 50-75 bps over next 2/3 policies) though we believe the stage is ripe for a larger rate cut. If the rate cut is of 25 bps only, then RBI could indicate more cuts through a possible shift in stance/ policy statement. RBI should also take a holistic approach with liquidity framework as call rates are liquidity agnostic.



GLOBAL GROWTH WILL REMAIN WEAK

- Economic prospects are now weaker in nearly all G20 countries than previously anticipated. Vulnerabilities stemming from China and the weakening European economy (growth has been revised down particularly sharply in Germany and Italy, apart from Brexit) combined with a slowdown in trade and global manufacturing, high policy uncertainty and risks in financial markets, could undermine strong and sustainable medium-term growth worldwide.
- Trade growth, a key artery in the global economy, has also slowed markedly, to around 4% in 2018 from 5.25% in 2017. Furthermore, as per world trade outlook indicator, which gives the "real time" information on the trajectory of world trade relative to recent trends, the recent level of 98.6 (the lowest since October 2016) indicates trade growth in coming months will be below-trend. The moderation in the overall index was driven by decline in all indices, with export orders in particular continuing to decline steadily over the course of the year and remaining below trend. Indices for automobile production and sales electronic components and agricultural raw materials have moved from 'on trend' to 'below trend'. Meanwhile, international air freight and container port throughput have dipped but remain on trend.
- Substantial policy uncertainty remains in Europe, including over Brexit. A disorderly exit would raise the costs for European economies substantially. The increase in tariffs between UK and EU as a result of WTO rules coming into effect would reduce GDP by around 2% (relative to baseline) in the United Kingdom in the next two years. The costs could be magnified if this also induces a further decline in business and financial market confidence.
- GDP growth in China is projected to moderate gradually to 6% by 2020. New fiscal policy stimulus is being implemented, although the extent and effectiveness of some measures is difficult to gauge and monetary policy has eased. Scope remains for further policy support if required, but this would further delay the necessary deleveraging of the corporate sector and aggravate risks to financial stability.
- Crude markets have remained broadly supported, but purely by supply cuts led by producer group OPEC and by aggressive sanctions by the US against Iran and Venezuela. The greatest downside risk to our oil price view is demand weakness on slower economic growth. The number of rigs drilling for new oil production in the United States has been falling in 2019 and hit its lowest level since April 2018 last week, at 833 operating rigs.

US MAY PLUNGE INTO RECESSION: BUT HOW QUICKLY IS THE QUESTION

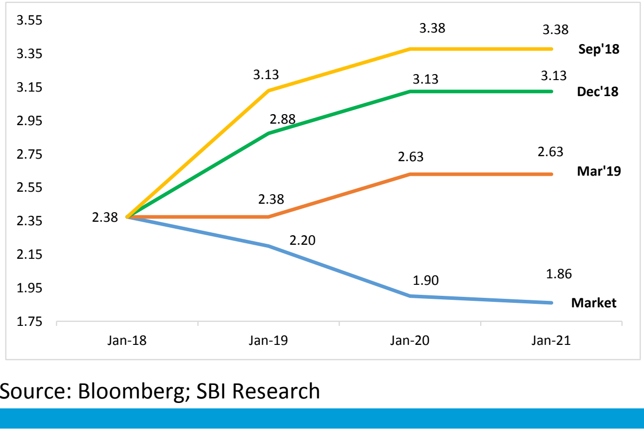
- A consensus is yet to emerge when US could turn into a slowdown mode following the yield curve inversion last week. There is an interesting relationship between US inverted yield curve (i.e. 10 year G-sec yield minus 1 year yield) and US recession. If we analyse the data since 1950s, it is clearly evident that recession in US follows inverted yield curve (every instance, except one occasion). The average duration of lead months of inverted yield curve and US economy slipping into recession is 14 months and average duration of recession is 12 months. By this logic, US might plunge into recession by the end of 2019 or early 2020. Interestingly, Countries like Canada and Mexico are also showing inverted yield curves. In India and other emerging economies, the spread is positive and quite large, however the spread could narrow down if the fears of global slowdown increase. This would mean a decline in 10 year yield rates from the current levels.
- Interestingly, a plot of Fed Fund Futures and Market clearly indicates US markets are pricing in a rate cut in second half of 2019.

Inverted Yield Curve (10y minus 1y) and US Recession

First Yield Curve Inversion	Lead (in months)	Recession Start Date	Duration of Recession (in months)
Dec-56	8	Aug-57	8
Sep-59	7	Apr-60	10
Dec-67	24	Dec-69	11
Mar-73	8	Nov-73	17
Sep-78	16	Jan-80	6
Sep-80	10	Jul-81	17
Feb-89	17	Jul-90	8
Apr-00	11	Mar-01	8
Jan-06	23	Dec-07	19
Average	**14**	**-**	**12**

Source: NBER, FRED, SBI Research

Fed Dot Plot vs. Fed Funds Futures

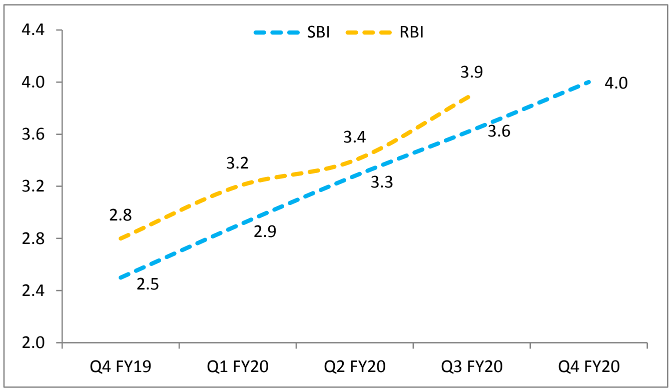


Source: Bloomberg; SBI Research

DOMESTIC GROWTH LOOKING INCREASINGLY VULNERABLE

- Domestic demand conditions now looks increasingly weak and fragile. For example, a point of major concern is that over the years the share of households savings in gross domestic savings has declined significantly. From 68.2% in FY12 the share declined to 56.3% in FY18. This trend is disturbing and need to be reversed. One of the possible reason of such decline may be increase in real household debt, as interest rates have not declined commensurately. Additionally, latest global forecasts indicate that El Nino weather phenomenon is gaining strength and may potentially affecting the South-west monsoon in India. According to the US National Oceanic and Atmospheric Administration, there is an 80% chance that El Nino will prevail in March-May and 60% during the June-August period. El Nino affects the flow of moisture-bearing winds from the cooler oceans towards India, negatively impact the summer monsoon, which accounts for over 70% of annual rainfall. It remains to be seen how it would actually evolve over the next few months, but if it does retain its strength after the summer, it could ruin the prospects of a good monsoon in India, and this could have a further dampening impact on rural demand that is already at a distress.
- Our inflation forecasts are much lower than RBI forecasts. For FY20 also we believe that RBI projections are approximately 30 bps more than SBI projections. As per our projections (and as well as of RBI's also) average CPI inflation in FY20 will stay comfortably anchored at below 4%.
- We expect GST collection for Union Government for Mar'19 will be at Rs 1.01 lakh crore. However, this does not preclude the Government staring at fiscal challenges given the slowdown in tax collections.

CPI Inflation Forecast (RBI vis-à-vis SBI) in %

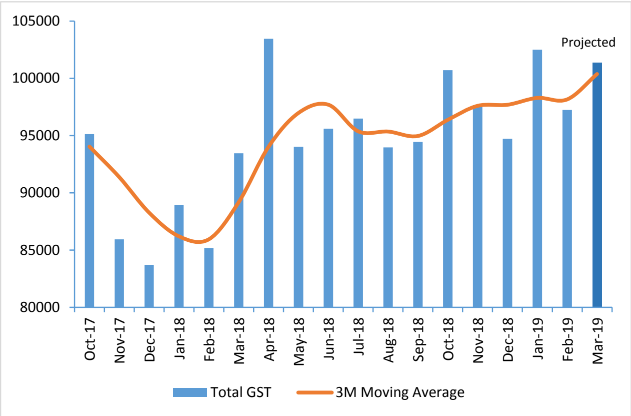


Source: SBI Research

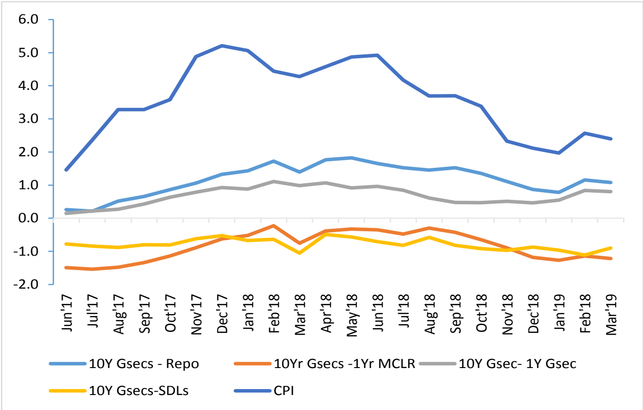
YIELD SPREAD AND LIQUIDITY

- If we look at the historical trend of yield spread between '10yr G-sec and Repo' and '10yr G-sec and 1yr G-sec', the gap which was becoming wider since Jul'17 is now converging with each other. This could be largely attributed to future uncertainties.
- On liquidity front, RBI should be commended for the several ingenious and bold moves in recent times to improve market microstructure, including the most recent step of swap transaction of augmenting liquidity management apart from frequent communication with markets.

Month wise GST collection (Rs crore)



Yield Spread (%)



Source: SBI Research

RURAL DISTRESS STILL HURTING

- Procurement data published by NAFED suggest that procurement agencies could not procure even half of the quantity sanctioned by Centre's Department of Agriculture, Cooperation and Farmers welfare (DAC&FW) at MSP. Thereby the impact on food prices will remain significantly low in many States.
- Pradhan Mantri Kisan Samman Nidhi (PM-KISAN) Yojana which was introduced by Government to address the farmer distress in the country by providing direct income support of Rs 6,000 per year to 12 crore small and marginal farmers is expected to have less impact on both consumption and Food Prices.
- Nevertheless, state-wise CPI inflation data for Jan'19 and Feb'19 reveal states have witnessed modest pick-up in inflation. But this increase in inflation couldn't be attributed to PM-KISAN alone as in States like Kerala where only 4% farmers have been covered under the scheme have also seen the jump in inflation. It is in fact too early to see the impact of the scheme on inflation as the scheme started at the end of Feb'19. Even if we assume in certain scenarios the food prices increased by let say @ 2%, @5% or @10%, then the CPI inflation will still be decisively below 4% for most of FY20.
- International experience suggests, there is some time lag on impact of cash transfer to boost consumption growth. However, the yearly income support amount of Rs 75,000 crore (approximately) to 12 crore farmers may not have much impact on over all consumption expenditure as the amount contributes only 0.6% of total PFCEs .
- Besides, historical trend suggests, during the years when general elections are held there is a significant jump in revenue expenditure which directly impacts the consumption growth and it slows down thereafter. Thus, the net effect on consumption could go either way, but it is unlikely that this cash transfer will have a significant impact on inflation.

Procurement in Kharif 2018 (in tonnes)

State	Estimated Crop Production	Sanctioned Procurement Quantity	Quantity Procured by NAFED & FCI	Procurement of sanctioned Quantity (%)
Oilseeds Procurement (Groundnut, Sesamum, Nigerseed & Soyabean)				
Gujarat	2837700	675000	447638.22	66
Rajasthan	2991200	748000	235440	31
Uttar Pradesh	156000	33000	8763	27
Telangana	316000	79000	15560.3	20
Madhya Pradesh	569200	142250	28501	20
Maharashtra	3888000	250000	1283.02	0.5
Karnataka	327200	81800	6	0.01
Odisha	17500	4375	0	0
Pulses Procurement (Moong, Urad & Toor)				
Uttar Pradesh	326000	65000	29743	46
Gujarat	427200	106800	21002	20
Maharashtra	1348500	323000	51106	16
Haryana	7100	1775	225	13
Tamil Nadu	62500	14625	651	4
Andhra Pradesh	140796	35199	735	2
Odisha	275700	41000	0	0

Source: NAFED, SBI Research

All India Average Price Movement of Kharif crops Post MSP Announcement (price per quintal)

Crops		Weight in CPI	MSP 2018-19	Feb-19	Growth Feb'19 over MSP (%)	Scenario 1 @2%	Scenario 2 @5%	Scenario 3 @10%
Cereals	Wheat*	2.73	1840	2098	14.0	5	14	27
	Paddy	4.75	1750	2010	14.8	10	24	48
Coarse Cereals	Barley*	0.05	1440	1846	28.2	0	0	1
	Jowar	0.23	2430	2276	-6.3	0	1	2
	Bajra	0.11	1950	2106	8.0	0	1	1
	Maize	0.06	1700	1913	12.5	0	0	1
	Ragi	0.05	2897	2320	-19.9	0	0	1
Pulses	Gram*	0.29	4620	4991	8.0	1	1	3
	Masur*	0.3	4475	5786	29.3	1	2	3
	Arhar	0.80	5675	5408	-4.7	2	4	8
	Moong	0.36	6975	5673	-18.7	1	2	4
	Urad	0.27	5600	5349	-4.5	1	1	3
Oilseeds	Mustard*	1.33	4200	3951	-5.9	3	7	13
	Soyabean	0.30	3390	3660	8.0	1	2	3
	Groundnut	0.33	4890	4909	0.4	1	2	3
	Seasamum	0.01	6249	9999	60.0	0	0	0
	Nigerseed	0.01	5877	4447	-24.3	0	0	0
	Cotton	0.05	5150	5263	2.2	0	0	1
Impact on CPI						24	60	120

Source: AGMARKET, SBI Research Note: *: MSP for 2019-20

Central Govt. Revenue Expenditure during pre & Post election

General Election	Held in Month	Previous two year Average Growth	Growth in Year following General Election	Difference in bps
13th	Sept-Oct 1999	17.22	9.71	751
14th	Apr-May 2004	9.6	6.13	347
15th	Apr-May 2009	24.52	14.86	966
16th	Apr-May 2014	9.72	7.35	237

Source: SBI Research

CONSUMPTION DEMAND AKA AUTOMOBILE PRODUCTION AND SALES SLOWING DOWN

- February sales for the auto industry declined to a new low as weak consumer demand continues into a sixth straight month. According to the Federation of Automobile Dealers Associations (FADA) total auto sales in Feb'19 stood at 14,52,078 as compared to 15,79,349 units in the same period last year. The yoy drop stands at 8.06%, but the month on month drop is 15.30% from 17,14,400 units sold in January 2019.
- The Passenger Car segment sales remained subdued during February'19, owing to a spike in ownership costs coupled with a rise in interest cost due to liquidity squeeze on back of NBFC issue and higher insurance premium, dampening consumer buying sentiment.
- The country's largest car maker Maruti Suzuki India cut production by over 8% in February on account of subdued demand. The same is happening across the auto industry. All major auto companies are reducing their monthly production figure by 10% to 15% due to low demand and increase in inventories despite various discounts offered to consumers and it further suggests demand to remain subdued in near term.

Slow down in Auto mobile Production (In Lakh)

Companies	Usual Monthly Production	Expected Production	Cut in Production (%)
Maruti Suzuki	1.50	1.20	20.0
Tata Motors	0.21	0.18	14.3
M&M	0.31	0.27	12.9
Hero MotoCorp	6.00	5.10	15.0
Royal Enfield	0.70	0.60	14.3
HMSI	5.00	4.25	15.0

Source: SBI Research

SLOWDOWN IN TRADE DYNAMICS

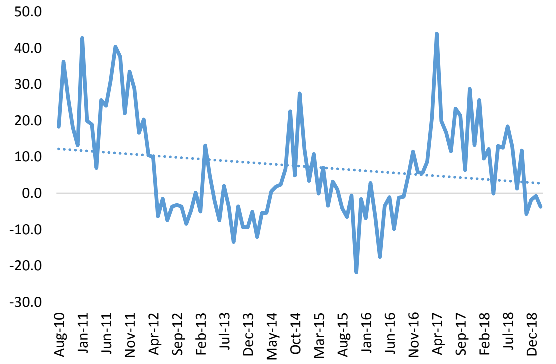
<u>Non-oil non-gold imports slowdown</u>

- After reaching a peak in Apr'17, growth in non-oil non-gold imports of India has been on a declining trend. This in turn indicates weak domestic economic momentum.

<u>Major export items have not picked up</u>

- Among the top exports of India, drugs and pharmaceuticals and electronic goods are performing well in recent months. Meanwhile, engineering goods, gems & jewellery and petroleum products which constitute around 50% of our exports have not picked up.
- IIP growth and export growth are moderately correlated with a correlation coefficient of 0.35. If we look at production growth of export oriented industries in IIP, many industries with more weight including coke and petroleum products, pharmaceuticals, medicinal and botanical products, machinery and equipment are witnessing de-growth. Even other industries are slowing down. This implies that global economic activity is impacting domestic growth through the trade channel.

Non-oil non-Gold imports (% yoy)



Source: CSO; SBI Research

Top exports of India (% yoy)

Export ($Mn)	Feb-18	Nov-18	Dec-18	Jan-19	Feb-19
Engineering Goods	-1.4	-16.4	-3.1	1.1	1.7
Gems & Jewellery	-5.1	-16.9	-19.2	6.7	-2.1
Petroleum Products	34.9	42.7	13.2	-19.0	-7.7
Organic & Inorganic Chemicals	30.1	12.3	5.5	15.6	4.1
Drugs & Pharmaceuticals	14.4	3.2	-0.7	15.2	16.1
RMG of all Textiles	-10.2	9.0	2.8	9.3	7.2
Cotton Yarn/Fabrics/made-ups, Handloom Products etc.	0.4	-5.3	-5.5	4.9	2.2
Electronic Goods	27.6	37.1	50.8	67.0	46.1
Rice	26.6	-23.1	1.3	3.3	3.0
Plastic & Linoleum	19.5	28.6	20.2	17.6	5.3

Source: SBI Research, Ministry of Commerce

Production growth of export oriented inudstries in IIP (% yoy)

	Weight in IIP	Jan-18	Oct-18	Nov-18	Dec-18	Jan-19
Textiles	3.3	1.9	5.6	-4.8	-2.9	-2.2
Wearing apparel	1.3	-12.8	31.5	22.1	16.5	16.4
Coke and refined petroleum products	11.8	11.5	1.6	3.1	-5.4	-2.3
Chemicals and chemical products	7.9	3.4	0.9	-6.4	2.7	2.1
Pharmaceuticals, medicinal chemical and botanical products	5.0	22.0	6.1	-2.1	0.3	-2.3
Rubber and plastics products	2.4	-2.5	7.2	-6.1	-4.4	-4.2
Computer, electronic and optical products	1.6	22.5	29.9	1.4	3.5	0.4
Electrical equipment	3.0	-2.6	2.5	-9.6	12.9	7.8
Machinery and equipment n.e.c.	4.8	14.9	21.9	-0.1	9.2	-2.2
Other transport equipment	1.8	32.0	24.8	7.4	17.9	6.8

Source: SBI Research, MoSPI, Ministry of Commerce

CORPORATE SECTOR HOSTAGE TO SLOWDOWN IN ORDER BOOK

Slowdown in Investment and Order inflows

- Investment scenario, as can be referred from orders and contract awarded has declined during Q3FY19 by 13% to Rs 921 bn from Rs.1056 bn in Q2FY19 and Rs 1105 bn in Q1FY19. Major sectors where orders and contracts awarded during FY19 (up to Dec) are mainly in the areas such as Railways, Roadways etc. which mainly driven by Government.
- In L&T, one of the major players in capital goods segment order flow has declined by around 12% in Q3FY19 as compared to same period previous year. Further, we are observing majority of order inflow are from infrastructure sector and outcome of continued focus by public sector on infra capex. BHEL has also reported decline in order flow position to Rs 302 bn in FY19 as against Rs 409 bn in FY18.

Major Sectors where orders and contracts awarded during FY19 (up to Dec) (Rs in crore)

Major Sector	Q1FY19		Q2FY19		Q3FY19	
	Projects	Amount	Projects	Amount	Projects	Amount
Roadways	641	27,778	837	43,155	430	28,627
Railways	58	3,059	54	5,446	69	8,382
Automobiles	4	462	2	2,976	9	8,064
Real Estate	68	18,527	57	1,606	53	4,852
Irrigation	53	13,839	59	7,043	27	4,709
Electricity & Non Conventional Energy	93	8,158	70	9,432	52	4,302
Power Distribution	90	13,515	49	969	48	3,769
Airways (Aviation Infrastructure)	25	1,820	38	6,693	29	3,591
Water & Sewerage Pipeline & Distribution	121	3,060	101	6,532	47	3,352
Shipping Infrastructure	10	1,825	9	269	5	2,438
All Sectors	1,642	110,464	1,595	105,527	1,071	92,104

Source: Projects Today; SBI Research

Order inflow in Q3FY19 vis-à-vis Q3FY18 (Rs in cr)

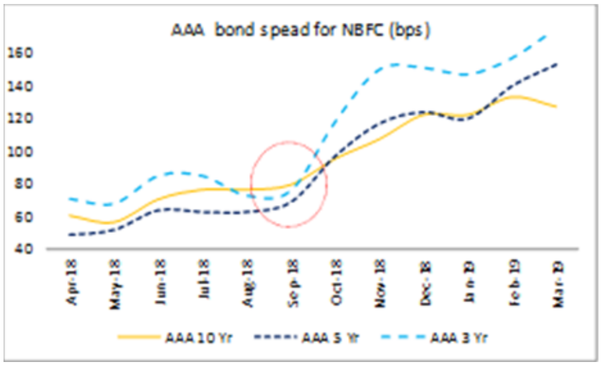
Company	Q3FY18	Q3FY19
ABB	134	115
SIEMENS	3257	3391
GE T&D	7832	14414
BHEL	29001	6400
L & T	48200	42200
THERMAX	1413	1480
KEC international	5553	3598
Kalpataru Power	2812	1392
JMC Projects	1332	1110
Crompton Greaves	1516	1615
BEML	540	3926
BEL	1146	2164
Total	102736	81805

Source: Company/Market reports; SBI Research

NBFCs

- In NBFCs space most of the NBFCs have witnessed an increase in cost of funds and are trying to shore up the liquidity levels as can be seen from the rise of average spread between the sovereign 10 year paper and AAA rated corporate bond since Sep'18. Spread has gone up from 76 bps in Aug'18 to 133 bps in Feb'19, while for three year paper the same has shot up from 73 bps in Aug'18 to 175 in March'19. Fund houses also reduced their share of investment in CP of NBFC as the same has declined from 11.31% in July'18 to 8.16% in January'19.
- Corporate Bond issuance by Financial Sector (NBFC) decreased by 25% in the 4 months ended Jan'19 (Oct'18) as compared to the previous four year (Jun to Sep'18). With limited availability of liquidity and sell down of portfolios, NIMs will be under pressure across the board with small and low rated NBFCs facing balance sheet contraction. NBFCs with higher exposure to SMEs/ Loan against shares and developer loans likely to see pain in FY20 also.

AAA Bond Spread for NBFCs



Source: CSO; SBI Research

Corporate Credit and Results

- Though we have witnessed double digit credit growth, the same is not broad based and is in selective areas only. Apart from retail, growth is observed mainly in Power, Road and PSEs only. Capex led growth from listed companies will remain muted and working capital would remain key to credit growth. In NBFC, growth is seen mainly to entities backed by worthy promoters/Government.

*****

ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management , corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

DISCLAIMER

CONTACT DETAILS

Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India
Corporate Centre
Madam Cama Road
Nariman Point
Mumbai - 400021

Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone: 022-22742440

: @kantisoumya