Ecowrap

'Be the Bank of Choice for a Transforming India'

Issue No. 34, FY20
Date: 27 August 2019

ARE WE EXAGGERATING THE CURRENT SLOWDOWN?

There is indeed evidence that economy is undergoing a slowdown. We believe the most crucial factor that is reinforcing is that rural wage growth (in real terms) is now barely expanding. Also, the weighted contribution of clothing (a non-discretionary item) in rural CPI has plunged from 39 bps in Jun'18 to almost zero in Jul'19. We also expect Q1FYGDP to be at 5.6% with a downward bias.

However, if we go beyond the macro picture interesting trends appear. First, the auto sector slowdown in India is a part of the global crisis that is unfolding. Studies done in the sector show that Auto sales in Asia-Pacific are expected to fall 2-3.5% this year after declining roughly 1% in 2018. Second, it's not all doom and gloom in the FMCG sector, where the volume growth decline of listed companies in Q1 FY20 in single digits is now being quoted universally to justify the abundance of growth slowdown. Interestingly, **it is pertinent to note that volume growth was dismal, mostly negative for major companies in Q1 FY18 due to which growth in Q1 FY19 was much higher, thereby making the volume figures in Q1 FY20 appear weaker. So is the current moderation more of a statistical artefact**?

This apart, the change in the behavioral pattern of consumers which is leaning more towards Herbal and Ayurveda oriented personal care products, presently being made in the unorganised or small business segments which are not formally captured by the data survey teams, could also be one of the reasons for a downward bias in the data. Separately, consumers are now looking for healthier options (for biscuits and snacks) and natural products (in case of beauty products), and thus Britannia biscuits might be selling in double digits! With increasing tilt towards e-retailers, consumers are now also buying bigger packets and thus the demand for smaller sachets is declining. Consumers are also looking towards good quality products from unlisted companies. Clearly, this changing consumer behavior needs better understanding and not merely a dismissal of only muted demand.

Meanwhile, among the many steps announced by FM on Friday, two steps stand out. First, bank recapitalization of Rs 70,000 crore at one go. According to our estimates, Rs 35,000 crore will go in provisioning and Rs 35,000 crore will be available for growth capital. This will generate credit growth of Rs 4-5 lakh crore, as the Government is suggesting. Further, assuming credit growth of 12% in FY20 and risk weight of 70%, our estimates suggest that PSBs might require a growth capital of around Rs 50,000 crore (vis-à-vis Rs 35,000 crores), hence rest Rs 15,000 crore might have to be raised from the market. Secondly, MSMEs have also been a recipient of the largesse. Definition of MSME based on turnover should happen quickly.

Indian markets staged a smart recovery on 26 Aug'19. However, the decline in Rupee is a reflection of trade war escalation. With Chinese currency at a theoretical level to depreciate below 7.5 per dollar, to completely offset the effects of tariffs it can be catastrophic for the global currency markets. Rupee has seen historical lows already and Yuan depreciation can cause further troubles for it. We hope US and China must talk to put an end to bouts of global market frenzy.

Q1 FY20 GDP GROWTH AT AROUND 5.6% WITH DOWNWARD BIAS

- Our composite leading indicator suggests GDP growth to slowdown further from 5.8% in Q4 of FY19 to 5.6% with downside bias in Q1 FY20 on account of low automobile sales, deceleration in air traffic movements, flattening of core sector growth and declining Government capex. We track 33 high frequency leading indicators and calculate the acceleration rate (i.e. number of indicators showing acceleration divide by total indicators). We found that acceleration rate which was 52% (as 17 indicators accelerated) in Mar'19 declined sharply to 28% (only 9 indicators accelerated) in Jun'19.
- Considering the present macro environment, it will be difficult to achieve the 7% growth target in this fiscal. Our primary estimate suggests that GDP growth will be below 6.5% in FY20 .

WILL RATE CUTS BY RBI SUFFICE?

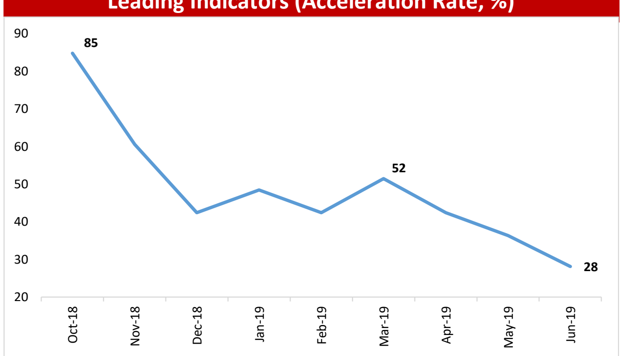
- Under the current macro environment, monetary policy seems to be less effective than fiscal policy as 'improper transmission mechanism' fails to pass on benefits to the real economy. Apart from this, low interest rate does not guarantee rise in demand for investment as it is the "future expectation" that drives investment decision rather than cost.
- The high inflation and high interest rates of the 1970s generated a revolution in macroeconomic thinking, policy and institutions. The low inflation, low interest rates and stagnation of the last decade has been longer and more serious and deserves at least an equal response. In this context, the role of monetary policy seems to be limited.

Mapping of Leading Indicators and GDP Growth

Year	Quarter	% of indicators showing acceleration	GDP growth (%)
FY18	Q1	58	6.0
	Q2	70	6.8
	Q3	67	7.7
	Q4	70	8.1
FY19	Q1	70	8.0
	Q2	64	7.0
	Q3	61	6.6
	Q4	45	5.8
FY20	Q1	36	5.6

Source: SBI Research

Leading Indicators (Acceleration Rate, %)



Source: SBI Research

- Recently, China's central bank unveiled a key interest rate reform to help steer borrowing costs lower for companies and support a slowing economy that has been hurt by a trade war with the United States. Banks now must set rates on new loans by mainly referring to the LPR and use LPR (based on rates of open market operations) as the benchmark for setting floating lending rates. PBoC further added that banks will be barred from setting any implicit floor on lending rates in a coordinated way.

RURAL SLOWDOWN

- We believe the most crucial factor that is reinforcing the demand slowdown is slow growth in rural wage. The real rural wage growth (adjusted by CPI-Rural Laborers) has plunged from 14.6% in FY14 to merely 1.1% in FY19. The subsequent decline in wage growth and structural changes resulted in stagnating per capita income growth (in real terms) and hence to keep the consumption expenditure at the same level, household savings also declined.
- In the last one year the weighted contribution of clothing (a non-discretionary item) in rural CPI has plunged from 39 bps in Jun'18 to almost zero in Jun'19 and Jul'19, indicating demand slowdown.

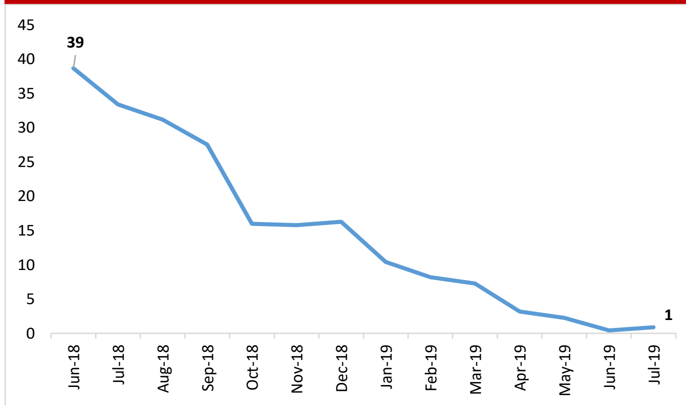
AUTO SLOWDOWN—NOT AN ISOLATED PHENOMENON

- The slowdown in the automobile segment is not just restricted to India but is spread across other nations.
- Besides India, China, Indonesia, Malaysia are also going through auto slowdown. Countries like South Korea, Thailand and Japan though marginally positive in Jul'19, recorded negative growth in June'19.
- Auto sales in Asia-Pacific, estimated at around 43-44 million vehicles in the previous year, are expected to fall 2-3.5% this year after declining roughly 1% in 2018.
- Even in Germany, the automotive production declined by 12% in the first half of this year owing to falling sales in the US and China.

FMCG SECTOR DATA HIDES MORE THINGS THAN IT REVEALS

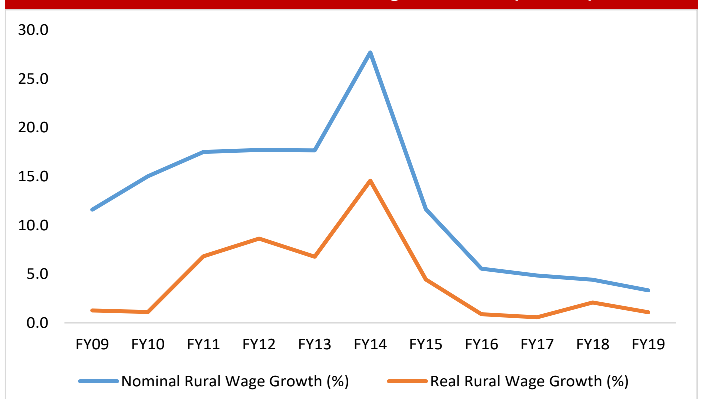
- Slowdown in FMCG sector has been capturing attention all across media currently. However, what FMCG sector is witnessing is a moderation and a change in consumer behavior and preferences.
- 87 listed entities in the space have declared their Q1FY20 results with topline growth of 11% yoy and bottom line growth of 14% yoy.
- Recent results show some companies witnessing higher volume growth of as high as 21% (KRBL Ltd), 12% (Nestle, Britannia) and companies of personal care (Colgate-Palmolive, HUL) with lower volume growth of 4-5%. While home care, food and refreshments have shown increase in volumes, certain sections including beauty and personal care have witnessed volume decline.
- It seems that consumer's preferences are undergoing structural shift. Britannia which particularly manufactures biscuits has seen increase in volume, while on the other hand the condition of Parle is not great with falling sales of Parle biscuits. This may be related to change in preferences of customers towards more healthy options of biscuits and snacks.
- Another factor could be the change in preferences of the consumers from high-end branded products towards good quality products of small companies which are not listed.
- **Other important point being missed is the base effect**. Higher growth in Q1 FY19 was due to dismal performance in Q1 FY18, which in turn makes the volume growth figures this fiscal look moderate. If **we consider the case for HUL, volume growth was 4% yoy in Q1FY18 which grew to 12% yoy in Q1 FY19 and in Q1 FY20 it is only 5% yoy.**

Rural Clothing (Weighted Contribution in bps)



Source: SBI Research

Nominal & Real Rural wage Growth (% YoY)



Source: SBI Research

Auto Sales Growth (%Y-o-Y)							
Month	China	Indonesia	Malaysia	South Korea	Thailand	Japan	India
01-2018	11.5	11.6	-0.2	6.1	16.2	-0.5	31.1
02-2018	-11.4	-0.4	-4.5	-16.1	10.3	-2.2	23.3
03-2018	4.5	-0.1	-6.9	-8.9	12.1	-3.5	18.4
04-2018	11.3	14.7	10.1	-5.8	25.2	3.2	18.4
05-2018	9.1	7.4	-15.1	-1.6	27.9	-0.2	13.8
06-2018	4.7	-11.2	28.2	-8.9	25.9	-5.0	26.3
07-2018	-4.2	25.9	41.0	-8.0	25.7	3.3	10.4
08-2018	-3.8	5.2	26.8	1.4	27.7	2.5	6.0
09-2018	-11.6	6.5	-23.7	-19.2	14.3	-2.0	5.4
10-2018	-12.0	12.4	0.5	29.6	26.8	12.5	16.3
11-2018	-13.9	4.8	-1.8	0.7	21.2	8.6	4.2
12-2018	-13.0	3.3	-11.9	15.3	8.9	-1.7	-2.0
01-2019	-15.7	-14.5	8.7	8.3	17.3	2.1	-3.9
02-2019	-13.7	-13.4	-1.8	-0.1	9.1	1.2	-2.5
03-2019	-5.1	-11.4	9.6	-3.9	8.5	-4.0	-11.6
04-2019	-14.6	-17.8	6.2	2.2	8.7	3.4	-13.6
05-2019	-16.4	-16.3	41.4	3.7	3.7	6.5	-7.4
06-2019	-9.6	1.2	-34.0	-0.6	-2.1	-0.7	-10.4
07-2019	-4.3	-17.1	-25.7	6.0		4.1	-15.3

Source: SBI Research

- **Had the Q1 FY19 growth be 7-8%, growth rate for Q1 FY20 would have been in the range of 9-10% yoy. Thus the recent moderation might be more of a statistical artefact.**
- Additionally, moderation in FMCG sector is not just limited to India. According to the reports in Asia Pacific FMCG volume growth peaked to 4.4% yoy in Q4FY18 which then eased to 2.9% yoy in Q4FY19 and further to 2.3% yoy in Q1 FY20.
- Furthermore, FMCG sector is witnessing a change in spending priorities world over. In the past five years globally there has been an increase in consumer spending on groceries (44%), technology and communication (36%), education (34%), travel (33%) and healthcare (32%).
- Another trend that is emerging from customers' behavior is that in case of beauty products customers have now become conscious while purchasing them. The packaging claiming natural does not convince them, instead the customers analyse the ingredients list and choose the brand which satisfies them. This is happening in India as well.
- Meanwhile, a study on India reveals that demonetization and GST have changed the market for FMCG. Digital modes of payment have increased among consumers. Both offline and online methods of payment are used by consumers as per their convenience and suitability. Another mode that is being developed is shopping through the app and then collecting the products at convenient pick-up stores.

MSME SECTOR: RECENT MOVES POSITIVE

- The sector is struggling due to the growing incidence of sickness of the sector. Besides, non-availability of authentic financial data, vulnerability on account of delayed payments by buyers, technological challenges due to low awareness, absence of single MSME data repository, low awareness about various govt. initiatives and lack of compliance to statutory/legal/environmental norms are some of the challenges the sector is currently going through.
- A need for appropriate public policy that would accord high priority to this sector to achieve balanced, sustainable, more equitable and inclusive growth in the country.
- Further, change in definition of Micro, Small and Medium enterprises from 'investment in plant & machinery/equipment' to 'annual turnover' will make it transparent, progressive, easier to implement and improved ease of doing business.
- Delayed Payments of receivables is the major stress factor for MSMEs. So, need for a centralised authority to monitor and take action for delayed payments. In the maiden speech, FM assured to make payment of the MSME dues in 30-days and this will address the liquidity problem in the sector.

BANK CAPITAL INFUSION

- As on June'2019, three Banks i.e. PNB, IOB and CBI Capital Adequacy Ratios are still below the regulatory requirement and seven Banks (see table) Net NPAs (NNPA) are still higher than the desired level of below 6% under Prompt corrective actions (PCA) framework.
- Assuming credit growth of 12% in FY20, PSBs, including SBI, are requiring a growth capital of around Rs 50 billion given a Risk weight of 70%.
- Government has recently announced upfront capital infusion of Rs 70 billion into PSBs. Given the fact that three banks are short of the required regulatory capital and seven are above the threshold NNPA, we assume around 50% of the capital announced may go to capital and provisioning requirements of the Banks, while the balance 50% of the same i.e. Rs 35 billion will serve as growth capital for the PSBs, which will support credit growth of Rs 4.5 trillion to Rs 5 trillion.

Results of Major Listed FMCG Companies

Company	Growth in Q1FY20 vis a vis Q1FY19 (%yoy)		
	Net Sales Value	Volume	Remarks
KRBL Ltd	63.8	21	Volume growth (Rice) of 21% from indian market and 152% from export
Nestle India Ltd	11.4	12	Food and Dairy Products i.e. Infant Cereals, Noodles, Pasta, Ketchups, Coffee etc.; growth in Milk products 8.5%, Maggi Pasta etc. 15%, Confectionary 22.5% and Beverages 4.2%
Britannia Industries Ltd	7.0	12	Food i.e. Biscuits, Wafer, Milk Shakes, etc.
Dabur India Ltd	10.5	9.6	Home care, Oral care and Healthcare vertical grew at double digit growth of 11%,11% and 18% respectively, Food business recorded a growth of 1.5% only
Marico Ltd	5.5	7	Parachute Coconut Oil (Rigid packs) grew by 9%, Saffola (Refined Edible Oil) grew by 3% by volume
Hatsun Agro Product Ltd	15.2	-	Food and Dairy Products
Godrej Consumer Products Ltd	0.9	5	Soaps growth is 3% while Household insecticides -4% by value
Hindustan Unilever Ltd	6.7	5	Food & refreshment section grew by 10% and 8% respectively, while Beauty and Personal care section reported growth of 4% only
Colgate-Palmolive (India) Ltd	4.1	4	Personal Care - Toothpaste, Toothbrush, Soap, Handwash etc.
Heritage Foods Ltd	12.0	-	Food and Dairy Products - Milk sales grew by 8% and Curd by 30% by volume
Emami Ltd	2.4	-	Navaratna grew by 4%, Kesh King by 30%, 7oils in one grew by 31%, Pain management and Male grooming range declined by 6% and 7% respectively. Boro plus range declined by 7% and health care range also declined by 3%
Memo:			
Asia Pacific FMCG Volume Growth (% yoy)			
Q2FY18	2.8		
Q3FY18	4.4		
Q4FY18	2.9		
Q1FY20	2.3		

Source: CLine; Company; Nielsen, SBI Research

Classification of enterprises as micro, small &medium enterprises (in Rs)

Type of Enterprise	MSME Act 2006		Our Suggestions
	Manufacturing	Services	All enterprises
	Investment in Plant and Machinery	Investment in Equipment	Annual Turnover
Micro	25 lakh	10 lakh	5 crore
Small	25 lakh to 5 crore	10 lakh to 2 crore	5 to 75 crore
Medium	5 to 10 crore	2 to 5 crore	75 to 250 crore

Key parameters as on June'2019 of PSBs and SBI

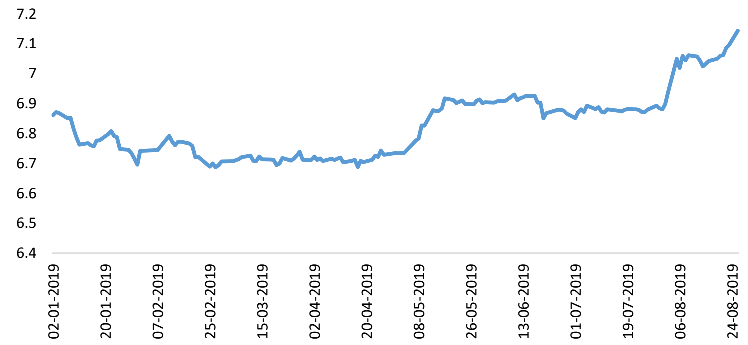
Name of the Bank	Advances (Rs crore)	CAR (%)	NNPA (%)
SBI	2238294	12.89	3.07
PNB	468429	9.77	7.17
BOI	376078	14.35	5.79
BOB	669034	11.50	3.95
Canara Bank	449290	11.70	5.35
Union Bank of India	321473	11.43	7.23
OBC	170121	13.77	5.91
IOB	147606	10.02	11.04
Allahabad Bank	164702	12.55	5.71
Andhra Bank	180258	13.72	5.67
Indian Bank	184336	13.62	3.84
Corporation Bank	121437	12.01	5.69
CBI	165102	9.58	7.98
Syndicate Bank	216002	13.70	5.96
UCO Bank	118447	10.88	8.98
BOM	93032	11.66	5.98
P&S	65195	11.35	7.77
United Bank	73249	12.60	8.19

Source: Bank Analyst Presentations; SBI Research

GLOBAL ECONOMY SHROUDED IN UNCERTAINTIES

- US had announced in August that effective September 1, 10% tariffs would be charged on $300 billion worth of Chinese goods. It also tagged China as currency manipulator, after Yuan crossed the much-watched 7 per US dollar mark.
- However, there was some respite in trade tensions when US delayed tariffs on certain products and removes items from the list. However, there was no announcement about the measures coming into effect on September 1.
- China, in retaliation, has on Friday announced the application of tariffs between 5% and 10% on $75 billion worth of US goods, effective1 September. If applied, this will take the total of US exports to China with exclusive tariffs at $185 billion.
- In response US President Donald Trump tweeted that On Oct. 1, tariffs on $250 billion Chinese products will rise from 25% to 30%. Tariffs planned for Sept. 1 on $300 billion worth of Chinese goods will now be 15%, instead of 10%.
- This escalation is going to impact the global growth and stability.
- Yuan which had crossed the 7 per dollar mark has on 5 August is showing no signs of strengthening. Since April Yuan has depreciated by 6%. With Yuan at 7 per dollar, it would have to depreciate beyond 7.5 mark beginning January 2020, to completely offset the impact of tariffs.
- This can be catastrophic for the global currency markets. Rupee has seen historical lows already and Yuan depreciation can cause further troubles for it.

Yuan Movement vis-à-vis USD



Source: SBI Research

Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point
Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
@kantisoumya