

# Floods will hit tyre & coffee industries

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## FRONT RUNNING

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The stock market ignored bad news out of Turkey that led to a rout for emerging market currencies. Instead, investors hailed strong Q1 earnings reports, strong industrial activity and lower headline inflation. The resumption of China-USA trade talks was viewed with optimism since every global investor is hoping that the US backs down on threats of hiking import tariffs and, ditto the Chinese.

The rupee crash was not unexpected. The Turkish lira just provided a trigger. India has a large, growing trade deficit and the Current Account Deficit could rise to 2.5 per cent of GDP in 2018-19. Even at ₹70.23 to the USD, the rupee might still be overvalued, going by the Real Effective Exchange Rates computed by the RBI.

Reserves have declined by \$21 bn (about five per cent of reserves) since April which indicates the RBI has been selling forex to defend the rupee. Foreign portfolio investors (FPIs) have been net buyers of rupee debt and equity in August. This is a relief since it stops

outflows due to FPI redemptions.

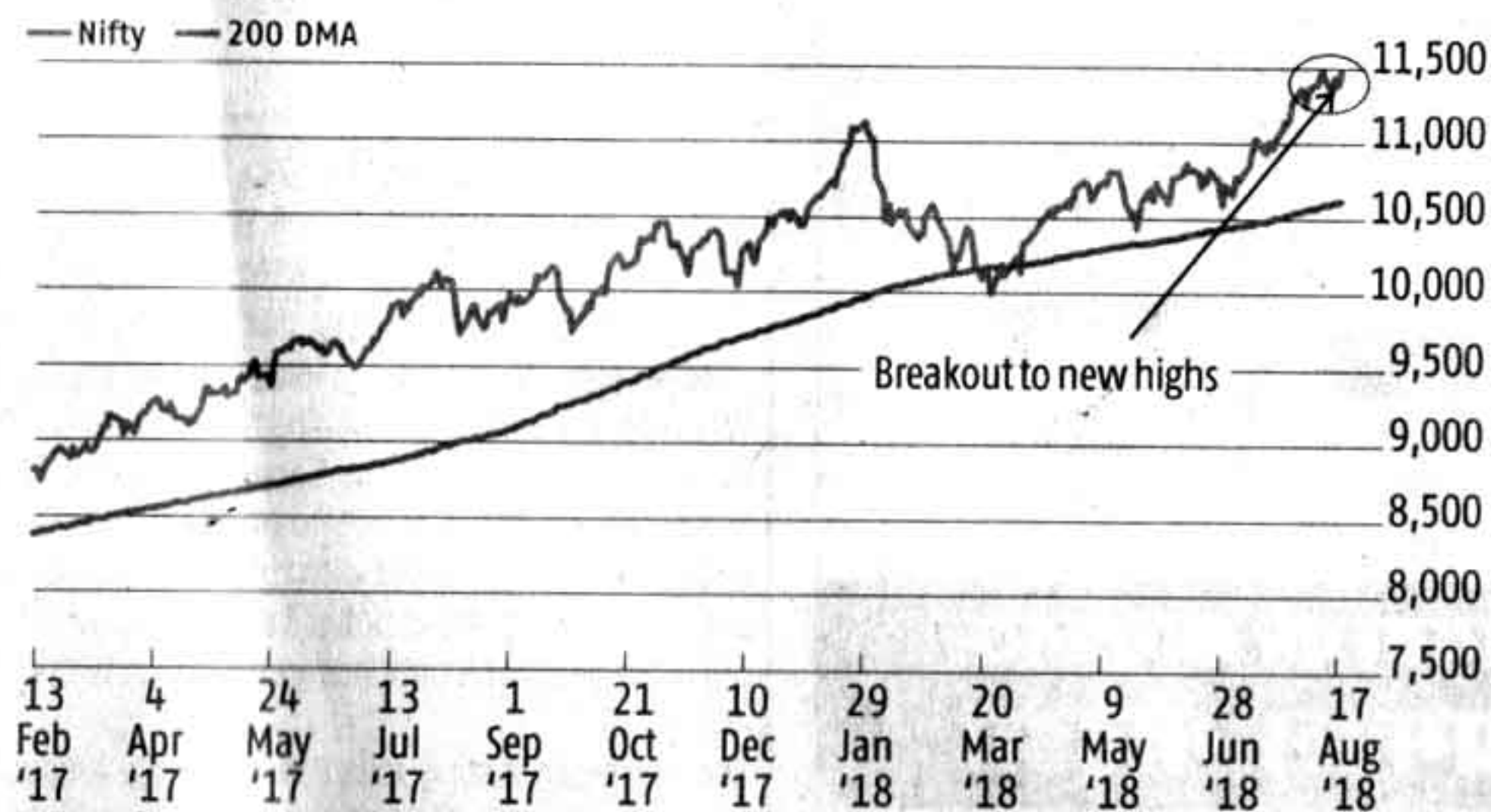
The disastrous Kerala and Kodagu floods will eventually impact the markets. The tyre industry will be hit hard, by the loss of rubber production since the state produces around 90 per cent of India's rubber. Coffee prices may spike. Banks such as the South Indian Bank and Federal Bank, and NBFCs such as Muthoot and Mannapuram will also be hurt. There would be supply disruptions in spice markets.

However, at the moment, there's been little impact. The markets noted a strong Index of Industrial Production (IIP) approvingly. The IIP picked up to seven per cent in June. The April-June 2018 cumulative growth rate for the IIP stands at 5.2 per cent over the corresponding period of the previous year but this is hard to deseasonalise due to the GST effect.

Inflation also fell. The Consumer Price Index for July was up 4.17 per cent year-on-year which was a considerable improvement on 4.84 per cent for June. The Monetary Policy Committee (MPC)'s stated target of four per cent is only a little below the headline number. However, the dip was caused almost entirely by food inflation falling sharply, to 1.7 per cent. Food inflation is volatile. If food and the other volatile element, fuel (up eight per cent) are removed, we have sticky, "core" inflation.

Core inflation is running at above six per cent. Core components such as housing, transport, healthcare, education, clothing, are all up to 12-month highs and these are all non-volatile sectors where prices tend to stay up when they go up. The high core component makes it very likely that the RBI will not even con-

## INCHING UP



	Value		Equations
	Previous (Aug 3, '18)	Current (Aug 17, '18)	Change %
Nifty value	11,360.8	11,470.75	0.97
Index PE	28.11	28.23	0.43
Index dividend yield	1.18	1.17	-0.85
Index book value	3.7	3.74	1.08
USD INR (RBI ref rate)	68.72	70.23	-2.20
FII net equity buys/sales (Aug 1-17) (₹ bn)	22.64	24.09	
DII net equity buys/sales (Aug 1-17) (₹ bn)	38.46	3.79	

\* = Jul 1-31 Net equity buys/ sales

NB FIIs sold net debt of ₹109.7 bn (June) & bought net debt of ₹0.43 bn (July)

sider cutting rates but the falling headline inflation might induce the MPC to maintain status quo in the next review.

Q1 earnings reports were good. The combined net profit of 2,271 companies, whose first quarter (Q1) results are available, was up 7.9 per cent year-on-year (YoY) during April-June 2018. Revenue growth was even better at 18.7 per cent YoY, the fastest pace in three years. Combined net profit at ₹1.08 trillion was

the highest in four years. This was due to a base effect. The combination of demonetisation and the roll-out of GST reduced sales and profits over the last two fiscals.

Energy, and metal and mining companies were among the top performers. These sectors together accounted for 59 per cent of net sales growth and almost all of the profit growth. Rising commodity prices may, however, affect profit margins in downstream indus-

tries such as automobiles.

Recoveries in the steel industry in particular, meant some good news for banks. The gross non-performing assets (GNPAs) of listed domestic banks dipped by ₹220 billion in the Q1 FY19, compared to the previous quarter (Jan-Mar 2018). A study of 40 listed banks showed that GNPAs declined to ₹10.03 trillion at end-June 2018, from ₹10.25 trillion at end-March 2018. The resolution of Bhushan Steel and Electrosteel Steels, and accelerated provisioning helped reduce GNPAs. Net NPAs, also declined by ₹325 bn crore to ₹4.85 trillion in June, from ₹5.18 trillion at end-March.

Credit rating agency CARE Ratings, said another quarter of similar bad loan reduction would indicate that the worst was over. Steel could be the pivotal industry in this equation. The crash in emerging currencies will make steel imports from Russia vastly cheaper for instance. If that happens, the domestic steel industry could be in the doldrums again despite protectionist tariffs. On the other hand, margins in the auto industry would improve if metals prices declined.

The market has continued to move up, hitting successive highs through last week. This is due to the FPIs changing stance from being heavy net sellers to moderate buyers. However, the uptrend still remains narrow. Small-caps and mid-caps have underperformed though there are signs that retail traders are getting back into the game. Technically speaking, it's hard to set targets for a market that's trading a new zone. But we do know from historic data that a narrow market is rarely sustained for a great length of time.