Macroeconomics | First cut

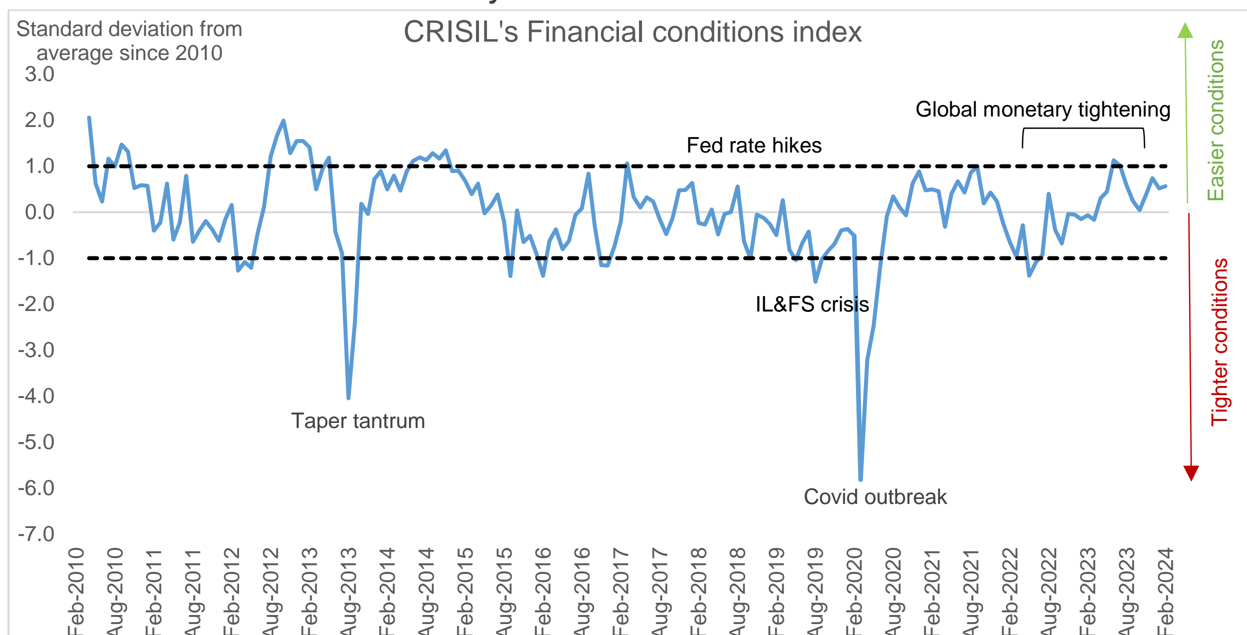
Conducive run continues

March 2024

Positive milieu draws in foreign investors

- Financial conditions in India remained favourable in February, as a slimmer budget deficit helped boost investor confidence, foreign investors stepped up buying government securities, and bank credit growth stayed buoyant
- CRISIL's Financial Conditions Index (FCI) summarises the state of financial conditions by collating key parameters across the domestic markets. The gauge stood at 0.6 in February, slightly better than January's 0.5. A positive reading indicates conditions are easier compared with the average since 2010
- The Interim Budget for next fiscal buoyed the markets in February, specifically the government's aim to cut the fiscal deficit to 5.1% of GDP next fiscal from 5.8% this year and lower borrowings. Bond yields fell sharply after the announcement
- While liquidity has been tight, its impact has so far been limited to the money markets. Broader bank lending rates rose mildly, while credit growth accelerated. Liquidity conditions have started to ease in March, which could take some pressure off money market rates
- Foreign portfolio investors (FPIs) continued to pour money into India despite rising US treasury yields and crude oil prices. Indian bonds have been drawing global investor interest ahead of their inclusion in the global bond indices. FPIs have been net-buyers in March so far in both the equity and debt segments

Financial conditions stable in February



Note: Higher value indicates easier financial conditions, and vice versa. Index within dotted lines (1standard deviation) represents conditions within the comfort zone
Source: CRISIL

Factors that improved financial conditions

- **Domestic bond yields** declined in February despite rising crude oil prices and hardening US yields. The 10-year G-sec yield declined to an average of 7.08% from 7.18% in the previous month. Yields dropped sharply earlier in the month when the government announced a reduction in fiscal deficit and gross market borrowings in the Interim Budget for next fiscal. Softening inflation and FPI inflows into debt also helped temper yields
- **Narrower liquidity deficit**: Systemic liquidity remained in deficit in February, if slightly less so compared with January. This is reflected in the RBI's net infusion of Rs 1.86 lakh crore (0.8% of net demand and time liabilities, or NDTL) in February, a touch lower than Rs 2.07 lakh crore (0.9% of NDTL) in January. A high credit-deposit ratio has kept liquidity in deficit. But a lower deficit in February compared to January was due to an increase in government spending. The RBI conducted variable repo rate auctions during the month to inject liquidity into the banking system. The weighted average call money rate (WACR) eased in February due to lower liquidity deficit, though it remained above the repo rate of 6.5%. The WACR eased 10 bps on-month averaging 6.66%
- **Net FPI inflows:** FPIs net-invested $3.8 billion in February compared with an outflow from $0.8 billion in January. This was primarily due to a surge in investments in government bonds ahead of their inclusion in the JP Morgan Emerging Market Bond Index. FPI inflows into debt increased to $2.7 billion in February from $2.4 billion in January. The debt segment has recorded net inflows for 11 consecutive months. FPIs turned net sellers in equity: they invested $0.2 billion, while outflows were $3.1 billion in January.
- **Bank credit growth accelerated** for the second consecutive month to 16.5%[1] in February from 16.1% in January. Sectoral data[2] for January shows the increase was driven by agriculture (20.1% vs 19.5% in December), services (20.7% vs 19.6%) and personal loans (18.4% vs 17.7%). Growth credit card dues outstanding moderated compared with the previous month (31.3% vs 32.6%), as did industry credit (7.8% vs 8.1%)
- **The rupee remained strong in February,** averaging Rs 83 per dollar in February compared with Rs 83.1 per dollar in the previous month. FPI inflows pushed up the rupee while a stronger dollar exerted some pressure
- **Rising equities:** The S&P BSE Sensex and the Nifty 50 advanced mildly on-month in February, rising 0.8% and 1.5% on-average, respectively. Some gains were seen as a fiscally prudent interim Union Budget led to positive sentiment. Market volatility was higher in February than in January

Factors that were a drag

- **US treasury yields rose** for the second month in a row. The yield on the 10-year note surged to an average of 4.21% in February from 4.06% in January. Job market data was robust in February, while core inflation remained high, leading to concerns that interest rates will remain higher for longer. Rising crude oil prices also resulted in higher yields
- **Higher lending rates:** The transmission of the MPC's past rate hikes to bank lending rates continued at a gradual pace in February. While the MPC has raised policy rates by 250 bps since April 2022, the rise in bank lending rates has been slower. Housing and auto loan rates rose by 231 bps and 155 bps, respectively. In February, housing and auto loan rates rose mildly by 2-3 bps averaging 9.29% and 9.77%, respectively. The one-year MCLR was unchanged at 8.8%. It has risen 155 bps since April 2022. Bank lending rates are above their pre-pandemic average, and higher lending rates could lead to some softening in bank credit going forward
- **Rising money market rates:** Money market rates other than the weighted average call rate (WACR), such as the rates on the six-month commercial paper (CP), six-month certificate of deposit (CD) and the 91-day treasury bill (T-bill) hardened on-month. The rate on the six-month CP rose sharply to 8.47% from 8.22% in the

[1] As on February 23, excluding the impact of the HDFC merger
[2] Excluding impact of HDFC merger

previous month. The 91-day T-bill rate and the six-month CD rate rose 4 bps (to an average of 6.99%) and 6 bps (to an average of 7.82%), respectively

- **Global crude oil prices increased** for the second month in a row as geopolitical tensions in the Middle East continued. Brent crude oil prices rose to $83.8 per barrel average from $80.3 per barrel last month

Financial conditions may be less growth supportive in fiscal 2025

Financial conditions had been conducive to growth in fiscal 2024, particularly as bank credit growth was in double digits for the second year in a row. Cleaned bank balance sheets played a crucial role in supporting growth even as interest rates rose at a gradual pace.

Buoyant growth and disinflation has pushed expectations of rate cuts by major central banks. We do not expect the RBI to cut rates before June 2024, as it remains cautious on food inflation risks. S&P Global expects the Federal Reserve to cut rates from June 2024 as well.

The RBI is taking measures to check excessive risk-taking in various market segments. The RBI's move to increase risk weights for non-banks and unsecured consumer lending is expected to temper credit growth. CRISIL MI&A sees it at 13.5-14.5% next fiscal compared with an estimated 14.5-15.5% this fiscal. Non-banking credit is expected to see a sharper slowdown of 15-16% next fiscal from 17-18% this fiscal. This would also have an impact on the pace of economic growth next fiscal.

However, the markets may continue to benefit from FPIs, given the current strong macroeconomic position and the opportunity created by their inclusion in global bond indices.

Table: How financial conditions evolved across market segments this fiscal

		Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24
Policy rate	Repo rate (%)	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
	Repo rate, inflation-adjusted (%)	1.8	2.2	1.7	-0.9	-0.3	1.5	1.6	0.9	0.8	1.4	1.4
Liquidity conditions	Net absorption(-)/injection(+) under LAF (% of NDTL)	-0.8	-0.4	-0.6	-0.8	-0.6	0.1	0.2	0.3	0.5	0.9	0.8
Money market	Call money rate (%)	6.5	6.6	6.5	6.5	6.6	6.7	6.7	6.8	6.8	6.8	6.7
	91 day T-bill (%)	6.8	6.8	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.0	7.0
	CP 6-month rate (%)	7.6	7.6	7.5	7.4	7.5	7.6	7.8	7.9	8.0	8.2	8.5
Debt market	10-year G-Sec (%)	7.2	7.0	7.0	7.1	7.2	7.2	7.3	7.3	7.2	7.2	7.1
	Term premium (%)	0.7	0.5	0.5	0.6	0.7	0.7	0.8	0.8	0.7	0.7	0.6
	AAA bond spread' (%)	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.4	0.4	0.3
	AA bond spread" (%)	2.9	2.9	3.0	2.9	2.6	2.68	3.2	3.3	3.3	0.9	1.8
Lending rates	MCLR (1 year) (%)	8.6	8.6	8.7	8.7	8.6	8.7	8.7	8.7	8.8	8.8	8.8
	Auto loan rate (%)	9.8	9.8	9.8	9.8	9.8	9.8	9.7	9.7	9.7	9.7	9.8
	Housing loan rate (%)	9.4	9.4	9.4	9.4	9.4	9.4	9.3	9.3	9.3	9.3	9.3
Credit availability	Bank credit growth (y-o-y,%)	15.9	15.4	16.2	14.7	14.9	15.3	15.2	16.2	15.6	16.1	16.5
Money supply	M3 growth (y-o-y %)	9.5	10.1	13.4	10.6	10.8	10.9	10.8	11.2	10.9	11.0	10.9
Equity market	Sensex (%*)	4.4	6.8	8.0	12.0	10.1	11.2	8.9	8.7	16.0	17.1	16.8
	NSE VIX	11.9	12.5	11.2	11.2	11.6	11.2	11.1	11.6	13.5	14.1	15.5
Forex market	Rs/USD (m-o-m %)	-0.3	0.4	-0.1	-0.1	0.8	0.3	0.2	0.1	0.0	-0.2	-0.2
Foreign capital	Net FPI (USD bn)	1.7	5.9	6.8	5.8	2.2	-1.7	-2.1	2.9	10.1	-0.8	3.8
Global conditions	S&P500 (%*)	-1.8	-1.2	3.3	6.9	5.6	4.5	1.4	5.9	11.2	13.9	18.4
	US 10Y Treasury yield (%)	3.5	3.6	3.7	3.9	4.2	4.4	4.8	4.5	4.0	4.1	4.2
	Brent ($/barrel)	84.1	75.7	74.9	80.1	86.2	94.0	91.1	83.2	77.9	80.2	83.8

Favourable
Neutral
Adverse

*Note: ^Spread over the repo rate; term premium is the 10-year G-sec's spread over the repo rate; 'spread over 10-year G-sec; "spread over five-year G-sec; *% change with respect to a two-year moving average; a positive % rupee change implies depreciation against the US dollar, and vice versa; credit data excludes the impact of a bank with non-bank*
Source: RBI, National Securities Depository Ltd, US Department of the Treasury, CEIC, CRISIL

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