Macroeconomics | First cut

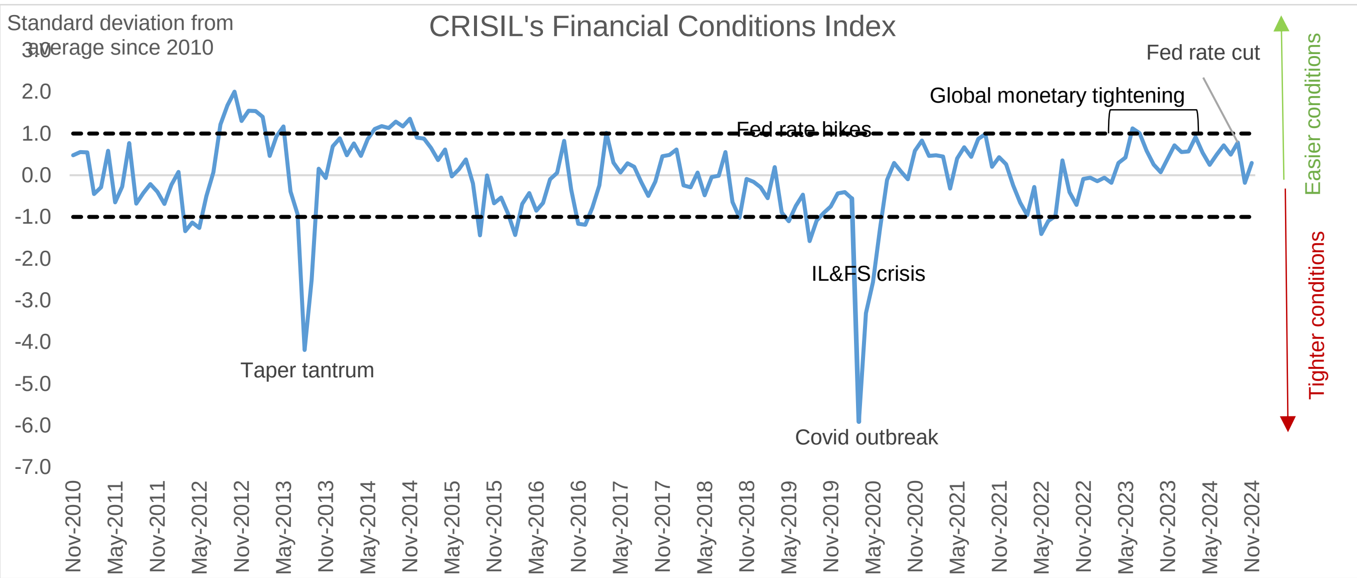
FPIs tone down selling

December 2024

Domestic financial conditions improve with lower FPI outflows

- Domestic financial markets have been facing pressure from foreign portfolio investor (FPI) outflows since October. However, the selling intensity reduced in November, which improved domestic financial conditions.
- CRISIL Financial Conditions Index (FCI), which is a combination of parameters from India's major financial market segments,[1] rose to 0.3 in November from -0.2 previous month, implying easing financial conditions. However, the FCI in October-November averaged 0.1, lower (tighter) than 0.7 in the second quarter.
- Lower FPI outflows on month supported the improvement in the FCI.
- That said, FPIs remained net sellers for the second consecutive month. Stronger US dollar and Treasury yields after the presidential election results there have been exerting pressure on FPI flows.
- With FPI outflows and a strengthening dollar, the rupee hit a record low in November. However, the Reserve Bank of India's (RBI) interventions in the forex market could have limited the rupee's depreciation.
- FPI outflows and increased currency demand during the festival season have also been draining the domestic liquidity. The RBI expects it to remain under pressure in the near future, which prompted the central bank to cut banks' cash reserve ratio (CRR) 50 basis points (bps) in December.
- In our view, conditions are turning favourable for a rate cut in February. Inflation is showing signs of softening while the impact of the RBI's past rate hikes has been squeezing credit growth this fiscal.

Financial conditions improve in November



Source: CRISIL

[1] CRISIL's FCI is constructed based on 15 parameters across money, debt, equity and foreign exchange markets, along with monetary policy and bank lending conditions. Higher FCI value means easier financial conditions and vice versa

Why financial conditions eased

- **Net FPI outflows narrowed:** FPIs continued to be net sellers in November, but the outflow reduced significantly on month. They withdrew $2.5 billion in November, much lower than the $11.5 billion in October. The outflows from the equity segment declined sharply ($2.5 billion vs $11.2 billion) while those from debt were stable at $0.4 billion.
- **Oil declined:** Global crude oil prices softened as demand in China was subdued. Brent prices decreased to $74.4 per barrel on average in November from $75.7 per barrel previous month.
- **Stable domestic bond yields:** Indian bond yields were broadly stable in November. The yield on the benchmark 10-year G-sec averaged 6.81% during the month, the same as October. Though mild net FPI outflows put some pressure on the yields, it was offset by softer crude oil prices.
- **Stable money market rates:** Money market rates remained stable as systemic liquidity remained in surplus. The weighted average call money rate (WACR; the operating target for the monetary policy) averaged 6.52% (up 3 bps on month), on par with the repo rate of 6.5% and unchanged from the previous month. Other rates such as the rate on the 91-day treasury bills (6.46%), six-month commercial papers (7.74%) and six-month certificates of deposit (7.4%) were also unchanged.

What factors were a drag

- **Stronger US dollar and Treasury yields:** Donald Trump's victory in the US presidential elections boosted the dollar, which appreciated a sharp 2.2% on month. US Treasury yields hardened for the second straight month. The yield on the 10-year Treasury bond rose to 4.36% on average from 4.1% in October. Concerns over higher fiscal deficits under Trump and a rise in Consumer Price Index (CPI)-based inflation (2.6% in October vs 2.4% in September) drove up the yields. Both these factors hit FPI flows to India and put pressure on the rupee.
- **Rupee weakness:** The rupee depreciated 0.4% on month in November**,** averaging at Rs. 84.4, a record low. A stronger dollar and FPI outflows pressured the currency. It is notable the rupee depreciated at a lesser rate than the dollar's appreciation. The RBI's interventions in the forex market (by selling dollars) could have limited the depreciation of the rupee.
- **Reducing surplus liquidity**: Systemic liquidity remained in surplus in November but moderated on month. Under its liquidity adjustment facility, the RBI net absorbed Rs 1.4 lakh crore (0.6% of net demand and time liabilities, or NDTL) in November, a touch lower than Rs 1.5 lakh crore (0.6% of NDTL) in the previous month. The reasons for the marginal decline were FPI outflows (and the resultant RBI intervention in the forex market), GST outflows and rising currency in circulation because of the festival season while a sharp increase in government spending kept the liquidity in surplus.
- **Higher lending rates:** The one-year marginal cost of fund based lending rate (MCLR) rose 5 bps to 8.95%. Auto loan rates were up 1 bp on average to 9.74% while housing loan rates were stable at an average of 9.15%. Elevated lending rates are weighing down on bank credit growth. All these lending rates are now higher than their pre-pandemic five-year averages. Deposit rates were stable at 6.88%.
- **Marginal decline in bank credit growth:** Bank credit growth continued to soften marginally to 11.2% in November from 11.5% in October.

  Sectoral data for October shows that credit growth in agriculture (15.5% in October vs 16.4% in September), industry (7.9% vs 8.9%) and services (12.7% vs 13.7%) are leading the slowdown in credit growth. Credit growth slowed across industries of various sizes — large (6% vs 6.5%), medium (19.6% vs 20.5% and, micro and small (10% vs 13.4%). Within services, non-banking financial companies saw credit growth slowing to its lowest level since October 2021 (6.4% vs 9.5%). Retail credit growth also moderated to 12.9% vs 13.4%. The decline was sharper in other personal loans (10.9% vs 11.4%) and credit cards (16.9% vs 18%), which are key indicators of unsecured lending.

- **Losses in equities:** Indian equities saw losses for the second straight month with the benchmark indices S&P BSE Sensex and Nifty 50 falling 2.6% and 3.3% on-average respectively. Persistent foreign capital outflows, dull corporate earnings, US election result and escalations in geopolitical conflicts weighed on investor sentiment. Volatility in equity markets rose in November, with the NSE volatility index (VIX) rising to average at 15.3 from 13.9 in October.

Rate cuts may support financial conditions next year

We expect inflation to soften in the coming months and make room for rate cuts. The first one we expect to come in February. Lower inflation is premised on easing food inflation given a healthy agricultural output.

While major global central banks have begun cutting rates, market volatility has increased after the US elections. The US Federal Reserve's (Fed) path to further rate cuts is unclear because President-elect Trump has promised higher import tariffs, which are likely to add to inflationary pressures.

S&P Global sees fewer rate cuts by the Fed in 2025 than it had expected three months ago. Overall, the global environment is conducive to pursuing rate cuts.

Domestic growth is moving closer to pre-pandemic decadal average this fiscal, after posting above-average 8.2% last year. While healthy agricultural production is expected to support rural demand, the lagged impact of previous rate hikes is playing out in other sectors. Elevated interest rates and high inflation could weigh on discretionary consumption, especially in the urban areas.

Overall, easing domestic inflation will be the main driver of the RBI's rate cuts from February. That said, the cumulative reduction in the upcoming cutting cycle would be less than the 250-bps hike affected since May 2022 as domestic growth momentum is projected to remain healthy and global rate cut cycle will also be shallower.

Table: How financial conditions fare across different segments

		Pre-pandemic 5-year average	Annual average				Current fiscal							
		FY16-20	FY21	FY22	FY23	FY24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24
Policy rate	Repo rate (%)	**6.3**	*4.0*	*4.0*	*5.5*	*6.5*	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
	Repo rate, inflation-adjusted (%)	**2.0**	*-2.2*	*-1.5*	*-1.1*	*1.1*	1.7	1.7	1.4	2.9	2.8	1.0	0.3	1.0
Liquidity conditions	Net absorption(-)/injection(+) under LAF (% of NDTL)	**-0.5**	*-3.0*	*-3.9*	*-0.9*	*0.0*	-0.1	0.6	0.2	-0.4	-0.7	-0.4	-0.6	-0.6
Money market	Call money rate (%)	**6.2**	*3.4*	*3.3*	*5.4*	*6.6*	6.5	6.6	6.6	6.5	6.5	6.6	6.5	6.5
	91 day T-bill (%)	**6.5**	*3.3*	*3.5*	*5.8*	*6.9*	6.9	6.9	6.8	6.7	6.6	6.6	6.5	6.5
	CP 6-month rate (%)	**7.6**	*4.4*	*4.3*	*6.9*	*7.8*	7.9	7.9	7.9	7.8	7.8	7.8	7.7	7.7
Debt market	10-year G-sec (%)	**7.2**	*6.0*	*6.3*	*7.3*	*7.2*	7.2	7.0	7.0	7.0	6.9	6.8	6.8	6.8
	Term premium (%)	**1.0**	*1.9*	*2.3*	*1.8*	*0.7*	0.7	0.5	0.5	0.5	0.4	0.3	0.3	0.3
	AAA bond spread' (%)	**0.6**	*0.7*	*0.5*	*0.2*	*0.3*	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3
	AA bond spread'' (%)	**2.0**	*3.6*	*2.0*	*3.5*	*2.6*	2.0	2.1	2.1	2.1	2.3	2.3	2.0	2.1
Lending rates	MCLR (1 year) (%)	**8.3**	*7.4*	*7.1*	*7.9*	*8.7*	8.9	8.8	8.9	8.9	8.9	9.0	9.0	9.0
	Auto loan rate (%)	**9.6**	*8.0*	*7.7*	*9.0*	*9.8*	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7
	Housing loan rate (%)	**9.1**	*7.4*	*7.1*	*8.4*	*9.3*	9.3	9.3	9.3	9.3	9.2	9.2	9.2	9.2
Credit availability	Bank credit growth (y-o-y,%)	**9.7**	*5.9*	*7.0*	*14.2*	*15.7*	15.3	16.1	13.9	13.7	13.6	13.0	11.5	11.2
Money supply	M3 growth (y-o-y %)	**9.7**	*12.2*	*9.6*	*8.9*	*10.9*	10.9	12.1	9.7	10.0	10.2	10.8	11.1	10.4
Equity market	Sensex (%*)	**8.7**	*7.6*	*27.0*	*8.7*	*11.4*	17.0	15.5	18.2	21.8	20.2	22.5	17.6	13.5
	NSE VIX	**15.6**	*25.8*	*17.9*	*17.5*	*12.4*	11.7	20.2	15.6	13.5	14.9	13.3	13.9	15.3
Forex market	Rs/$ (m-o-m, %)	**0.2**	*-0.2*	*0.4*	*0.6*	*0.1*	0.5	0.0	0.1	0.1	0.4	-0.1	0.3	0.4
Foreign capital	Net FPI ($ bn)	**0.6**	*3.0*	*-1.3*	*-0.5*	*3.4*	-1.9	-1.5	5.0	5.8	3.0	11.2	-11.5	-2.5
Global conditions	S&P 500 (%*)	**8.9**	*14.0*	*24.3*	*-2.8*	*7.5*	19.1	21.0	23.6	24.5	21.5	23.1	24.7	25.3
	10-year US Treasury yield (%)	**2.3**	*0.9*	*1.6*	*3.4*	*4.1*	4.5	4.5	4.3	4.2	3.9	3.7	4.1	4.4
	Brent ($/barrel)	**57.4**	*44.8*	*80.0*	*95.4*	*83.0*	90.1	82.0	82.6	85.3	80.9	74.3	75.7	74.4

Favourable
Neutral
Adverse

*Notes: ^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 for Apr-Jul excludes the impact of a bank with non-bank*
Sources: RBI, National Securities Depository Ltd, US Department of the Treasury, CEIC, CRISIL

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