

Macroeconomics | **First cut**

Getting tighter

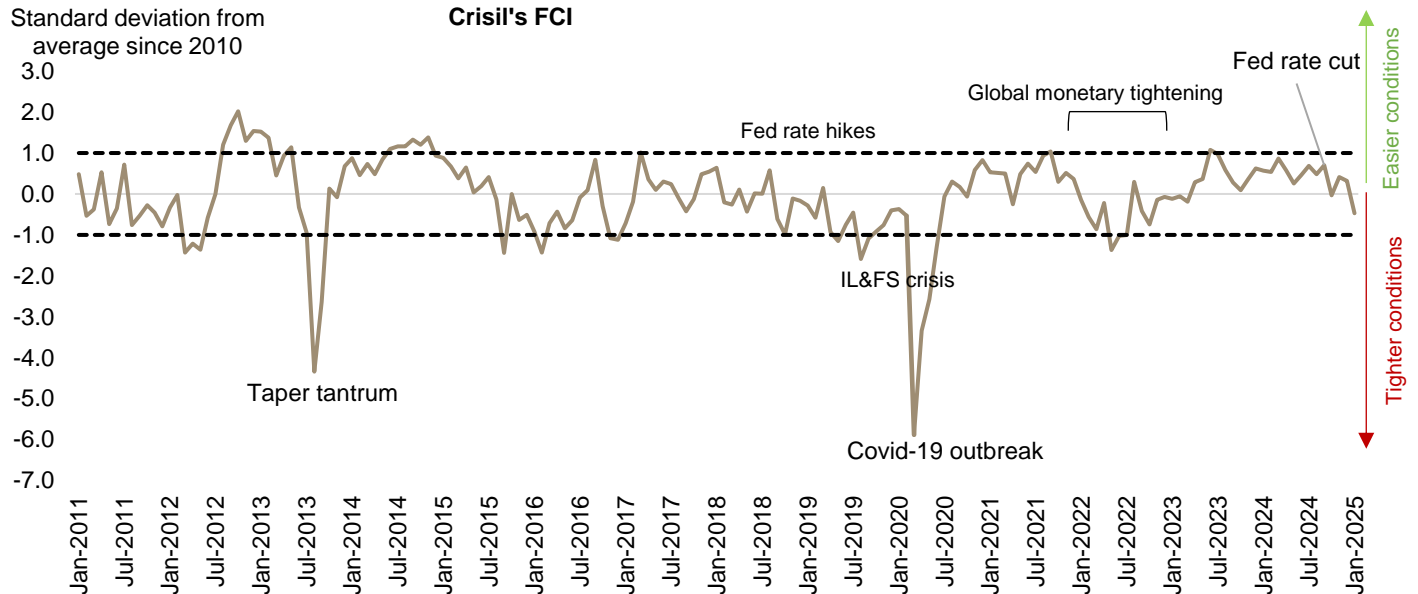
February 2025

Pincer effect of both global and domestic factors

- Crisil's Financial Conditions Index (FCI) ¹ reflected tighter milieu in January amid rising global uncertainties. Indicating relative tightness in liquidity conditions, the index entered the negative zone for the first time in 22 months. The FCI stood at -0.5 in January, compared with 0.3 in December. Lower the value, tighter the financial conditions
- Despite entering the negative zone, from a long-term trend perspective the FCI remains in the identified comfort zone i.e., within one standard deviation from the long-term average
- Sharp depreciation in the rupee against the dollar (by 1.5% on-month and 3.8% on-year), a pullback by foreign portfolio investors (FPIs) and a possible-defensive foreign exchange intervention by the Reserve Bank of India to curb rupee volatility brought tightness in liquidity conditions
- Domestic liquidity deficit hit a 15-year low to reach Rs 3.15 lakh crore on January 23, putting an upward pressure on money market rates
- In February, citing a softer inflation outlook, the Monetary Policy Committee (MPC) of the RBI cut the repo rate by 25 basis points (bps), while maintaining its neutral stance, which allows it the flexibility to move based on data. Meanwhile it remains committed to provide sufficient system liquidity to ensure rate actions are transmitted

¹ Crisil's FCI gathers 15 parameters across money, debt, equity and foreign exchange markets, along with monetary policy and bank lending conditions.

Financial conditions tightened in January



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

Source: Crisil

What led to the tightening of financial conditions?

- **FPI outflows:** FPIs were net sellers in January, withdrawing \$9 billion (in the equity, debt and hybrid categories) from Indian markets, compared with net inflows of \$3.1 billion in December. Majority of outflows came from the equity segment, with net outflows of \$9 billion (vs inflows of \$1.8 billion in December) due to uncertainty about the US government's trade policies. FPIs remained net buyers in debt, investing \$0.5 billion, albeit lower than the \$1.6 billion in the previous month as the spread between the US and Indian yields narrowed. US Treasury yields rose to their highest monthly average since October 2023 in January (4.63% vs 4.39% in December) due to the debt issuance by the US government and expectations of shallower rate cuts by the Fed
- **Rupee depreciation:** The rupee depreciated 1.5% on-month in January (and 3.8% on-year) plummeting past the 86 per dollar-mark, a record low. Heightened uncertainty led by concerns regarding a broader trade war, the resultant FPI outflows and a stronger dollar led to the depreciation
- **Deficit liquidity:** The deficit in systemic liquidity deepened in January with the RBI requiring to net-inject Rs 2.04 lakh crore (0.8% of net demand and time liabilities, or NDTL) vs Rs 0.68 lakh crore (0.3% of NDTL) in December under its liquidity adjustment facility. FPI outflows, RBI's forex interventions and rising currency in circulation have been driving the deficit in liquidity
- **Higher money market rates:** The deficit in liquidity weighed on money market rates. The weighted average call money rate (WACR), which is the operating target for monetary policy, was broadly stable at 6.61% (down 2 bps on-month), remaining above the repo rate of 6.5% (in January). The WACR eased a tad towards the end of the month as liquidity conditions improved. Other money market rates rose on-month. The rate on the six-month

commercial paper rose 20 bps (to 7.92%), while that on a similar tenure certificate of deposit rose 13 bps (to 7.62%), the highest monthly averages for both since March 2024. The rate on the 91-day Treasury bill rose to 6.57% from 6.48%

- **Losses in equities:** Indian equities indices declined in January, driven by heavy FPI selling and concerns over weaker-than-expected third-quarter earnings. The benchmark S&P BSE Sensex and Nifty 50 were down 3.8% and 3.6% on average, respectively. Markets were also more volatile than the previous month, with the NSE volatility index rising to average 15.9 from 14.0 in December
- **Rising crude oil prices:** Global crude oil prices rose in January amid fresh US sanctions on Russia and colder temperatures in the northern hemisphere. Brent crude rose to an average of \$79.2 per barrel from \$73.8 per barrel in December

Where there was some comfort

- **Stable domestic bond yields:** Although higher crude oil prices, tighter domestic liquidity conditions and hardening US Treasury yields put upward pressure on the domestic benchmark 10-year government security yield, they dipped towards the end of the month as the RBI's aggressive liquidity-infusion plans fuelled expectations of interest rate cuts. The yield which stayed broadly stable on-month (at 6.75% average, cooling to 6.69% by month-end) provided some comfort to the FCI
- **Pick-up in bank credit growth:** Bank credit growth held up at 11.4% on-year in January and kept the FCI from dipping further.

Credit growth slowed considerably from 15.2% at the beginning of fiscal 2025 due to the impact of high lending rates. Sectoral data² for December shows credit growth slowed across categories since the beginning of the fiscal. Agriculture (12.5% in December from 19.8% in April), personal loans (12% from 17.4%) and services (11.7% from 19.2%) saw a slowdown in credit growth. Industry, on the other hand, witnessed a rise in credit growth this fiscal (7.2% vs 6.9%).

RBI's easing cycle begins amid uncertainty

The MPC's easing cycle has begun. Similar to the tightening cycle, this time too there seems to be increased reliance on liquidity management. The MPC reduced the cash reserve ratio (CRR) in December and in January conducted variable repo rate auctions injecting Rs 2.7 lakh crore on average, and purchased government securities worth Rs ~58,000 crore to infuse systemic liquidity. In February, the MPC announced its first policy repo rate cut of 25 basis points (bps) and announced further measures to inject durable liquidity (through open market operations, forex buy-sell swap and a 56-day variable rate repo).

As CPI comes closer to the MPC's target of 4%, we expect further easing in monetary policy.

The domestic growth-inflation mix will be the key determinant of the RBI's rate cuts. We expect India's gross domestic product to rise slightly to 6.5% in fiscal 2026 from 6.4% this fiscal, driven by easing inflation, repo rate cuts and reduction in income tax. That said, a lower fiscal impulse — as the government plans to reduce its fiscal deficit — will

² Figures for April exclude the impact of the HDFC merger

weigh on growth. Exports face risks from intensifying tariff wars. Central banks are looking at higher risks to growth and inflation amid the global tariff war set off by the US. The Fed paused its rate cutting cycle in January. S&P Global expects only one rate cut between the first half of calendar 2025 and the second half of 2026.

Given the backdrop, our base case is 75-100 bps of rate cuts in the current cycle. This will be shallower than the 225 bps cuts around the Covid-19 pandemic. We also expect the RBI to use other instruments, such as liquidity and foreign exchange interventions, to support financial conditions.

Table: How financial conditions fare across different segments

		Pre-pandemic 5-year average	Current fiscal									
		FY16-20	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25
Policy rate	Repo rate (%)	6.3	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
	Repo rate, inflation-adjusted (%)	2.0	1.7	1.7	1.4	2.9	2.8	1.0	0.3	1.0	1.3	2.2
Liquidity conditions	Net absorption(-)/injection(+) under LAF (% of NDTL)	-0.5	-0.1	0.6	0.2	-0.4	-0.7	-0.4	-0.6	-0.6	0.3	0.8
Money market	Call money rate (%)	6.2	6.5	6.6	6.6	6.5	6.5	6.6	6.5	6.5	6.6	6.6
	91 day T-bill (%)	6.5	6.9	6.9	6.8	6.7	6.6	6.6	6.5	6.5	6.5	6.6
	CP 6-month rate (%)	7.6	7.9	7.9	7.9	7.8	7.8	7.8	7.7	7.7	7.7	7.9
Debt market	10-year G-sec (%)	7.2	7.2	7.0	7.0	7.0	6.9	6.8	6.8	6.8	6.7	6.8
	Term premium (%)	1.0	0.7	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.2	0.3
	AAA bond spread* (%)	0.6	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.4	0.3
	AA bond spread* (%)	2.0	2.0	2.1	2.1	2.1	2.3	2.3	2.0	2.1	2.2	2.2
Lending rates	MCLR (1 year) (%)	8.3	8.9	8.8	8.9	8.9	8.9	9.0	9.0	9.0	9.0	9.0
	Auto loan rate (%)	9.6	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7
	Housing loan rate (%)	9.1	9.3	9.3	9.3	9.3	9.2	9.2	9.2	9.2	9.2	9.2
Credit availability	Bank credit growth (y-o-y, %)	9.7	15.3	16.1	13.9	13.7	13.6	13.0	11.6	10.6	11.2	11.4
Money supply	M3 growth (y-o-y, %)	9.7	10.9	12.1	9.7	10.0	10.2	10.8	11.1	11.1	9.3	9.6
Equity market	Sensex (%)	8.7	17.0	15.5	18.2	21.8	20.2	22.5	17.6	13.5	13.9	8.5
	NSE VIX	15.6	11.7	20.2	15.6	13.5	14.9	13.3	13.9	15.3	14.0	15.9
Forex market	Rs/\$ (m-o-m, %)	0.2	0.5	0.0	0.1	0.1	0.4	-0.1	0.3	0.4	0.7	1.5
Foreign capital	Net FPI (\$ bn)	0.6	-1.9	-1.5	5.0	5.8	3.0	11.2	-11.5	-2.5	3.1	-9.0
Global conditions	S&P 500 (%)	8.9	19.1	21.0	23.6	24.5	21.5	23.1	24.7	25.3	24.8	22.0
	10-year US Treasury yield (%)	2.3	4.5	4.5	4.3	4.2	3.9	3.7	4.1	4.4	4.4	4.6
	Brent (\$/barrel)	57.4	90.1	82.0	82.6	85.3	80.9	74.3	75.7	74.4	73.8	79.2

	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; *percentage change with respect to a two-year moving average; a positive percentage rupee change implies depreciation against the US dollar, and vice versa; credit data for April-June excludes the impact the merger of a bank with non-bank

Sources: RBI, National Securities Depository Ltd, US Department of the Treasury, CEIC, Crisil

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