Macroeconomics | First cut

FPIs drive financial conditions

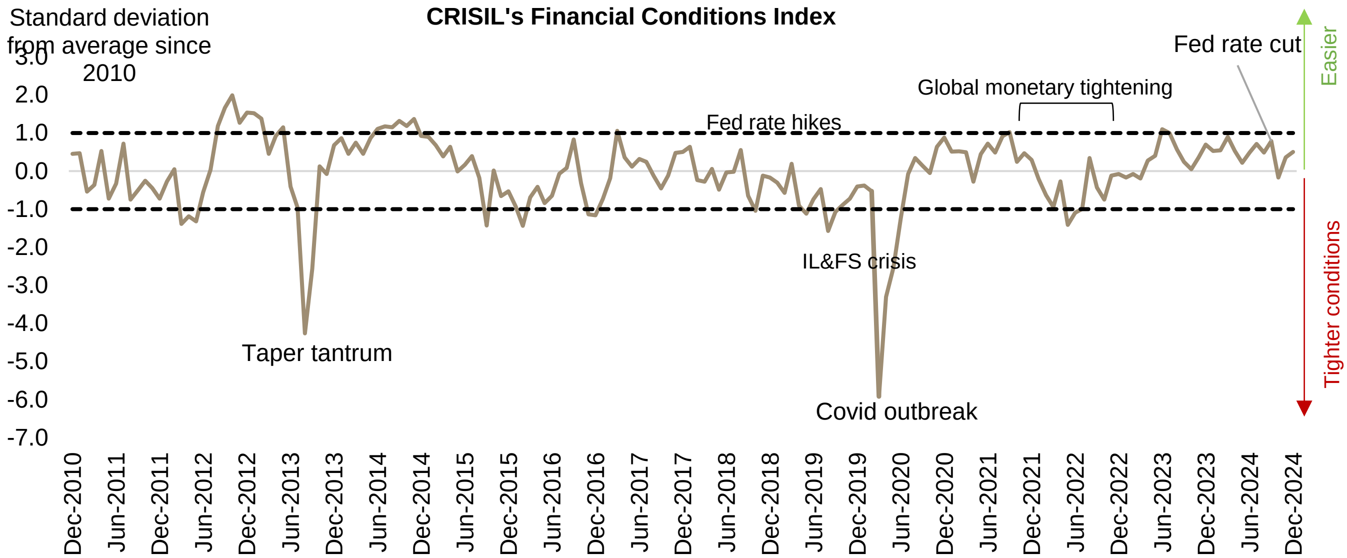
January 2025

Foreign capital inflows help ease financial conditions in December

- Domestic financial conditions improved marginally on-month in December. The CRISIL Financial Conditions Index (FCI), an indicator capturing parameters from India's major financial market segments,[1] rose to 0.5 from 0.4 in November[2]
- Foreign portfolio investors (FPI) returned to Indian markets in the first half of the month as US treasury yields cooled. This buoyed equities and supported softer domestic yields. Falling crude prices augured well for inflows into oil importing economies such as India. But a rapidly strengthening dollar, put pressure on the rupee and it high a fresh low against the dollar.
- Domestic liquidity tightened despite the Reserve Bank of India (RBI) cutting the cash reserve ratio (CRR) on the back of increased currency demand during the festival season and tax outflows. Tighter liquidity pushed up money market rates. An uptick in bank credit growth provided some support to domestic liquidity
- On average, financial conditions were tighter in the December quarter relative to the September quarter, with the FCI averaging 0.2 in October-December against 0.7 in July-September. The strengthening of the United States (US) dollar, particularly after President Donald Trump's election, put pressure on domestic financial conditions via waning capital flows in October and November

[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
[2] A higher value indicates easier financial conditions and vice versa

Financial conditions ease slightly in December



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

Which factors supported financial conditions…

- **Lower cash reserve ratio:** The RBI cut the CRR in two tranches of 25 basis points (bps) in December to 4%, keeping liquidity from slipping further into a deficit
- **Return of FPI inflows:** FPIs turned net-buyers after two months of outflows. In December, the FPIs brought in $3.1 billion from an outflow of $2.5 billion in November. While net inflows in equity were $1.8 billion (vs outflow of $2.6 billion in November), net inflows in debt came to $1.6 billion (outflow of $0.4 billion). Most inflows came in at the beginning of the month, when US yields were easing; the FPIs were net-sellers in the second half
- **Pick-up in bank credit growth:** Bank credit growth ticked up to 11.5% in December[3] on-month from 10.6%. That said, this is much lower than the 15.3% at the beginning of this fiscal
- Sectoral data[4] (available till November) shows credit growth has softened sharply in key categories such as agriculture (15.3% in November vs 19.8% in April), personal loans (13.3% vs 17.4%) and services (13% vs 19.2%). On the other hand, industrial credit growth has picked up from 6.9% to 8% in November
- **Rising equities:** Indian equities gained for the first time in three months. The benchmark S&P BSE Sensex and Nifty 50 rose 1.5% and 1.1% on average, respectively. The indices gained in the first half of the month driven by expectations of higher government spending and positive global cues such as softening crude oil prices. The NSE volatility index (VIX) declined to average 14.0 in December from 15.3 in November, implying reduced volatility

[3] As on December 13
[4] Figures for April exclude the impact of the HDFC merger

- **Decline in domestic bond yields:** The yield on the benchmark 10-year government security (G-sec) benchmark eased to 6.74% on-month in December from 6.81%. India's gross domestic product data released on November 29 indicated a sharp deceleration in growth in the second quarter of the fiscal, driving down yields. FPI inflows in debt and a lower domestic inflation print also had a cooling effect on yields. That said, the deficit in systemic liquidity put some pressure on yields
- **Lower crude oil prices:** Global crude oil prices eased as supply of oil is expected to remain robust amid demand concerns in China. Brent crude eased 0.8% on-month to average $73.8 per barrel.
- **Stable lending rates:** Key lending rates remained stable on-month with the RBI's policy rates staying unchanged. Auto and housing loan rates and the one-year Marginal Cost of Fund Based Lending Rate were steady, averaging 9.74%, 9.15% and 9%, respectively. All these key rates are above their five-year pre-pandemic averages. Deposit rates too were stable at 6.88%

…and which factors were a drag

- **Deficit liquidity**: After being in surplus for five straight months, systemic liquidity switched to deficit mode. Advance tax outflows, rising currency in circulation during the festive season and lower government spending put pressure on systemic liquidity. However, the CRR cut added to primary liquidity in the banking system, which curtailed additional demand under the liquidity adjustment facility. The RBI net-injected Rs 0.68 lakh crore (0.3% of net demand and time liabilities, or NDTL) in December under its liquidity adjustment facility, in contrast to the net absorption of Rs 1.4 lakh crore (0.6% of NDTL) in the previous month
- **Higher money market rates:** Money market rates rose in December due to the deficit in systemic liquidity. The weighted average call money rate, the operating target for monetary policy, was up 12 bps to average 6.64%, its highest monthly average in ten months and above the repo rate of 6.5%

  The rate on the six-month certificate of deposit rose 8 bps to average 7.48%. The rise in the 91-day Treasury bill rate was less pronounced at 2 bps (to average 6.48%)

- **Weaker rupee:** The rupee depreciated 0.7% on-month in December to a record low of 85 per dollar, driven by a stronger dollar. That said, FPI inflows capped the decline in the domestic currency

Conditions likely to turn favourable for rate cuts soon

We expect the RBI's easing cycle to begin from February. The central bank's neutral policy stance gives it flexibility to cut rates.

Food inflation, the main roadblock for rate cuts, is expected to ease given healthy agricultural production.

While monetary easing is underway in several key economies, uncertainty regarding the extent of rate cuts has risen. Trump's victory brings with it expectations of tariffs increasing inflationary pressures and tax cuts adding to fiscal stress in the US. Due to these factors, S&P Global sees fewer rate cuts by the Federal Reserve in 2025 than its previous projections.

Overall, though, the global environment remains supportive for rate cuts. In December, the Fed cut the funds rate 25 bps to 4.25%-4.5%.

In India, slowing domestic growth in recent quarters had further raised calls for rate cuts by the RBI. The National Statistical Office's first advance estimate predicts a sharp growth slowdown to 6.4% this fiscal after high 8.2% growth in the previous one, weighed down by high interest rates and low fiscal impulse.

All-in-all, we expect the rate cut is just around the corner.

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
Policy rate	Repo rate (%)	**6.3**	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
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
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
	91 day T-bill (%)	**6.5**	6.9	6.9	6.8	6.7	6.6	6.6	6.5	6.5	6.5
	CP 6-month rate (%)	**7.6**	7.9	7.9	7.9	7.8	7.8	7.8	7.7	7.7	7.7
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
	Term premium (%)	**1.0**	0.7	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.2
	AAA bond spread' (%)	**0.6**	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.4
	AA bond spread'' (%)	**2.0**	2.0	2.1	2.1	2.1	2.3	2.3	2.0	2.1	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
	Auto loan rate (%)	**9.6**	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
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	11.5
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	10.7
Equity market	Sensex (%*)	**8.7**	17.0	15.5	18.2	21.8	20.2	22.5	17.6	13.5	13.9
	NSE VIX	**15.6**	11.7	20.2	15.6	13.5	14.9	13.3	13.9	15.3	14.0
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
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
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
	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
	Brent ($/barrel)	**57.4**	90.1	82.0	82.6	85.3	80.9	74.3	75.7	74.4	73.8

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-Jun excludes the impact of a bank with non-bank*

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

Analytical contacts

Dharmakirti Joshi
Chief Economist, Crisil Ltd
dharmakirti.joshi@crisil.com

Dipti Deshpande
Principal Economist
dipti.deshpande@crisil.com

Pankhuri Tandon
Senior Economist
pankhuri.tandon@crisil.com

Sharvari Rajadhyaksha
Economic Analyst
sharvari.rajadhyaksha@crisil.com

Media contacts

Ramkumar Uppara
Media Relations
Crisil Limited
M: +91 98201 77907
ramkumar.uppara@crisil.com

Roma Gurnani
Media Relations
Crisil Limited
M: +91 70662 92142
roma.gurnani@ext-crisil.com

Sanjay Lawrence
Media Relations
Crisil Limited
M: +91 89833 21061
sanjay.lawrence@crisil.com

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