Macroeconomics | First cut

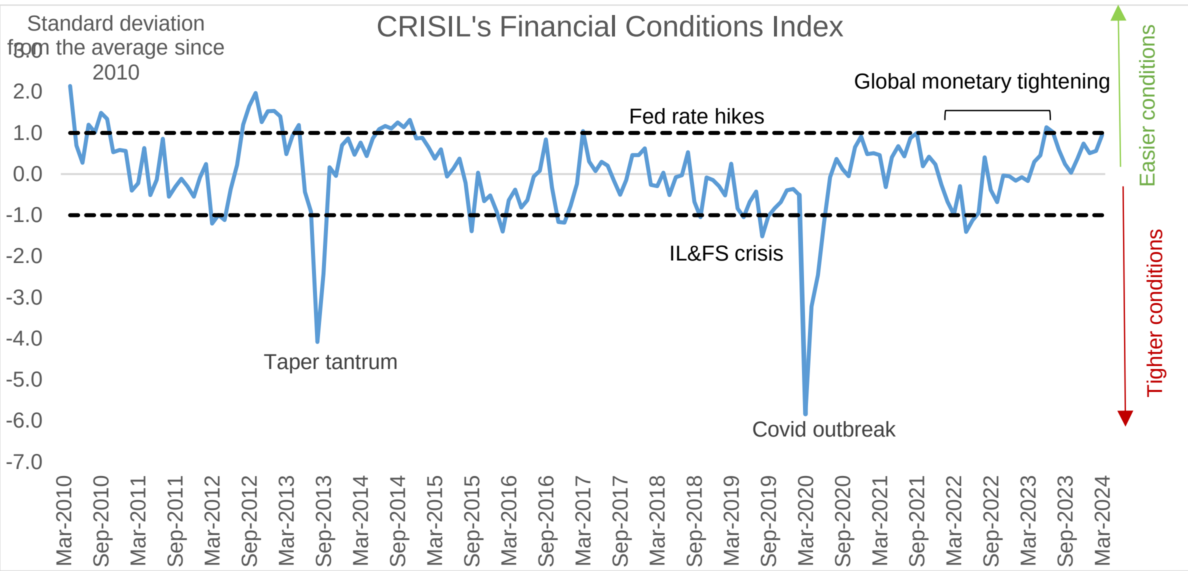
Financial conditions easiest since August

April 2024

Foreign fund inflow and improving liquidity conditions lend support

- Financial conditions eased for second consecutive month in March. CRISIL's Financial Conditions Index (FCI) improved 40 basis points to 1.0 in March, reaching the highest level since August 2023. A higher FCI value indicates easier financial conditions, and vice versa.
- Foreign capital inflow almost doubled relative to the previous month, benefitting both equity and debt markets. India's strong growth and the imminent inclusion in two emerging market bond indices this fiscal have been drawing foreign investors.
- Liquidity conditions improved this month, easing the debt- and money-market rates.
- While bank credit growth was strong, there were signs of moderation in certain segments, due to the impact of the RBI's regulatory measures, such as those for credit to NBFCs and personal loans. Its impact could continue percolating to the broader economy in the current fiscal.
- On average, financial conditions were easier in fiscal 2024, with FCI increasing to 0.6 in fiscal 2024 from -0.4 previous year. Foreign portfolio investors (FPIs) played a key role in supporting the domestic financial markets. Bank credit growth was higher in fiscal 2024, despite tighter liquidity.
- The current fiscal begins with unchanged repo rates by the RBI. Globally, major central banks are currently cautious about cutting rates, amid slower disinflation and strong growth. On the domestic front, while the forecast of an above-normal monsoon bodes well for disinflation, freak weather events and crude oil prices are the lurking risks. Government bond yields have firmed up as markets price in delay in rate cuts from RBI. 'Higher for longer' interest rates and the RBI's regulatory measures could weigh on financial conditions over the next few months.

Financial conditions in March were the easiest since August



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 eased financial conditions

- **Net FPI inflow:** Net inflow from FPIs surged to $6.3 billion in March from $3.8 billion in February, driven by a rise in equity inflow to $4.2 billion from $0.2 billion. The debt segment, too, witnessed inflow, but with a decline to $1.6 billion from $2.7 billion. Pre-positioning ahead of India's inclusion in the global bond indices has led to a surge in FPI inflow into the debt market. This segment has seen twelve consecutive months of net inflow.
- **Deficit in domestic liquidity narrows significantly:** The RBI net-injected Rs 0.4 lakh crore (0.2% of net demand and time liabilities, or NDTL), much lower than the Rs 1.86 lakh crore (0.8% of NDTL) in February, due to higher government spending and the return leg of a USD-INR sell-buy swap auction. The central bank managed liquidity both ways through repos and reverse repos.
- **Softer money-market rates:** Money-market rates eased on-month due to a narrower deficit in liquidity. The weighted-average call money rate (WACR) eased 12 bps, averaging 6.5%. Rates on other money-market instruments – such as the six-month commercial paper (CPs; by 32 bps to average 8.15%), six-month certificates of deposit (CDs; by 15 bps to average 7.67%) and the 91-day treasury bills (T-bill; by 9 bps to average 6.91%) – also softened on-month.
- **Domestic bond yields ease for the fifth consecutive month:** The yield on the 10-year G-sec declined marginally to an average of 7.06% from 7.08%. Yields softened at the beginning of the month, after Bloomberg announced that it would be including Indian G-secs in its Emerging Markets Local Currency Index from January 2025. A narrower deficit in domestic liquidity and FPI inflow into the debt segment contributed to the decline. However, other factors, such as hardening US yields and rising global crude oil prices, capped the decline in domestic yields.
- **Equities advance on-month:** S&P BSE Sensex and Nifty 50 rose 1.3% and 1.1% on average, respectively. The indices rallied at the begging of the month, as domestic growth data (released on the last day of February) showed strong GDP growth. Higher FPI inflow also improved the sentiment.
- **Robust bank credit growth:** Bank credit growth inched down marginally, but remained robust at 16.3%[1], compared with 16.5% in February. Sectoral data[2] for February indicates that industry credit growth picked up (8.6% versus 7.8%). Bank credit growth picked up for large (7.1% vs 6.2%) and medium-sized industries (12.5% versus 10%). Credit growth in the agriculture sector remained high and unchanged at 20.1%, while credit growth in services inched up (24% versus 23.9%). However, personal loans saw a slight moderation in credit growth (18.1% versus 18.4%), with the slowdown seen in vehicle loans, loans against gold, and the 'others' category.

Factors that were a drag

- **Bank lending rates remain high and broadly stable:** Bank lending rates, which are above their pre-pandemic average, have been a drag on financial conditions for the past several months. The one-year MCLR and auto-loan rates remained unchanged at 8.8% and 9.77%, respectively, while home loan rates rose 2 bps on average to 9.31%. Transmission of rate hikes to the home loan rates is almost complete, as they have has risen 233 bps since April 2022 compared with a 250 bp hike in the repo rate. However, transmission to other lending rates, such as the one-year MCLR and the auto loan rates, has lagged, as these rates have risen 155 bps each. Deposit rates rose 7 bps in March to average 6.86%; these rates has risen 177 bps since the RBI began hiking rates.
- **US Treasury yields:** The yield on the 10-year US Treasury bond remained high at 4.21% on average in March, compared with the same level in the previous month. Data released during the month led to concerns that rates will remain higher for longer. US inflation data released during the month showed an uptick, and the rise in global crude oil prices also kept US yields under pressure.

[1] As on March 22, excluding the impact of the HDFC merger
[2] Excluding impact of HDFC merger

- **Global crude oil prices rise:** Crude oil prices rose 2% rise on-month to average $85.4 per barrel in March, compared with $83.8 per barrel in February. Crude oil prices have been rising for the past four months, due to geopolitical uncertainty.

The path to rate cuts gets cloudy

The new financial year began with steady rates. The RBI's Monetary Policy Committee kept the repo rate unchanged for the 14th month in a row, while maintaining the stance of 'withdrawal of accommodation'.

Globally, central banks are cautious about easing interest rates under current conditions, given sticky inflation and resilient growth. In particular, the US recently witnessed higher inflation and stronger labour markets than expected, raising the uncertainty about the timing and magnitude of rate cuts. Major global central banks could begin rate cuts from mid-2024, but the timing may vary across economies.

Additionally, geopolitical risks refuse to abate and crude oil prices are back at $90 per barrel.

For India, weather is another important guide for monetary policy actions, given its sizeable influence on food and overall inflation. Initial forecasts from the India Meteorological Department (IMD), which predict an above-normal monsoon this year, could help bring down food inflation. However, the impact of the looming heatwave and crude oil prices are a monitorable.

'Higher for longer' interest rates could restrict the easing of financial conditions over the next few months before rate cuts begin.

Moreover, the RBI's regulatory measures to clamp down risky bank lending in certain segments are expected to moderate credit growth and overall growth this year.

Nevertheless, India's inclusion in the global bond indices this year and low external vulnerability are expected to continue drawing in foreign investors and supporting India's financial markets.

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	Mar-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	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	1.6
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	0.2
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	6.5
	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	6.9
	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	8.1
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	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	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	0.3
	AA bond spread'' (%)	2.9	2.9	3.0	2.9	2.6	2.7	3.2	3.3	3.3	0.9	1.8	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	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	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	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	16.3
Money supply	M3 growth (y-o-y %)	9.5	10.1	13.4	10.6	10.8	10.9	10.8	11.2	11.0	11.0	10.9	11.2
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	17.0
	NSE VIX	11.9	12.5	11.2	11.2	11.6	11.2	11.1	11.6	13.5	14.1	15.5	13.8
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	0.0
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	6.3
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	21.3
	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	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	85.5

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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