Macroeconomics | First cut

Dust settles, optimism returns

July 2024

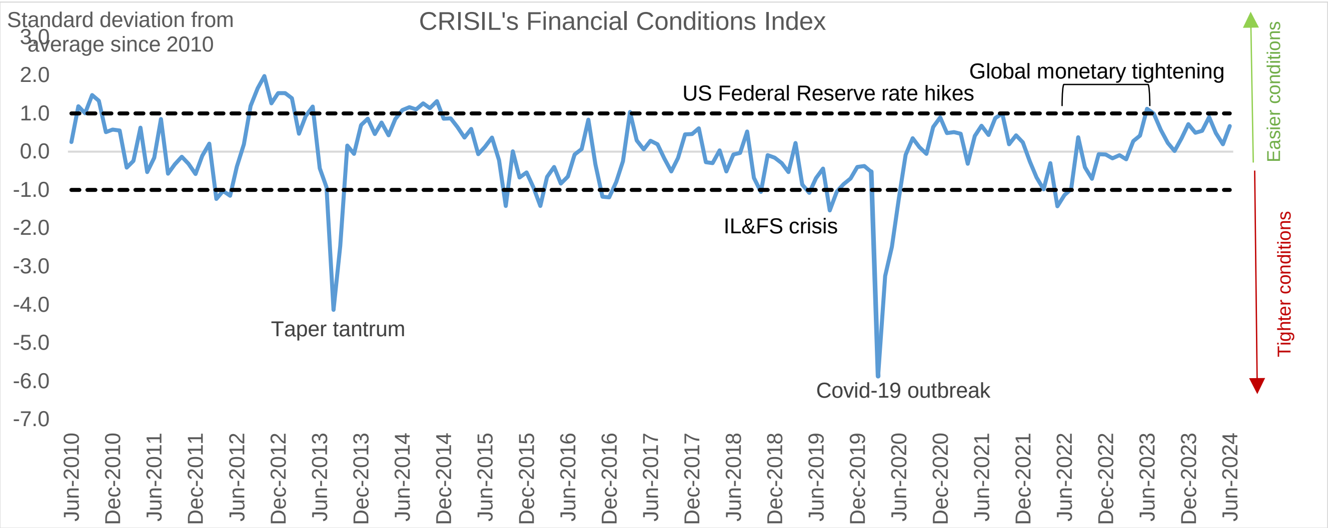
Terrain showed improvement in June

- With the suspense over new government formation ending and the monetary policy landscape unchanged, domestic financial conditions, as measured by the CRISIL's Financial Conditions Index (FCI), improved in June after weakening over the past two months
- CRISIL FCI, a summary indicator that captures key parameters across India's major market segments[1], rose to 0.7 in June from 0.2 previous month (*see chart below*)
- This happened as foreign portfolio investors (FPIs) net-invested after two months of outflows, coinciding with a sharp rise in equity market indices. Investor optimism revived following signs of stability at the Centre and no indications of major changes in the fiscal policy. Additionally, improving domestic liquidity conditions and global cues supported the markets

Financial conditions healthy despite tight monetary conditions

- Monetary conditions continue to be tighter than pre-pandemic levels. The repo rate is higher than the five-year average preceding the pandemic and liquidity conditions are tighter (*see the table on page 4*). Globally, policy rates in major advanced economies remain at decadal highs, while crude oil prices remain elevated
- Yet, major domestic market parameters, particularly equity and debt markets are performing better than pre-pandemic trend. FPI flows are higher, driven by improving Indian macro fundamentals, and its inclusion in global bond indices. Credit growth is higher than pre-pandemic average despite higher interest rates.
- The country's economic resilience was corroborated by the Reserve Bank of India's (RBI) June Financial Stability Report, which indicated strengthening of balance sheets of domestic financial institutions. However, the central bank remains wary of the frequency of shocks post the pandemic

Uptick in financial conditions in June



[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

Note: Higher FCI means easier financial conditions, and vice versa. FCI staying within black dotted lines shows it in comfort zone
Source: CRISIL

Several factors supported financial conditions in June

- **Systemic liquidity deficit narrows:** The deficit decreased in June compared with the previous month. The RBI's net injection of Rs 0.55 lakh crore (0.2% of net demand and time liabilities, or NDTL) during the month was significantly lower than Rs 1.38 lakh crore (0.6% of NDTL) in May. Credit growth slowed in June, while deposit growth was unchanged (12.2%[2] vs 12.1%), which helped ease liquidity conditions
- **FPIs turn net buyers:** Foreign portfolio investments rose in June, especially in the equity segment, with net inflows of $5 billion in June compared with net outflows of $3.1 billion the previous month. The equity segment saw inflows of $3.2 billion, following two straight months of outflows. FPI inflows into the debt segment also increased to $1.8 billion from $1.1 billion
- **Equities rise:** Indian equities rose in June, recording their highest monthly gains so far this year. The benchmark indices – S&P BSE Sensex and Nifty 50 – gained 3.9% each on average due to several factors including strong gross domestic product (GDP) data released at the end of May, the RBI raising its growth forecast for the ongoing fiscal and robust earnings by major companies. Volatility too reduced compared with the previous month, with the India Volatility Index (VIX) averaging 15.6 during the month, down from a 19-month high of 20.2 in May
- **Money market rates soften:** The rates fell on-month owing to easing liquidity conditions, with the weighted average call money rate (WACR) softening 2 basis points (bps) to 6.6% on average and the rate on the 91-day treasury bill (T-bill) easing 11 bps to 6.8% on average
- **Domestic bond yields ease:** Domestic government security (G-sec) yields declined in June with the yield on the benchmark easing marginally to 7.0% on average from the previous month's 7.04%. Lower yields were supported by easing US treasury yields, a narrower systemic liquidity deficit and robust FPI inflows in the debt market. Stable crude oil prices on average during the month also helped keep yields under control
- **US treasury yields decline:** The yields eased sharply in June with the yield on the 10-year treasury note sliding 18 bps to average 4.31%. Data released in June showed a decline in the producer price index and rising jobless claims, leading to hopes that the US Federal Reserve (Fed) would initiate rate cuts soon
- **Global crude oil prices stable:** The prices were broadly stable in June compared with the previous month. Brent crude oil prices averaged $82.6 per barrel during the month compared with $82 per barrel in May
- **Rupee stable:** The Indian currency was broadly stable against the dollar in June supported by FPI inflows. It averaged 83.5 per dollar compared with 83.4 per dollar in May

Moderation in bank credit growth and high lending rates limit easing of financial conditions

- **Bank credit growth moderates:** Credit growth moderated to 15.6%[3] in June from 16.1% in May. Credit growth moderated in the first quarter of fiscal 2025 (15.7% average) compared to the previous quarter (16.3%) led by slowing credit growth in credit cards outstanding. The RBI increased risk weights for unsecured loans due to which growth in credit cards outstanding has slowed to 26.2% in May (latest available data) from 31.3% in January

[2] As on June 14, excluding the impact of the HDFC merger
[3] As on June 14, excluding the impact of the HDFC merger

Sectoral data[4] for May showed credit growth was strongest in agriculture (21.6%) followed by services (20.7%). Servies credit growth was driven by non-banking financial corporations (NBFCs; 16%) and trade (17.7%). Credit growth in personal loans was also in double digits (17.8%) led by robust credit in personal credit cards (26.2%). Industrial credit growth was softer at 8.9%

- **Bank lending rates high:** The rates were broadly stable in June, though some saw an uptick. The one-year marginal cost of funds-based lending rate (MCLR) rose 6 bps to 8.85%. While the home loan rate remained unchanged at 9.35% on average, auto loans rates rose one bp to 9.79%. Deposit rates rose 3 bps to 6.88% on average

  Bank lending rates and deposit rates have risen well above pre-pandemic levels in the current cycle. That said, the extent of rise has not been on par with the 250-bps hike in policy rates. Although transmission is almost complete for the home loan rate (237 bps), it lags for the one-year MCLR (160 bps) and auto loan rate (158 bps). Deposit rates have risen 179 bps in the current cycle

RBI remains wary of monetary easing due to strong growth conditions

Financial conditions have been supportive for growth so far. With recent economic growth being stronger than expected and inflation still away from target, the RBI has been wary of monetary easing. The RBI's Monetary Policy Committee (MPC) maintained its policy rates and stance in June.

We now see the RBI cutting rates starting October 2024 at the earliest, and have lowered our expectation to two rate cuts this fiscal against three foreseen earlier. The expectation of an above-normal monsoon this year paves the way for cooling of inflation, though its distribution will be monitored over the next three months. Moderation in economic growth may also cap inflationary pressures. That said, any weather and geopolitical shocks will remain monitorables.

The US Fed too, is likely to wait until December for a rate cut, according to S&P Global.

Domestically, higher-for-longer rates could cap the easing of financial conditions this fiscal.

Amid higher-for-longer rates, the impact of past monetary tightening is likely to continue. Rates are also rising in real terms gradually with moderating inflation. Credit growth is expected to be tamed, especially in segments such as NBFC and unsecured consumer credit targeted by the RBI. Overall, we expect these factors to weigh on GDP growth this fiscal.

[4] Excluding the impact of HDFC merger

Table: How financial conditions compare with pre-pandemic trends

		Pre-pandemic 5-year average	Annual average				Current fiscal		
		FY16-20	FY21	FY22	FY23	FY24	Apr-24	May-24	Jun-24
Policy rate	Repo rate (%)	**6.3**	*4.0*	*4.0*	*5.5*	*6.5*	6.5	6.5	6.5
	Repo rate, inflation-adjusted (%)	**2.0**	*-2.2*	*-1.5*	*-1.1*	*1.1*	1.7	1.8	N/A
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
Money market	Call money rate (%)	**6.2**	*3.4*	*3.3*	*5.4*	*6.6*	6.5	6.6	6.6
	91 day T-bill (%)	**6.5**	*3.3*	*3.5*	*5.8*	*6.9*	6.9	6.9	6.8
	CP 6-month rate (%)	**7.6**	*4.4*	*4.3*	*6.9*	*7.8*	7.9	7.9	7.9
Debt market	10-year G-sec (%)	**7.2**	*6.0*	*6.3*	*7.3*	*7.2*	7.2	7.0	7.0
	Term premium (%)	**1.0**	*1.9*	*2.3*	*1.8*	*0.7*	0.7	0.5	0.5
	AAA bond spread' (%)	**0.6**	*0.7*	*0.5*	*0.2*	*0.3*	0.2	0.3	0.4
	AA bond spread'' (%)	**2.0**	*3.6*	*2.0*	*3.5*	*2.6*	2.0	2.1	2.1
Lending rates	MCLR (1 year) (%)	**8.3**	*7.4*	*7.1*	*7.9*	*8.7*	8.9	8.8	8.9
	Auto loan rate (%)	**9.6**	*8.0*	*7.7*	*9.0*	*9.8*	9.8	9.8	9.8
	Housing loan rate (%)	**9.1**	*7.4*	*7.1*	*8.4*	*9.3*	9.4	9.4	9.4
Credit availability	Bank credit growth (y-o-y,%)	**9.7**	*5.9*	*7.0*	*14.2*	*15.7*	15.3	16.1	15.6
Money supply	M3 growth (y-o-y %)	**9.7**	*12.2*	*9.6*	*8.9*	*10.9*	10.9	12.1	10.9
Equity market	Sensex (%*)	**8.7**	*7.6*	*27.0*	*8.7*	*11.4*	17.0	15.5	18.2
	NSE VIX	**15.6**	*25.8*	*17.9*	*17.5*	*12.4*	11.7	20.2	15.6
Forex market	Rs/$ (m-o-m, %)	**0.2**	*-0.2*	*0.4*	*0.6*	*0.1*	0.5	0.0	0.1
Foreign capital	Net FPI ($ bn)	**0.6**	*3.0*	*-1.3*	*-0.5*	*3.4*	-1.9	-1.5	5.0
Global conditions	S&P 500 (%*)	**8.9**	*14.0*	*24.3*	*-2.8*	*7.5*	19.1	21.0	23.6
	10-year US Treasury yield (%)	**2.3**	*0.9*	*1.6*	*3.4*	*4.1*	4.5	4.5	4.3
	Brent ($/barrel)	**57.4**	*44.8*	*80.0*	*95.4*	*83.0*	90.1	82.0	82.6

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 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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