Macroeconomics | First cut

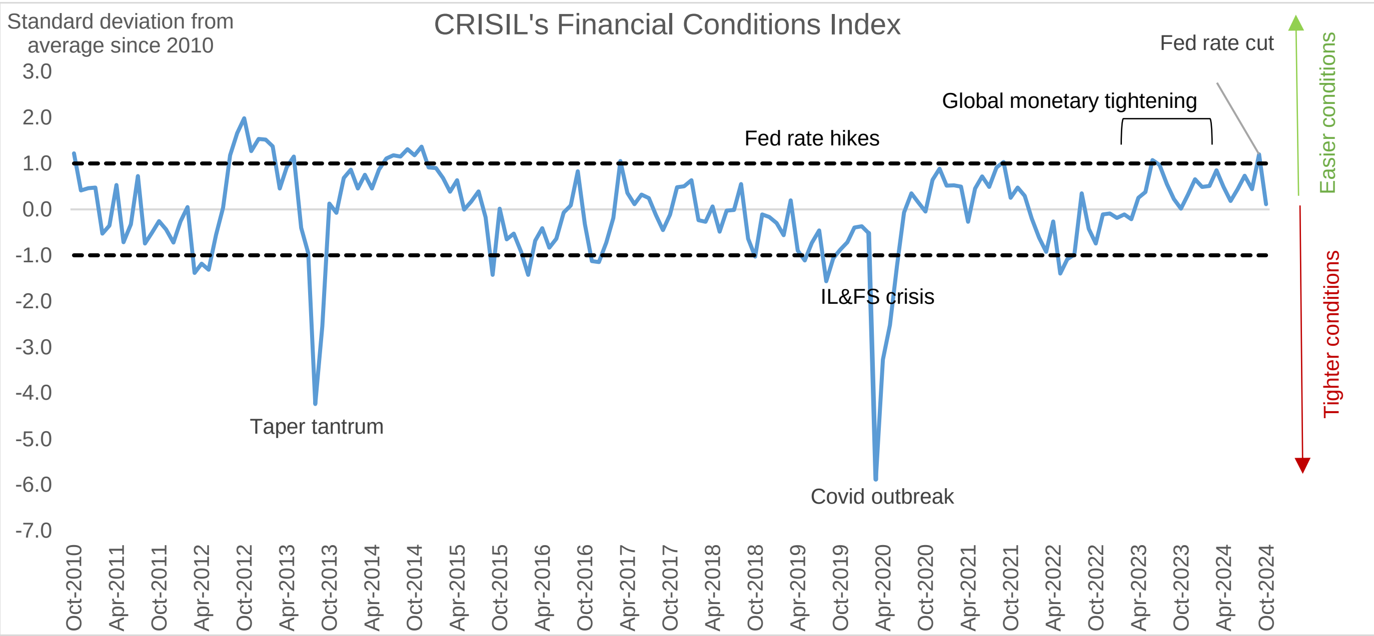
Financial conditions stable amid FPI selling

November 2024

Domestic financial conditions in the comfort zone despite FPI outflows

- Short-term capital flows to India from foreign portfolio investors (FPIs) have been highly volatile. After record-high inflows in September, October logged the highest post-pandemic outflows. Yet, this did not significantly drag India's financial conditions, CRISIL's Financial Conditions Index (FCI) shows
- CRISIL's FCI - which is a combination of parameters from India's major market segments along with policy and lending conditions[1] – stood at 0.1 in October, compared with 1.2 in the previous month. This meant financial conditions were tighter in October than in the previous month. However, the FCI value remained positive, implying easier conditions than the long-term average
- FPI outflows primarily hit the equity markets. The pressure on domestic interest rates was limited, as it was offset by easier domestic monetary conditions. The Reserve Bank of India (RBI) changed its stance to 'neutral' in October, while systemic liquidity conditions improved. Additionally, stable crude prices supported the Indian financial markets. The rupee depreciated at a moderate pace during the month
- That said, the lagged impact of the RBI's past rate hikes is gradually being felt in the broader economy. Bank credit growth has been slowing in the past three months, including for personal loans. This is likely to impact consumption, especially in urban areas

CRISIL FCI moderates in October



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

Capital outflows, slower bank credit growth tighten financial conditions

- **Net FPI outflows:** FPIs turned net sellers in October, withdrawing $11.5 billion (in equity, debt and hybrid categories) compared to an inflow of $11.2 billion in September. The equity market saw a record-high net outflow of $11.2 billion (vs an inflow of $6.9 billion in the previous month) in response to the rise in Chinese equities following the announcement of aggressive fiscal stimulus measures. The debt segment saw outflows for the first time in six months due to a narrower spread between Indian and US government bond yields. FPI outflows in debt stood at $0.4 billion vs an inflow of $2.9 billion last month

- **Rising US yields:** US Treasury yields surged to 4.1% in October from 3.7% in September as markets eased their expectations regarding future Fed rate cuts. Economic data released in October revealed a stronger job market than previously expected while retail core inflation rose unexpectedly leading to hopes that the Fed will cut rates less aggressively than previously anticipated
- **Losses in equities:** Indian equities recorded their first monthly loss in four months in October. The benchmark indices S&P BSE Sensex and Nifty 50 fell 2.7% each. Uncertainty regarding rate cuts by the RBI and geopolitics weighed on investor sentiments. FPI outflows also put downward pressure on Indian equities
- **Softer bank credit growth:** Bank credit growth softened to 11.5% in October from 13% in September. Sectoral data for September reveals credit growth eased across categories. Agriculture (16.4% vs 17.7%) and industry (8.9% vs 9.7%) saw sharper moderation, while credit growth inched down in services (13.7% vs 13.9%) and personal loans (13.4% vs 13.9%). That said, credit cards (a component of personal loans; 18% vs 19.9%) and non-banking financial companies (a component of services; 9.5% vs 11.9%) have seen credit growth slow significantly owing to the RBI clamping down on risky lending

Higher surplus liquidity caps tightening

- **Change in monetary policy stance:** Although the Monetary Policy Committee (MPC) kept the repo rate steady at its meeting in October, it changed the policy stance to ‘neutral’ from ‘withdrawal of accommodation’. This led to a drop in domestic bond yields at the beginning of the month

- **Higher surplus liquidity:** The surplus in systemic liquidity increased in October with the RBI net absorbing Rs 1.5 lakh crore (0.6% of net demand and time liabilities, or NDTL) compared with Rs 1.01 lakh crore (0.4% of NDTL) in September. Deposit growth outpaced credit growth during the month, leading to the higher surplus. The RBI reduced the sale of government securities (G-secs) drastically through open market operations to Rs 20 crore in October from Rs 5,815 crore in the previous month
- **Softer money market rates:** The weighted average call money rate (WACR; the operating target for monetary policy) eased 8 bps to average 6.49% owing to the increased surplus in liquidity. The rates on the 6-month certificate of deposit (CD), 6-month commercial paper (CP) and 91-day treasury bill eased 7 bps (to 7.4%), 10 bps (to 7.74%) and 12 bps (to 6.46%), respectively

Several key factors broadly stable

- **Crude oil prices:** Brent crude oil prices were broadly stable, averaging $75.7 per barrel in October compared with $74.3 in September. While oil prices rose a tad due to concerns over escalation of geopolitical conflicts, concerns over demand in the global economy offset the impact
- **Domestic yields:** The yield on the 10-year benchmark (G-sec) was steady at 6.81% on average in October. However, it ended the month at 6.84%, 9 bps higher than September-end. Although yields fell following the change in the RBI’s policy stance in early October, other factors such as falling FPI flows in debt, rising US yields and a higher domestic inflation print put upward pressure on domestic yields
- **Rupee:** The rupee was broadly stable in October, averaging 84/$ during the month compared with 83.8/$ in the previous month

- **Bank lending rates:** Most bank lending rates and deposit rates were stable during the month. Auto loan rates, the one-year marginal cost of funds-based lending rate (MCLR) and deposit rates were steady at 9.82%, 8.95% and 6.88%, respectively. On the other hand, auto loan rates eased to 9.23% from 9.32%.

  While the repo rate has risen 250 bps rise from April 2022, the increase in deposit rate (179 bps), one-year MCLR (170 bps) and auto loan rate (160 bps) has lagged since then. Home loan rates have comparatively risen more sharply by 224 bps

High food inflation delays domestic monetary easing

Even as major global central banks have begun cutting rates, the MPC has not initiated rate cuts yet.

The US Fed has cut policy rates twice by a cumulative 75 bps in 2024 so far, while the European Central Bank cut rates thrice by a cumulative 125 bps.

Elevated food prices remain a concern that is delaying the turn in repo rates. While a healthy monsoon should continue to ease food inflation and lead inflation on the RBI's desired glide path, food prices have not eased materially till date.

Despite rate cuts by major global central banks, global market volatility remains high because of geopolitical developments. Significant volatility was seen in early November in the run-up to the US presidential elections, which led to continued FPI outflows from India. Moreover, tensions in the Middle East remain high, which could intermittently impact markets.

The RBI may like to get clarity on how these risks will play out, before going in for a rate cut. Overall, we expect one rate cut by the RBI this fiscal.

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
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
	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
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
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
	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
	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
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
	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
	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
	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
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
	Auto loan rate (%)	**9.6**	*8.0*	*7.7*	*9.0*	*9.8*	9.8	9.8	9.8	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	9.4	9.3	9.3	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	15.1	13.6	13.0	11.5
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
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
	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
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
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
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
	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
	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

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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