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FINANCIAL MARKETS & BANKING UPDATE VOL. 1: FY2024-25

Corporate bond issuances and incremental credit growth reached all-time high in FY2024

APRIL 2024

Abbreviations

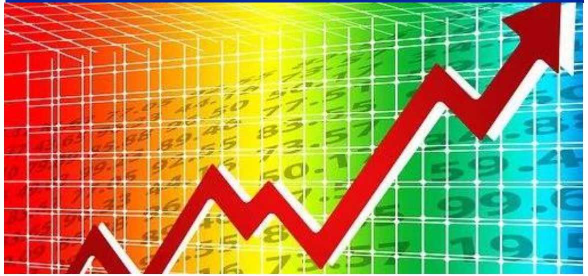
AUM: Assets Under Management	FSB: Fully Serviced Bonds	NDTL: Net Demand & Time Liabilities
BSNL: Bharat Sanchar Nigam Limited	FY: Financial Year	NBFC: Non-Banking Financial Company
CASA: Current and Savings Account Ratio	G-Sec: Government Securities	NSDL: National Securities Depository Limited
CAD: Current Account Deficit	GDP: Gross Domestic Product	OMO: Open Market Operations
CD: Certificates of Deposit	GFCE: Government Final Consumption Expenditure	PFCE: Private Final Consumption Expenditure
CDSL: Central Depository Services (India) Limited	GFCF: Gross Fixed Capital Consumption	PSB: Public Sector Bank
CEA: Central Electricity Authority	GoI: Government of India	PVB: Private Sector Bank
CIC: Currency in Circulation	GST: Goods and Services Tax	QoQ: Quarter on Quarter
CP: Commercial Paper	GVA: Gross Value Added	RBI: Reserve Bank of India
CPI: Consumer Price Index	HFC: Housing Finance Company	RDB: Rupee Denominated borrowings
CMB: Cash Management Bills	IDBI: The Industrial Development Bank of India	SIAM: Society of Indian Automobile Manufacturers
CRR: Cash Reserve Ratio	IIP: Index of Industrial Production	SIDBI: Small Industries Development Bank of India
CSO: Central Statistics Office	IPO: Initial Public Offer	SCB: Schedule Commercial Bank
CWP: Cash with Public	IMD: Indian Meteorological Department	SDL: State Development Loans
CY: Calendar Year	INR: Indian National Rupee	SLR: Statutory Liquidity Ratio
DII: Domestic Institutional Investors	JV: Joint Venture	TLTRO: Targeted long-term repo operations
DIPP: Department of Industrial Policy and Promotion	LAF: Liquidity Adjustment Facility	T-Bill: Treasury Bill
ECBs: External Commercial Borrowings	LIBOR: London Interbank Offered Rate	TTM: Trailing Twelve Months
EM: Emerging Markets	LPA: Long Period Average	UAE: United Arab Emirates
FAR: Fully Accessible Route	LRS: Liberalised Remittance Scheme	$: United States Dollar
FCCBs: Foreign Currency Convertible Bonds	LTRO: Long-term repo operations	VRR: Variable Rate Repo
FCI: Food Corporation of India	MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act	WoS: Wholly Owned Subsidiary
FDI: Foreign Direct Investment	MPC: Monetary Policy Committee	WPI: Wholesale Price Index
FII: Foreign institutional Investment	MSCI: Morgan Stanley Capital International	WACR: Weighted Average Call Rates
FPI: Foreign Portfolio Investment	MSF: Marginal Standing Facility	YTD: Year to Date
FPO: Follow on Public Offer	NABARD: National Bank for Agriculture & Rural Development	

Agenda

1 Foreign Investment and External Commercial Borrowings

2 Growth

3 Inflation



4 Deposit and Credit

5 Liquidity and Bond Yields

6 Annexures

Highlights - I

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The 10-year G-Sec yield is likely to trade between 7.0-7.2% in April-May 2024, before dipping to 6.8-7.0% over the subsequent two months. The yield curve is expected to largely remain flattish till the policy stance is changed.

FII flows are likely to remain robust at $40-45 billion in FY2025, aided by bond index inclusion and healthy domestic fundamentals, although an escalation in geopolitical tensions remains a key monitorable.

The 10-year G-Sec yield has remained volatile after the large easing seen after the Interim Budget for 2024-25, partly reflecting the movement in global yields amidst changing expectations around the timing and magnitude of rate cuts by the US Federal Reserve and also due to recent escalation of tensions in West Asia. ICRA expects the newly issued 10-year G-Sec yield (7.10 GS 2034) to trade between 7.0-7.2% in April-May 2024, and ease to 6.8-7.0% in the subsequent two months. ICRA expects the bond index inclusion, coupled with a mild dip in the GoI's market borrowings in FY2025, to drive the demand for G-Secs. This would lead to some decline in G-Sec yields, after a brief period of slightly higher yields in April-May 2024. This is also expected to augur favourably for corporate bond yields in the first half of the fiscal.

- **Record issuances in FY2024:** At Rs. 3.1 trillion, Q4 FY2024 witnessed strongest bond issuances in FY2024, partly led by softening of corporate bond yields. Overall, bond issuance rose by ~17% to Rs. 10.2 trillion in FY2024 from Rs. 8.7 trillion in FY2023. Looking ahead, elevated cost of bank funding, particularly for NBFCs following an increase in risk weights, demand for refinance from All India financial institutions (AIFIs) amid tight liquidity as well as the cooling-off of the benchmark yields would likely drive bond issuances. The stock of bonds outstanding is estimated to have risen by ~6.6% YoY to ~Rs. 46.0 trillion as on March 31, 2024 (Rs. 43.1 trillion as on March 31, 2023). ICRA expects the corporate bond outstanding to increase to ~Rs. 50.2-50.5 trillion by end of March 2025 (marking a YoY growth of 9.2-9.8%).
- **Net FII inflows eased to $9.3 billion in Q4 FY2024:** The net FPI purchases into the Indian markets (under equity, debt and hybrid) dipped to $9.3 billion in Q4 FY2024 from $10.9 billion in Q3 FY2024. This was entirely driven by a sharp fall in net equity inflows (to a four-quarter low $1.3 billion from $6.1 billion), even as inflows into the debt segment (to a 27-quarter high +$7.0 billion from +$4.4 billion) surged between these two quarters, ahead of the inclusion of GoI bonds in J.P. Morgan's Global Bond Index. After recording net outflows of $5.5 billion in FY2023, FPIs have infused a sizeable $41.0 billion into the Indian markets in FY2024, led by equity ($25.3 billion) and debt ($14.2 billion) segments. Going forward, ICRA estimates FPI inflows to remain robust at $40-45 billion in FY2025, supported by the bond index inclusion during the fiscal as well as healthy domestic fundamentals. However, escalation of geopolitical tensions could impact such flows, particularly in the equity segment.

Highlights - II

In spite of signs of recovery in Q3 FY2024, FDI inflows likely to trail the $46.9 billion recorded in FY2023.

Despite the impact of changes in taxation, LRS remittances lead total FDI outflows.

Gross ECB approvals expected to exceed previous year levels at $43-45 billion ($26.6 billion in FY2023) on the back of record approvals in H1 FY2024.

India's GDP growth expected to ease to sub-6% levels in Q4 FY2024, translating to a growth of 7.6% in FY2024; likely to moderate to 6.5% in FY2025, amid weakness in H1, followed by some recovery in H2.

- **FDI inflows witness recovery in Q3:** After declining in H1 FY2024, FDI inflows picked up pace aggregating at $42.1 billion in 11M FY2024. FDI inflows in Q3 FY2024 rose to $12 billion from $10.1 billion in Q3 FY2024. Further, inflows in Jan-Feb 2024 amounted for $8.9 billion, nearly as high as $9.5 billion during Q4 FY2023 ($7.1 billion in Jan-Feb 2023). Nonetheless, FDI inflows still trail the $44.5 billion recorded for the same period last year.
- **Gross overseas investments registered an uptick, while taxation changes impacted LRS outflows:** Gross FDI outflows in 11M FY2024 stood at $10.6 billion, 14% lower than $12.3 billion recorded for the corresponding period last year. Moreover, changes in taxation caused the outflows under the LRS to slow down to $6.5 billion in Q3 FY2024, after recording the three consecutive highest quarterly outflows so far in Q2 FY2024 at $9.2 billion ($9.1 billion in Q1 FY2024 and $7.8 billion in Q4 FY2023). Overall, cumulative outflows under the LRS aggregated to $29.4 billion in 11M FY2024 already exceeding aggregate LRS remittances of $27.1 billion for FY2023 ($19.6 billion in FY2022).
- **ECB approvals remain healthy in Q4 FY2024 after record levels in the previous quarter:** Gross ECB approvals in Q4 FY2024 (Jan-Feb 2024) stood at $5.3 billion ($6.9 billion in Q3 FY2024, $2.4 billion in Jan-Feb 2024). This followed from the sharp moderation to $8 billion in Q2 FY2024 from the record quarterly approvals of $20.7 billion in Q1 FY2024 on the back of big-ticket approvals. Led by the latter, the combined gross ECB approvals in 11M FY2024 of $41.2 billion, sharply exceeded the $22.8 billion seen in 11M FY2023. The cost of overseas borrowing remains elevated and a broad-based increase in ECB approvals is unlikely in the immediate term. Nonetheless, ECB approvals could see an uptick to $43-45 billion in FY2024 mainly due to the surge in Q1 (~$26.6 billion in FY2023, ~$39.9 billion in FY2022).
- **India's GDP growth to dip to sub-6% in Q4 FY2024:** The YoY growth in the IIP eased to 4.9% in Jan-Feb FY2024 from 6.1% in Q3 FY2024, indicating slowing industrial activity during the first two months of Q4 FY2024. Moreover, the agri-GVA is expected to record a YoY decline of 0.5% in Q4 FY2024, led by a dip in the output of most rabi crops, amid the backdrop of continuing El Nino conditions. Based on these trends and the mixed performance of service sector related indicators, we expect the YoY GDP growth to moderate to 5.9% in Q4 FY2024 from 8.4% in Q3 FY2024. Overall, ICRA expects GDP growth to print at 7.6% in FY2024, posting an expansion of above 7% for the third consecutive year. Thereafter, growth is expected to ease to 6.5% in FY2025, amid subdued outcomes in H1 FY2025 on the back of continued weak rural demand, slowdown in Government capex, muted external demand and waning benefits owing to the deflation in commodity prices. However, the pace of expansion in economic activity is expected to pick up in H2 FY2025.

Highlights - III

CPI inflation to ease to 4.6% in FY2025 from 5.4% in FY2024, led by softening in food inflation; adverse weather events pose key upside risk to the food inflation trajectory, going ahead.

ICRA expects a shallow rate cut cycle, limited to 50 bps at best, to commence from H2 FY2025.

After remaining tight during Dec-Feb 2024, liquidity conditions eased considerably over the next two months; the RBI is expected to conduct VRRRs to absorb surplus liquidity in the banking system.

- **CPI Inflation likely to ease to 4.6% in FY2025:** The headline CPI inflation eased to a three-quarter low of 5.0% in Q4 FY2024 from 5.4% in Q3 FY2024, owing to a dip across all non-food items, while food and beverages inflation remained elevated at 7.7%. Overall, the CPI inflation stood at 5.4% in FY2024, in line with our expectations. Going ahead, ICRA expects the headline CPI inflation to average at 4.6% in FY2025, slightly higher than the MPC's forecast of 4.5%. While this is expected to be driven by the softening in food inflation based on the assumption of an above-normal and well-distributed monsoon, any unpleasant surprises on the agro-climatic front could push up the food inflation trajectory and pose the risk of potential food price pressures transmitting to the core segment.
- **Rate cuts to be back-ended in 2024:** In our view, monetary easing is likely to be quite back-ended in 2024, pending clarity on various factors such as the turnout of the monsoon, evolution of crude oil prices as well as rate action from the US Fed. ICRA foresees a shallow rate cut cycle to commence only from H2 FY2025, limited to 50 bps at best.
- **Systemic liquidity to remain comfortable in near term:** The daily average systemic liquidity deficit moderated quite sharply from Rs. 1.9 trillion in Feb 2024 (-0.9% of NDTL) to just Rs. 0.4 trillion in March 2024 (-0.2% of NDTL), despite the advance tax and GST outflows during the latter month. This was attributed to a likely pick up in the GoI's spending, redemption of T-Bills and the return-leg of the USD/INR buy-sell swap of $5.1 billion on March 11, 2024. Thereafter, liquidity conditions have eased further in April 2024. ICRA expects liquidity conditions to remain comfortable in the near term, amid the onset of the lean season, and potential dollar purchases owing to awaited sizeable capital inflows after the Bond Index inclusion in a phased manner from June 2024 amid expectations of a modest current account deficit (CAD). The RBI is expected to continue to conduct VRRRs to absorb surplus liquidity in the banking system and align short-term money rates with the policy repo rate. The frequency of VRRs is likely to reduce with expectations of comfortable liquidity conditions.

Highlights - IV

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YoY deposit accretion is expected at 10.3-10.6% in FY2025 (12.6% in FY2024), with incremental deposits projected at Rs.19.4-20.0 trillion (Rs. 23.2 trillion in FY2024).

Incremental credit expansion is projected at Rs. 19.0-20.5 trillion in FY2025 (~Rs. 22.1 trillion in FY2024), translating to a YoY growth of 11.6-12.5%).

- **Highest ever deposit mobilisation recorded in FY2024** : Deposit expansion slowed to Rs. 4.1 trillion in Q4 FY2024 from Rs. 4.9 trillion in Q3 FY2024, although remaining higher than Rs. 3.1 trillion in Q4 FY2023. On the back of record deposit build-up in Q1 FY2024 due to strong FII inflows, accretion associated with withdrawal of the Rs. 2,000 note and steady build-up in the following three quarters, the deposits outstanding of the banking system rose to Rs. 203.7 trillion (+12.6% YoY growth) as on March 22, 2024 from Rs. 180.4 trillion as on March 24, 2023 (+12.9% YoY growth). Including the HDFC Ltd. HDFC Bank merger, the deposits outstanding stood at Rs. 204.8 trillion as on March 22, 2024 (+13.5% YoY growth). Furthermore, the incremental deposit build-up in FY2024 stood at Rs. 23.2 trillion (Rs. 24.3 trillion including the HDFC merger), which was much higher than the Rs. 15.8 trillion build-up in FY2023. Driven by expected moderation in credit growth and tight liquidity as well a larger base, deposit growth is expected to drop to 10.3-10.6% in FY2025 (incremental deposits of Rs. 19.4-20.0 trillion) and outstanding deposits are estimated at Rs. 224.2-224.8 trillion by March 2025 (including the impact of the HDFC merger).
- **Highest ever credit expansion recorded in FY2024**: Incremental credit expansion stood at Rs. 5.2 trillion in Q4 FY2024 (till March 22, 2024), which was sequentially lower than Rs. 6.1 trillion recorded in Q3 FY2024 (till December 29, 2023) but was significantly higher than Rs. 4.0 trillion in Q4 FY2023. The deceleration in the growth momentum follows the RBI directive to banks to increase risk weight for exposure to consumer credit and NBFC segment. Excluding HDFC Ltd., outstanding credit rose to ~Rs. 159.0 trillion as on March 22, 2024 (16.2% YoY over 136.8 trillion as on March 24, 2023, +15.3% YoY at Rs. 153.5 trillion on December 29, 2023). Including HDFC Ltd., outstanding credit stood at Rs. 164.3 trillion as on March 22, 2024 (20.2% YoY over 136.8 trillion as on March 24, 2023, +20.1% YoY at Rs. 159.2 trillion as on December 29, 2023). Credit expansion of Rs. 22.1 trillion in FY2024 was the highest ever credit growth for any year, far outpacing the Rs. 18.2 trillion expansion recorded last year. Growth is expected to eventually come off these levels on the back of tight liquidity as well as slackening of growth in key growth segments. Accordingly, ICRA estimates incremental expansion at Rs. 19.0-20.5 trillion in FY2025 (YoY growth at 11.6-12.5%) and credit outstanding at Rs. 183.1-184.6 trillion by March 2025 (including the impact of the HDFC merger).

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Thank You!