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FINANCIAL MARKETS & BANKING UPDATE VOL. 2: FY2024-25

Corporate bond issuances and incremental credit growth moderate in Q1 FY2025

JULY 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

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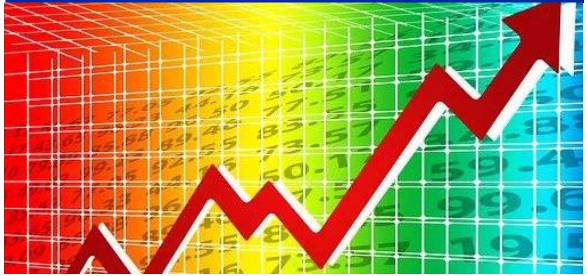
1 Foreign Investment and External Commercial Borrowings

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 at 6.80-7.15% in Q2 FY2025. Depending upon the direction and the extent of yield movement, the curve could further flatten or steepen from existing level.

Net FII inflows dipped to a five-quarter low of $1.5 billion in Q1 FY2025; ICRA expects inflows to remain robust at ~$40-45 billion in FY2025, aided by bond index inclusion and healthy domestic fundamentals.

The 10-year G-sec yield eased to 7.00% as on June 30, 2024 from 7.19% as on April 30, 2024 benefitting from the expectation of better fiscal consolidation following the announcement of higher-than-expected dividend of Rs. 2.1 trillion by the RBI, softening of global bond yields, and India's inclusion in the bond index. ICRA expects the 10-year G-sec yield to trade at 6.80-7.15% in Q2 FY2025. Yields may harden close to the upper limit of this range, if the expectations about the timing of rate cuts by the MPC are pushed beyond December 2024. ICRA expects a mild dip in the GoI's market borrowings in FY2025, which would improve the demand-supply balance and steadily increasing demand, driven by the bond index inclusion, would cool G-sec yields, going forward. This is also expected to augur favourably for corporate bond yields after June 2024. ICRA expects the conditions to remain conducive for bond issuances and, hence, bond issuances to remain healthy at Rs. 10.4-10.7 trillion in FY2025. ICRA anticipates the corporate bond outstanding to increase to Rs. 51.5-51.8 trillion by end of March 2025 (YoY growth of 8.9-9.5%).

- **Corporate bond issuances moderated in Q1 FY2025:** Bond issuances stood at Rs. 1.7 trillion in Q1 FY2025 (Rs. 3.1 trillion in Q4 FY2024, Rs. 2.7 trillion in Q1 FY2024). 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 could drive issuances.
- **Net FII inflows fell sharply in Q1 FY2025:** The net FPI purchases into the Indian markets (under equity, debt and hybrid) dipped sharply to a five-quarter low of $1.5 billion in Q1 FY2025 from $9.3 billion in Q4 FY2024. The moderation was driven by net equity outflows of $0.9 billion (over +$1.3 billion in Q4 FY2024), coupled with narrower inflows into the debt segment (+$2.3 billion down from 27-quarter high of $7.0 billion in Q4 FY2024). Thereafter, in July so far (till July 15, 2024), net FPI inflows have surged to $3.1 billion, largely supported by the equity segment (+$2.5 billion). 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. That said, any escalation in the geopolitical situation could impact such flows, particularly in the equity segment, during the fiscal.

Highlights - II

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FDI inflows settled at $46 billion for FY2024, mildly below the $46.9 billion recorded in FY2023.

Impact of changes in taxation seemingly subsided with LRS remittances, leading total FDI outflows to inch closer to the inflows.

Gross ECB approvals are likely to remain sizeable at $40-45 billion in FY2025, following the expected lines set in at $43 billion in FY2024.

India's GVA growth is estimated to ease to 5.7% in Q1 FY2025, amid weaker volume growth across most high frequency indicators, fading benefits of deflation in global commodity prices, uneven rains in June 2024, and the slowdown in GoI's capex owing to the General Elections.

- **FDI inflows stay strong in Q4 FY2024:** FDI inflows in Q4 FY2024 added ~$13 billion, aiding the tally for FY2024 to reach $46 billion. Further, inflows in April 2024 totaled $5 billion, mildly lower than $5.2 billion in April 2023. FDI inflows to likely remain range-bound at $45-50 billion for FY2025. Likely upside due to possible investment activity picking up, and possible downside risks from changing tax laws in Mauritius remain.
- **Gross overseas investments and LRS outflows witness uptick:** Gross FDI outflows in FY2024 stood at $14.1 billion, 4% higher than $13.5 billion recorded for FY2023. LRS outflows picked up to $6.9 billion in Q4 FY2024 after knee-jerk reaction to the changes in taxation in Q3 FY2024. Outflow under LRS continued to create a record for the third consecutive fiscal aggregating $31.7 billion in FY2024 ($27.1 billion in FY2023). During FY2024, total FDI and LRS outflows amounted to $42.7 billion (net of repatriations), which remained 92% of the total FDI inflows.
- **ECB approvals remained sizeable in FY2024:** Gross ECB approvals in Q4 FY2024 added $13 billion; almost double of $6.9 billion in Q3 FY2024. ECB approvals (net of refinancing) stood at $43.2 billion for FY2024 ($10.9 billion in Q4 FY2024). Further, in April 2024, the ECB approvals amounted to $3.6 billion (gross $4.2 billion). ECB approvals towards capex ($22.7 billion) in FY2024 surpassed the record level of ~$15.6 billion in FY2020. Even though the approvals remained lumpy and limited to few entities as the cost of overseas borrowing continued to stay elevated and are likely to remain so in the near term. However, additional approvals may be sought from few higher rated entities, in case the funding availability remains tight in the domestic markets (especially for NBFCs), making the ECB a more attractive option.
- **India's GVA growth to dip to sub-6% in Q1 FY2025:** Given the weak volume growth across several high frequency indicators, dissipation of the benefit of deflation in global commodity prices, deficient and uneven rainfall in June 2024, and with a slowdown in project execution and capital spending by the GoI owing to the General Elections, ICRA anticipates the GVA growth to moderate to 5.7% in Q1 FY2025 from 6.3% in Q4 FY2024. The slowdown is likely to be transient, with the GVA growth forecasted to exceed ~7% in H2 FY2025, aided by back-ended Government capex, a likely pick-up in private capex, and improved rural demand, if the rest of the monsoon season turns out to be favourable. Overall, ICRA expects the GVA growth to print at 6.5% in FY2025 (+7.2% in FY2024 PE). Further, we foresee a smaller wedge between the GVA and GDP growth in FY2025 over FY2024. As a result, the GDP expansion is expected to decelerate to 6.8% in FY2025 from 8.2% in FY2024 PE.

Highlights - III

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CPI inflation is expected to ease sharply, albeit temporarily, to 3.5% each in July-August 2024; however, a sustained spell of heavy rainfall can further push up perishable prices, which imbues caution into the near-term outlook.

ICRA expects a shallow rate cut cycle, limited to 50 bps at best, to commence from December 2024.

Liquidity conditions eased in Q1 FY2025 vis-à-vis Q4 FY2024, with the average daily systemic liquidity deficit more-than-halving in the quarter. Systemic liquidity is likely to remain comfortable in the near term, amid expectations of a meaningful pick up in the GoI's spending after the elections.

- **CPI Inflation expected to ease to 4.6% in FY2025:** The headline CPI inflation softened marginally to a four-quarter low of 4.9% in Q1 FY2025 from 5.0% in Q4 FY2024, benefitting from the continued cooling in core CPI, as well as fuel and light segments. Food and beverages was the only sub-group in the CPI basket to have recorded an uptick in the inflation to a three-quarter high 8.0% in Q1 FY2025 from 7.7% in the previous quarter, led by the hardening in oils and fats, cereals and products, and meat and fish. ICRA expects the CPI inflation is likely to ease sharply, albeit temporarily, to 3.5% each in July and August 2024, owing to a favourable base, which will partly absorb the impact of the sequential surge in vegetable prices. This will entail an average inflation of 4.0% in Q2 FY2025, as against the MPC's estimate of 3.8% for the quarter. However, a sustained spell of heavy rainfall can further push up perishable prices, which imbues caution into the near-term outlook. Overall, ICRA expects the CPI inflation to average at 4.6% in FY2025, slightly higher than the MPC's forecast of 4.5%.
- **Rate cuts unlikely before December 2024 policy:** Given the recent growth and inflation prints, ICRA expects the MPC to stay on hold in the August 2024 meeting. However, we do not rule out a stance change in October 2024 followed by a 25 bps rate cut each in December 2024 and February 2025, with an extended pause thereafter, if food inflation turns favourable on the back of a normal distribution of monsoon and the absence of any other global or domestic shocks.
- **Systemic liquidity to remain comfortable in the near term:** The average daily systemic liquidity deficit more than halved to Rs. 0.6 trillion in Q1 FY2025 (0.3% of NDTL) from Rs. 1.5 trillion in Q4 FY2024 (0.7% of NDTL), while remaining tight over Q1 of the past four years (surplus conditions). The tightness was largely driven by the substantial build-up of GoI cash balances amid uneven and sluggish spending during the election period. Durable liquidity has been comfortably in surplus, increasing to Rs. 3.5 trillion as on June 28, 2024, from Rs. 2.3 trillion as on March 22, 2024. However, systemic liquidity has recorded a surplus of Rs. 1.1 trillion in the first half of July 2024, which aided in pulling down the WACR below the repo rate in the ongoing month. Systemic liquidity conditions are likely to remain comfortable in the near term, amid expectations of a meaningful pick up in the GoI's spending after the presentation of the full Budget of FY2025 on July 23, 2024.

Highlights - IV

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YoY deposit accretion is expected at 9.5-9.8% in FY2025 (12.9% 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%.

- **Strong deposit accretion in Q1 FY2025**: Deposit expansion remained strong in Q1 FY2025 (till June 14, 2024) at Rs. 4.4 trillion (Rs. 4.1 trillion in Q4 FY2024); although it trailed the deposit accretion of Rs. 5.2 trillion in Q1 FY2024 (till June 16, 2023; deposit accretion was Rs. 11.2 trillion for entire Q1 FY2024). The sizeable deposit accretion in Q1 FY2024 was on account of withdrawal of Rs. 2,000 notes. The outstanding deposits of the banking system rose to Rs. 208.1 trillion (+12.1% YoY growth) as on June 14, 2024 from Rs. 185.7 trillion as on June 16, 2023 (+12.1% YoY growth). Including the HDFC Ltd.–HDFC Bank merger, the outstanding deposits stood at Rs. 209.0 trillion as on June 14, 2024 (+12.6% YoY growth). Driven by expected moderation in credit growth and tight liquidity as well a larger base, deposit growth is expected to drop to 9.5-9.8% in FY2025 (incremental deposits of Rs. 19.4-20.0 trillion) and outstanding deposit is estimated at Rs. 224.2-224.8 trillion by March 2025 (including the impact of the HDFC merger).
- **Slow credit growth in Q1 FY2025**: Incremental NFBC expansion stood at Rs. 3.0 trillion in Q1 FY2025 (till June 14, 2024), which was sequentially lower than Rs. 5.2 trillion recorded in Q4 FY2024 (till March 22, 2024) as well as than Rs. 3.4 trillion in Q1 FY2024 (till June 16, 2023). The deceleration in the growth momentum follows the RBI directive to banks to increase risk weights for exposure to unsecured consumer credit and NBFC segment. Going forward, tight liquidity conditions, high credit-to-deposit ratio coupled with any additional directives by the regulator around lending to consumer credit or any other segment of concern to the RBI could also moderate the growth momentum. Further, the RBI draft guidelines on additional provision on infrastructure exposure, if implemented, could also impact the credit growth. Excluding HDFC Ltd., credit outstanding rose to ~Rs. 162.0 trillion as on June 14, 2024 (15.5% YoY over Rs. 140.2 trillion as on June 16, 2023, +1.9% QoQ at Rs. 159.0 trillion on March 22, 2024). Including HDFC Ltd., credit outstanding stood at Rs. 167.1 trillion as on June 14, 2024 (19.2% YoY over Rs. 140.2 trillion as on June 16, 2023, +1.7% QoQ at Rs. 164.3 trillion as on March 22, 2024). Moreover, at elevated credit deposit levels, the headroom to grow the loan book by utilising the on-balance sheet liquidity will remain constrained. Accordingly, ICRA estimates incremental credit 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!