FINANCIAL MARKETS & BANKING UPDATE VOL. 3: FY2024-FY2025

Corporate bond issuances remained healthy while incremental credit growth continued to moderate in Q2 FY2025

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Abbreviations

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

Agenda

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Highlights - I

ICRA

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10-year G-Sec yield is likely to trade at 6.65-6.90% in the near term.

Net FII inflows surged to a 15-quarter high of $20.0 billion in Q2 FY2025; ICRA expects inflows to remain robust at $35-40 billion in FY2025, aided by the bond index inclusion and healthy domestic fundamentals.

- **Yield curve remains flat:** The 10-year G-Sec yields continued to soften in Q2 FY2025, closing at 6.86% as on August 31, 2024 (6.92% as on July 31, 2024, 7.00% as on June 30, 2024). Besides softening of global bond yields and weaker oil and commodity prices, announcement of lower fiscal deficit in the budget contributed to the rally in the yields. Subsequently, 10-year G-Sec yields further softened to 6.75% as on September 30, 2024 on account of rate cuts by the Federal Reserve. ICRA expects India's 10-year yield to track the movement in crude oil prices, which will remain volatile in the near term, even as the demand-supply dynamics for G-Secs are favourable, stemming from limited risks related to fiscal slippage, marginal increase in supply of G-Secs in H2 FY2025 over H2 FY2024, continued FPI inflows into G-Secs owing to the bond index inclusion, and likely additional rate cuts in the US. Following the change in stance to neutral by the Monetary Policy Committee in October 2024, ICRA expects the 10-year yield to trade between 6.65-6.90% in the near term.
- **Corporate bond issuances picked up in Q2 FY2025:** Bond issuance picked up momentum in Q2 FY2025 and stood at Rs. 3.0 trillion (Rs. 1.8 trillion in Q1 FY2025, Rs. 1.8 trillion in Q2 FY2024). Looking ahead, elevated cost of bank funding, particularly for NBFCs following an increase in risk weights as well as the cooling-off of the benchmark yields could drive issuances. 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 expects the corporate bond outstanding to increase to ~Rs. 51.5-51.8 trillion by end of March 2025 (marking a YoY growth of 8.9-9.5%).
- **Net FII inflows surged in Q2 FY2025:** The net FPI purchases into the Indian markets (under equity, debt and hybrid) surged to a 15-quarter high of $20.0 billion in Q2 FY2025 from $1.5 billion in Q1 FY2025. The uptick was driven by both net equity (to +$11.6 billion in Q2 FY2025 from -$0.9 billion in Q1 FY2025) and debt (+$7.9 billion from +$2.3 billion) inflows. Thereafter, FPIs turned into net sellers, with outflows amounting to a considerable $9.90 billion in October 2024 (till October 21), largely driven by the equity segment (-$9.87 billion), followed by relatively mild outflows in the debt segment (-$0.15 billion). Going ahead, the implications of additional rate cuts in the US for the DXY and INR, geopolitical tensions, and strength of domestic earnings are likely to impact FII inflows, particularly in the equity segment in the remaining part of FY2025. Overall, ICRA estimates FPI inflows at a robust $35-40 billion in FY2025, supported by the bond index inclusion during the fiscal as well as healthy domestic fundamentals.

Highlights - II

ICRA

FDI equity inflows surge, clocking $19.7 billion for 4M FY2025 against $45.8 billion in FY2024.

Impact of changes in taxation kept quarterly LRS remittances range-bound at $7 billion for the past three quarters.

Gross ECB approvals picked up in Q2 FY2025, with the rate cut by the ECB starting in Jun-24 followed by US Federal Reserve In Sep-24.

India's GVA growth is estimated to slow down to 6.4% in Q2 FY2025, owing to the impact of excess rainfall on mining and electricity, and that of an elevated base on manufacturing; however, agri and services sectors may see a pick-up vis-à-vis Q1.

- **FDI inflows surge on their path to recovery:** During Q1 FY2025, equity of ~$16.4 billion was added as FDI. Further, equity inflows in July 2024 totaled $3.3 billion taking the (TTM) FDI inflows to $51.6 billion for July 2024. FDI inflows to likely remain range-bound at around $45-50 billion for FY2025 with potential downside impact due to geopolitical concerns. Meanwhile, equity inflows from Mauritius bounced back in Q1 FY2025.
- **Gross overseas investments and LRS outflows witness uptick:** Gross FDI outflows in Q1 FY2025 stood at $3.4 billion, 32% lower than $5.0 billion recorded for Q4 FY2024. LRS outflows were $6.9 billion in Q1 FY2025. Outflow under LRS remained below $7 billion for each quarter after the higher tax collected at source requirements were implemented in Q3 FY2024. LRS outflows are likely to stay range-bound and trail the record levels ($31.7 billion) reached in FY2024.
- **ECB approvals picked up pace in August 2024:** Gross ECB approvals in 5M FY2025 aggregated to $20.2 billion over $26.1 billion in the corresponding period last year. During the period, ECB approvals towards the financial sector dominated the ECB market with approvals aggregating to $7.9 billion (38% of gross approvals). Approvals may rise after softening of cost of overseas borrowing following the rate cut by ECB and US Federal Reserve. However, any surge in geopolitical tensions may enlarge forex and hedging costs associated with the borrowings.
- **India's GVA growth to ease to 6.4% in Q2 FY2025:** The manufacturing GVA growth is expected to slow down in Q2 FY2025, amid an elevated base, offsetting the favourable impact of lower global commodity prices on corporate margins, as well as restocking before the festive season. Additionally, the adverse impact of excess rainfall on mining and electricity demand is likely to curtail the YoY growth of the industrial sector in the quarter. This will weigh on the overall GVA growth in Q2 FY2025 vis-à-vis Q1, even as the expansion in the agri and services sectors is expected to improve between these quarters. While ICRA estimates the GVA growth to ease to 6.4% in Q2 FY2025 from 6.8% in Q1 FY2025, the GDP growth in the quarter will depend on the GoI's subsidy pay-out and indirect tax inflows. Thereafter, ICRA expects growth to pick up above 7.0% in H2 FY2025, led by an improvement in agri GVA and rural demand, and an acceleration in Government capex. Overall, ICRA expects the GVA and GDP growth to print at 6.8% and 7.0%, respectively, in FY2025.

Highlights - III

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CPI inflation softened to a five-year low of 4.2% in Q2 FY2025, reflecting softer prints in the first two months; volatile vegetable prices, import duty hikes on edible oils and uptrend in global food prices imbue caution to the near-term inflation outlook.

The possibility of a rate cut in December 2024 policy appears low after larger-than-expected surge in CPI inflation in September 2024.

Liquidity conditions turned favourable in Q2 FY2025, with some pick up in GoI spending, moderation in CIC and ample capital inflows; although seasonal rise in demand for cash will drain banking liquidity, pick-up in GoI spending and bond inflows are likely to support systemic liquidity in H2 FY2025.

- **CPI inflation softened to 4.2% in Q2 FY2025, slightly higher than MPC's forecast of 4.1%:** The headline CPI inflation moderated to a 20-quarter low of 4.2% in Q2 FY2025 from 4.9% in Q1 FY2025. This entailed benign prints of 3.6-3.7% for July-August 2024 on account of a favourable base effect, before the CPI inflation surged to a nine-month high of 5.5% in September 2024. Barring miscellaneous and housing items, all other sub-groups including food and beverages witnessed base-effect led softening in Q2 FY2025 compared to Q1 FY2025. While the abundant monsoon has reduced the risks related to food grains and some other crops, the volatility in vegetable prices, recent uptick in global food prices and increase in import duty for edible oils imbues caution regarding the inflation outlook for the near term. Additionally, the core-CPI inflation is expected to continue to inch up through H2 FY2025, owing to high services demand, potential rise in clothing inflation after the YoY fall in cotton sowing, and potential transmission of rising commodity prices.
- **Low odds of a rate cut in December 2024 policy:** The substantial rebound in the CPI inflation print for September 2024 has dampened the possibility of the stance change in the October policy being followed up by a rate cut in the December 2024 meeting. For a rate cut to be forthcoming in the December 2024 policy review, either the CPI inflation will need to flatten considerably below 5.0% in the next print or the GDP growth for Q2 FY2025 will need to significantly undershoot the MPC's expectations.
- **Systemic liquidity may remain comfortable in H2 FY2025:** Liquidity conditions improved materially in Q2 FY2025, with the systemic liquidity displaying a sizeable surplus of Rs. 1.2 trillion (+0.5% of NDTL), as opposed to the deficit of Rs. 0.6 trillion (-0.3% of NDTL) in Q1 FY2025. This was on account of some pick up in the GoI's spending, surge in capital inflows and moderation in CIC in Q2 FY2025 over Q1. While as many as 49 VRRRs and few OMO sales of G-Secs were conducted to impound excess liquidity in the system in Q2 FY2025, the frequency of VRR auctions reduced sharply in the quarter. Looking ahead, the onset of the busy season, wherein the demand for cash increases in the festive and wedding period, will drain liquidity in the banking system. Although FPI equity flows remain vulnerable to geopolitical tensions, bond inflows are likely to remain healthy and the GoI's spending will witness a seasonal uptick in H2, which would support systemic liquidity. Overall, ICRA expects systemic liquidity conditions to remain comfortable in H2 FY2025, barring the intermittent tightness from frictional factors such as tax outflows.

Highlights - IV

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YoY deposit growth is expected at 10.3-10.7% in FY2025 (13.5% in FY2024), with incremental deposits projected at Rs. 21.0-22.0 trillion (Rs. 24.3 trillion in FY2024, including HDFC merger).

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%.

- **Deposit accretion remained healthy in Q2 FY2025**: Deposit accretion in Q2 FY2025 remained healthy at Rs. 6.3 trillion compared to Rs. 8.1 trillion in Q1 FY2025. With the healthy build up in deposits in Q1 FY2025, the deposit accretion in H1 FY2025 (till October 04, 2024) was strong at Rs. 14.4 trillion; although it trailed the deposit accretion of Rs. 15.6 trillion in H1 FY2024 (till October 06, 2023). The sizeable deposit accretion in H1 FY2024 had been on account of withdrawal of Rs. 2,000 notes and merger of HDFC Limited with HDFC Bank. The outstanding deposits of the banking system rose to Rs. 219.2 trillion (+11.8% YoY growth) as on October 04, 2024 from Rs. 196.1 trillion as on October 06, 2023 (+13.6% YoY growth). Excluding the HDFC Ltd–HDFC Bank merger, the outstanding deposits stood at Rs. 218.5 trillion as on October 04, 2024 (+12.2% YoY growth). Driven by expected moderation in credit growth as well a larger base, deposit growth is likely to drop to 10.3-10.7% in FY2025 (incremental deposits of Rs. 21.0-22.0 trillion) while the outstanding deposit is estimated at Rs. 225.8-226.8 trillion by March 2025 (including the impact of the HDFC merger).
- **Credit expansion remained low in H1 FY2025**: Incremental NFBC expansion stood at Rs. 4.3 trillion in Q2 FY2025 (till October 04, 2024) and was steady over the Rs. 4.4 trillion recorded in Q1 FY2025 (till June 28, 2024). Going forward, high credit-to-deposit ratio, implementation of new liquidity coverage ratio (LCR) guidelines by RBI, coupled with any additional directives by the regulator around any segment of concern to the RBI, could moderate the growth momentum further. Moreover, the RBI draft guidelines on additional provision on infrastructure exposure, if implemented, could impact the credit growth, since infrastructure is a large segment in bank credit. In addition, geopolitical events could disrupt the global demand-supply chain, thereby impacting availability and prices of various commodities/products and, hence, may impact the credit growth. Including HDFC Ltd., credit outstanding stood at Rs. 172.8 trillion as on October 04, 2024 (12.8% YoY over Rs. 153.2 trillion as on October 06, 2023, +2.6% QoQ at Rs. 168.5 trillion as on June 28, 2024). Excluding HDFC Ltd., credit outstanding rose to ~Rs. 168.1 trillion as on October 04, 2024 (14.1% YoY over Rs. 147.3 trillion as on October 06, 2023, +2.8% QoQ at Rs. 163.5 trillion on June 28, 2024). 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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