



Financial Markets & Banking Update —Vol. 2: FY2011-12

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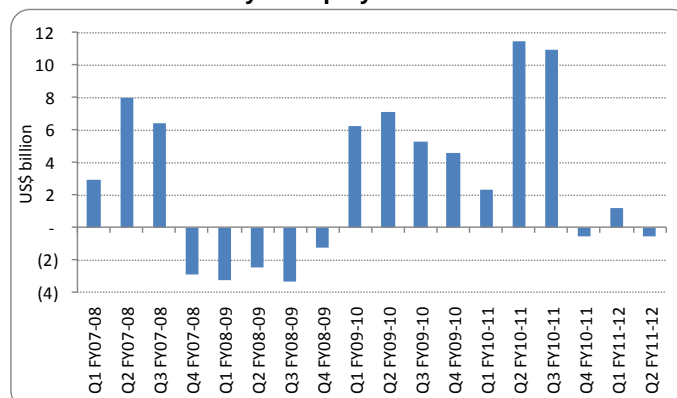
Highlights during quarter ended September 2011

- Foreign Institutional Investors (FIIs) inflows were marginally positive in Q2FY12, despite equity outflows.
- Sharp growth in Foreign Direct Investment (FDI) inflows in Q1FY12; magnitude of inflows in FY12 likely to exceed those in FY11.
- Inflows from External Commercial Borrowings (ECBs) remain strong in FY12 till August 2011 while Foreign Currency Convertible Bonds (FCCBs) volumes remain insignificant.
- Repo rate hiked twice by the Reserve Bank of India (RBI) in Q2FY12 to dampen inflationary pressures; while remaining elevated, both headline and core inflation eased mildly in September 2011.
- Signs of moderation emerge in consumption and investment growth; economic growth expected to moderate to 7.5-7.7% in FY12 from 8.5% in FY11.
- Systemic liquidity largely within RBI's comfort zone of +/-1% of NDTL in Q2FY12; may widen in Q3FY12 on account of considerable Government borrowings particularly if deposit growth eases and the pace of credit off-take remains strong.
- Credit and deposits grow faster than RBI targets; credit growth expected to moderate owing to growth pressures and an adverse base effect.
- Marginal pickup in Corporate bond issuances boosted by retail bond issuance.
- Corporate bond spreads narrow; to remain volatile in the near term.

Equity flows from FIIs marginally negative in Q2FY12

The net quarterly equity inflows from Foreign Institutional Investors (FIIs) were negative in Q2FY12 following a relatively weak performance of domestic equity markets. The benchmark NIFTY index has declined by 12.5% in Q2FY12 and 15.3% since March 2011, which is weaker compared to other markets during this period. According to data released by the Securities and Exchange Board of India (SEBI), the net equity FII outflow in Q2FY12 was US\$0.6 billion compared to a net inflow of US\$1.15 billion in Q1FY12 and an inflow of US\$11.5 billion in Q2FY11. The magnitude of FII equity inflows into the domestic equity markets during H1FY12 (US\$0.6 billion) has been weak as compared to H1FY11 (US\$13.8 billion) and the lowest since Q4FY08-09.

Chart 1: Net Quarterly FII Equity Inflows

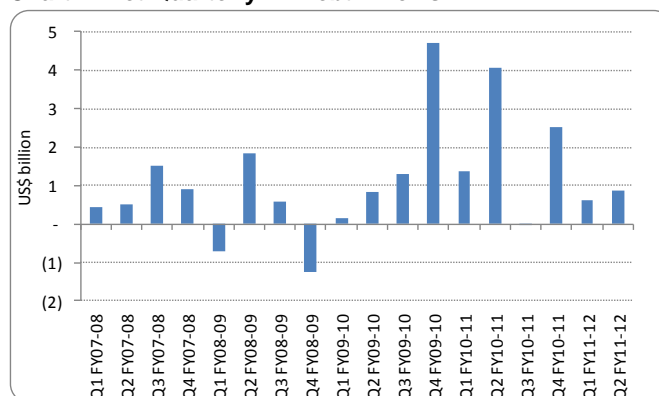


Source: SEBI

Debt FII flows remain low in Q2FY12; tightening yields may attract higher flows

FII inflows into the debt market improved marginally to US\$0.87 billion in Q2FY12 from US\$0.60 billion in Q1FY12. In spite of elevated bond yields, inflows in Q2FY12 were sharply lower than the inflows of US\$4.05 billion in Q2FY11, on account of a rise in risk aversion related to global developments. With global interest rates remaining benign and the yields on domestic treasury bills, Government securities and Corporate bonds expected to remain attractive in the near-to-medium term, FII debt inflows may improve in the near term.

Chart 2: Net Quarterly FII Debt Inflows



Source: SEBI

FIIs have already invested up to 97%¹ of the US\$10 billion limit for investment in Government Securities. The large remaining borrowing programme of Government of India (GoI) for H2FY12, which was recently revised upwards by nearly Rs. 53,000 crore to Rs. 220,000 crore, may prompt an upward revision in the FII ceiling in debt investments.

The limit on FII investment in Indian Corporate bonds was increased to US\$40 billion with a sub-limit of US\$15 billion in Debt-oriented Mutual Funds, and the remaining US\$25 billion in infrastructure companies and debt funds, with lock-in periods of 1-3 years. While the limit on investments in Debt-oriented Mutual Funds has been largely exhausted (99% as on September 30, 2011), data suggests that the utilisation levels regarding investment in Indian Corporate bonds is very low, as a majority of FIIs tend to invest in short-to-medium term papers.

Efforts being made by GoI and the regulators to improve the Corporate bond market by gradually removing the bottlenecks would aid in improved debt flows over a period of time.

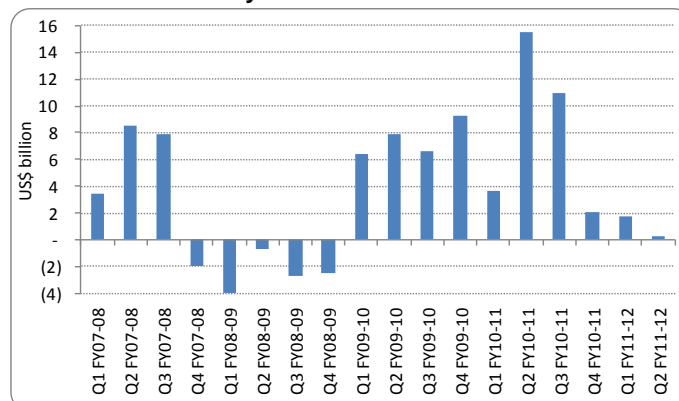
¹ As per data as on Sep-11 published by SEBI

Total FII inflows remains marginally positive in Q2FY12

With debt inflows remaining moderate in Q2FY12 and a net outflow on equity, the total FII investments in Indian markets of US\$0.28 billion were lower than the inflows of US\$1.75 billion in Q1FY12 and US\$15.55 billion in Q2FY11.

Globally, Central Banks have preferred to delay unwinding of the massive monetary stimuli as global growth indicators remain sluggish. Notwithstanding some downward revision, the outlook for Indian economic growth remains relatively strong compared to the developed markets. Accordingly, market sentiment for Indian equities may improve prompting higher FII inflows in the coming months.

Chart 3: Net Quarterly FII Inflows



Source: SEBI

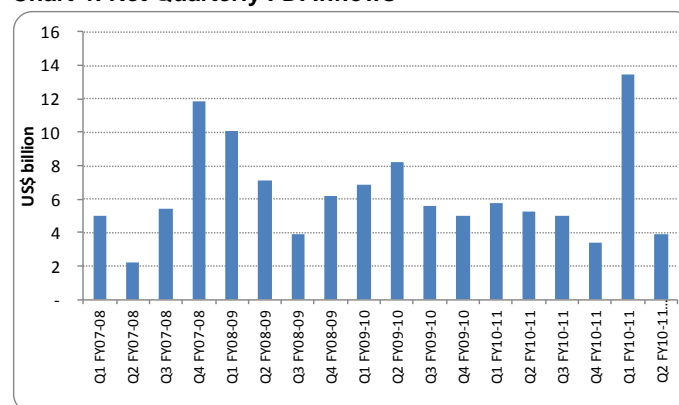
Nevertheless, continuing uncertainty over the sovereign debt crisis in the peripheral Euro-zone would crucially impact the Indian debt and equity markets. Any faltering of the global economic recovery in H2FY12 could lead to increased risk aversion and capital outflows from emerging economies. While global commodity prices may undergo a correction in such a scenario, the impact on domestic commodity prices and inflationary pressures would be influenced by movements in key foreign exchange rates. In the event of a sharper than expected economic slowdown or a rise in systemic risks related to catastrophic events (like sovereign defaults), further calibrated actions by Central Banks are likely to boost liquidity and support asset prices globally.

Additionally, the demand for Indian debt may improve as yields are likely to remain attractive for investors over the near-to-medium term, reflecting both the considerable supply of Government borrowing lined up for H2FY12 as well as the stance of monetary policy.

Sharp rise in FDI inflows in April-August 2011

The inflows via the Foreign Direct Investment (FDI) route rose sharply to US\$13.44 billion in Q1FY12, the highest in at least past five years, backed mainly by large investments in the pharmaceuticals and services sectors. The cumulative inflows in the months of April to August in 2011 at US\$17.4 billion were a sharp 95% higher than the US\$8.9 billion during the same months in 2010. While Mauritius (34%) and Singapore (17%) remained the top source of FDI inflows, the share of inflows from U.K. and Japan increased in the current fiscal to 15% (US\$2.5 billion) and 10% (US\$1.7 billion), respectively, while the share of inflows from USA fell sharply to 4%. Apart from services, telecom and housing, which accounted for 15%, 9% and 7%, respectively, of the total FDI inflows in April-August 2011, the inflows in the drugs and pharma sector (US\$3.0 billion) increased significantly to 17% of total inflows in the current fiscal from around 1% in the past decade. While the FDI inflows in Q1FY12 might have been driven by certain lumpy inflows, inflows in July-August 2011 recorded a growth of 26% as compared to the same months in 2010, and the total FDI inflows in the current fiscal may exceed the inflows recorded in FY11.

Chart 4: Net Quarterly FDI Inflows



* Data for Q2FY12 is upto Aug-11

Source: Ministry of Commerce and Industry

High domestic borrowing cost keeps ECB inflows strong in FY12; FCCB flows remain modest

Gross inflows through external commercial borrowings (ECBs) in the current fiscal remained buoyant at US\$15.4 billion in FY12 up to August 2011, the highest in the corresponding period in at least the past five years. At the same time, gross inflows through the FCCB route remained modest at US\$537 million in FY12 up to August 2011, as compared to US\$960 million in April-August 2010.

Chart 5: Gross Quarterly ECB Inflows

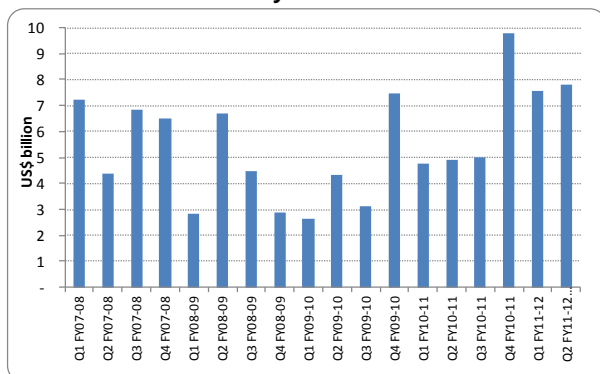
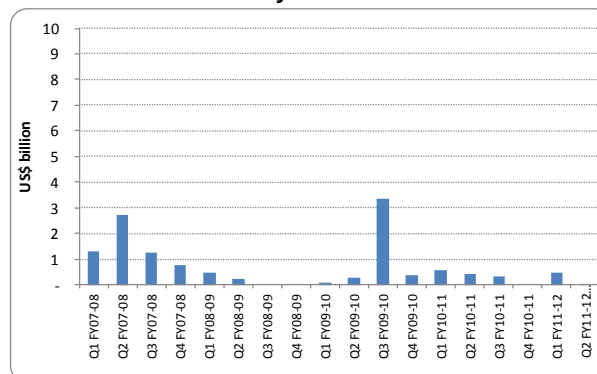


Chart 6: Gross Quarterly FCCB Inflows



* Data for Q2FY12 is upto Aug-11

Source: RBI

Several large issuances of ECBs were made in FY12 up to August 2011 mainly for purchase of capital goods, refinance of rupee loans including those for 3G/BWA auctions, onward lending by financial institutions and new projects in power, roads and port sectors. External borrowings for overseas acquisitions declined to US\$0.59 billion in April-August 2011 from US\$0.64 billion in April-August 2010. The major issuers during the period June 2011 to August 2011 included Aircel (US\$1.17 billion), Reliance Industries (US\$1.09 billion), Steel Authority of India, Indian Oil Corporation, Adani Power, NTPC and Tata Motors (US\$500 million each).

The RBI recently permitted refinancing through the ECB route to redeem maturing FCCBs, and several Corporates have cumulatively raised US\$119 million to redeem FCCBs. Additionally, the Central Bank recently introduced other changes aimed at boosting the inflow of funds through ECBs, such as an increase in the automatic approval limit to US\$750 million from US\$ 500 million each year and permission to raise yuan-denominated debt up to US\$ 1 billion. The RBI also permitted infrastructure companies to utilise of 25% of ECBs raised for repayment of Rupee-loans taken previously for capital expenditure for completed projects (subject to the balance 75% being used for capital expenditure for new projects). While the RBI has persisted with monetary tightening since March 2010 to dampen inflationary pressures, several Advanced Economies continue to maintain a soft monetary stance and interest rate differentials are expected to persist in the coming months. However, the attractiveness of ECBs to Indian Corporate entities as a source of fulfilling a part of their funding requirements would also depend on the outlook for the Indian rupee relative to currencies such as the US dollar. Even though some arbitrage opportunities may be available, raising funds through ECBs may be a challenge on account of a weakened lenders' appetite given the continuing uncertainty regarding the impact of the sovereign debt crisis on the global economic scenario.

FCCB flows are likely to remain volatile and dependent on equity capital markets over the next few quarters.

RBI hikes policy rates by 75 bps in Q2FY11; may raise the Repo rate by 25 bps in upcoming policy review

The RBI increased the Repo rate by 75 bps in Q2FY12 in two stages, to 8.25% from 7.50%, maintaining the focus of monetary policy towards containing inflation, which averaged 9.6% in Q1FY12 and Q2FY11. With this, the RBI has cumulatively increased the Repo rate by 350 bps since the unwinding of liquidity measures began in March 2010. The substantial tightening has resulted in a lagged impact on systemic interest rates and Banks have increased their base lending rates by nearly 250-275² bps and deposit rates by 175-250² since the beginning of policy tightening in March 2010.

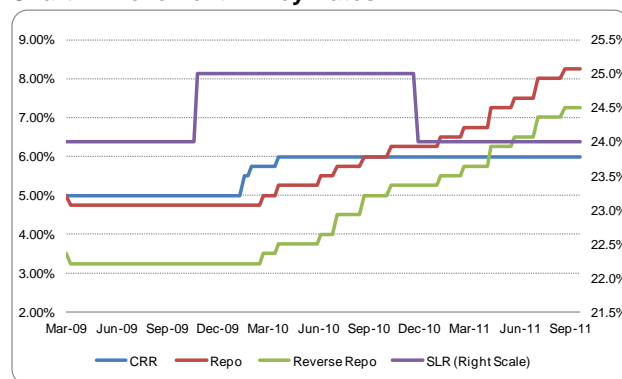
Nonetheless, systemic credit continues to exhibit robust growth of around 21% in the current fiscal in year-on-year (y-o-y) terms, despite an adverse base effect (related to higher funding requirement for the 3G and BWA telecom auctions in 2010), on account of certain factors such as a higher working capital requirement related to the elevated commodity prices as well as demand for funds from specific sectors such as power.

Notwithstanding a subdued domestic industrial growth in the recent months, signals of a moderation in investment and consumption growth and the uncertain outlook for the global economy, with headline and core inflation substantially higher than the RBI's comfort zone, ICRA expects that the Central Bank may increase the repo rate by 25 bps in the upcoming quarterly review of monetary policy, in order to reinforce the impact of the monetary tightening undertaken previously.

Systemic liquidity remained in deficit mode throughout Q2FY12, but largely remained within RBI's comfort zone of +/-1% of net demand and time liabilities, with the exception of a few days in September 2011 on account of pressures related to advance tax payments. The Marginal Standing facility (MSF) introduced by RBI in May 2011 available to Banks at 1% higher than Repo rate has been largely unutilised, as Banks were able to access adequate liquidity through the LAF.

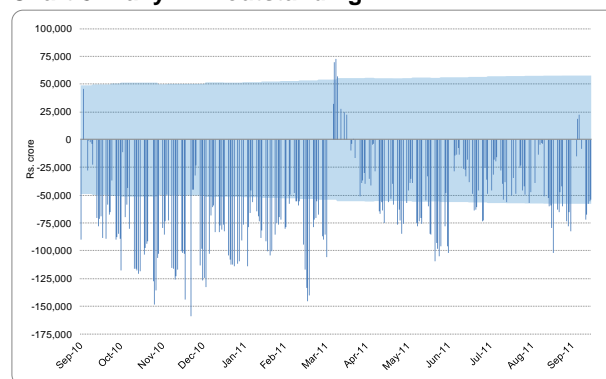
The call rate, which exhibited considerable volatility in FY11 owing to a substantial systemic liquidity deficit, has stabilised around the Repo rate in the current fiscal reflecting the improvement in the extent of the systemic liquidity deficit. In ICRA's opinion, systemic liquidity is likely to remain in deficit in Q3FY12 in line with RBI's stated policy towards the same and the considerable magnitude of borrowings to be made by the Central and State Governments in H2FY12. If credit off-take continues to grow at the current pace, while deposit growth dampens, the systemic

Chart 7: Movement in Key Rates



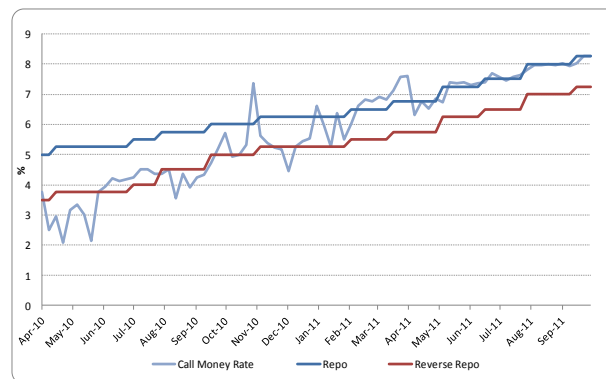
Source: RBI

Chart 8: Daily LAF outstanding



Note: Negative amounts indicate injection of liquidity by RBI
 Note: Shaded portion indicates 1% of NDTL

Chart 9: Movement of Call Rates



Source: RBI

² Relating to 5 major Banks as tracked by RBI

liquidity deficit could widen in the coming months.

Although systemic liquidity remained in deficit, Banks maintained excess SLR investments (including Reverse Repo) of nearly Rs. 3.2 lakh-crore on an average in Q2FY12, higher than the average of Rs. 2.5 lakh-crore in Q1FY12; the SLR levels remained high at 29.6% of NDTL on an average during Q2FY12 compared to 28.5% in Q1FY12, but declined marginally to 28.2% as on September 30, 2011 owing to a sharp rise in credit off-take. Bank funds parked in debt-oriented liquid mutual funds declined to around Rs. 70,000 crore from Rs. 1.05 lakh-crore in Q1FY12 following RBI's norm to reduce Banks' liquid investments to 10% of net worth.

Headline and core inflation ease mildly in September 2011, remain elevated

Headline wholesale price index (WPI) inflation averaged 9.6% in both Q1FY11 and Q2FY11 and remained above 9% for the tenth consecutive month in September 2011, substantially higher than the RBI's comfort zone. However, inflation eased mildly to 9.7% in September 2011 from 9.8% in August 2011. Moreover, the extent of upward revision of the initial estimates of WPI inflation was small in June 2011 (0.14%) and July 2011 (0.07%) as compared to the first five months of calendar year 2011 (0.50% to 1.27%). The rate of inflation related to non food manufactured products declined on a y-o-y basis to 7.6% in September 2011 from 7.8% in August 2011. Notably, the index levels declined or remained unchanged for six of the 11 sub-groups of non food manufactured products on a month-on-month basis, suggesting that inflationary pressures have begun to moderate in certain sectors. In particular, the price index for textiles recorded a decline for the fourth consecutive month, led by a sustained downtrend in the index for cotton textiles, reflecting a correction in raw cotton prices up to July 2011 (followed by a subsequent reversal of this trend). The index levels for non metallic mineral products and transport equipment & parts remained unchanged between August and September 2011.

Primary non-food inflation declined to 14.8% in September 2011 from 17.8% in August 2011, led by a sharp decline in the inflation related to fibres (primarily led by cotton) and moderate decrease in inflation related to oilseeds, with the latter reflecting an increase in the sown area in 2011 as compared to 2010.

Primary food inflation recorded a small decline to 9.2% in September 2011 from 9.6% in August 2011; lower inflation related to cereals, fruits and non-vegetarian protein items was offset by higher inflation related to pulses, vegetables and milk. In contrast to the forecast of a below-normal monsoon rainfall (95 +/-4%) made in June 2011 by the Indian Meteorological Department (IMD), the overall magnitude of rainfall was favourable in 2011 at 1.4% higher than the long period average. A substantial increase in area sown under rice in conjunction with the considerable available stocks of rice and wheat suggests that the inflation related to cereals is likely to remain moderate. However, prices of pulses are expected to continue to rise, reflecting the lower area sown under pulses in 2011 as compared to the previous year. Notwithstanding a slight moderation, inflation related to non-vegetarian protein items remained high at 9.7% in September 2011 (slightly lower than the 10.8% recorded in August 2011). Prices of non-vegetarian protein items are likely to remain rigid as an adequate supply response is unlikely in the short term. Manufactured food inflation has declined from 8.8% in June 2011 to 8.0% in both August 2011 and September 2011.

Fuel inflation rose to 14.1% in September 2011 from 12.8% in August 2011, following the revision in the price of petrol in mid-September 2011 and higher prices of bitumen, furnace oil, lubricants etc. Additionally, an increase in electricity tariffs was introduced by the State Electricity Regulatory Commissions (SERCs) in certain States; similar steps expected to be taken by SERCs in other States, particularly to offset the higher coal prices in 2011 relative to previous years, would exert pressure on fuel inflation in the coming months.

The price index for minerals declined for the second consecutive month in September 2011, with a correction in global prices offset to an extent by the depreciation of the rupee. Notwithstanding the anticipated adverse impact of the recent depreciation of the Indian rupee on the prices of imports, ICRA expects the headline inflation rate to decline to around 6.8-7.0% by March 2012 in line with the baseline projection made by the RBI, unless commodity prices increase sharply in the coming months.

Chart 10: WPI Inflation (y-o-y, Monthly)

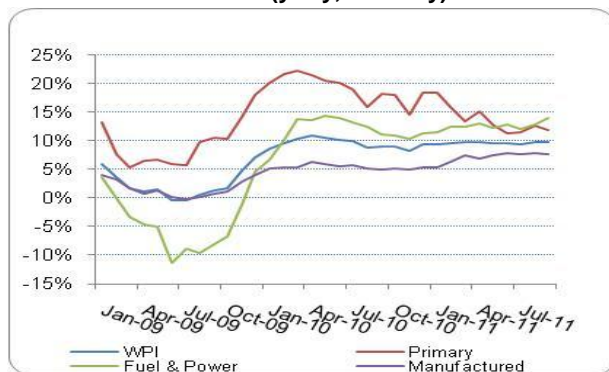
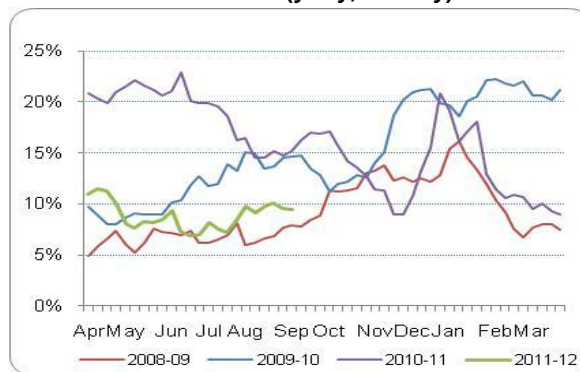


Chart 11: Food Inflation (y-o-y, Weekly)



Source: Office of the Economic Advisor, Ministry of Commerce and Industry, Government of India

GDP growth eases to 7.7% in Q1FY12; IIP data for July-August 2011 suggests moderation in growth of private consumption and investment demand

The gross domestic product (GDP) at factor cost (constant prices) expanded by 7.7% in year-on-year (y-o-y) terms in Q1FY12, lower than the 8.8% growth recorded in Q1FY11. Industrial growth moderated considerably reflecting the moderation in manufacturing growth (to 7.2% in Q1FY12 from 10.6% in Q1FY11) as well as a lacklustre sub-2% growth of the construction and mining & quarrying sub-sectors in Q1FY12; these two sub-sectors had displayed growth in excess of 7% in Q1FY11. Growth of the services sector remained largely steady at 10% in Q1FY12 relative to 10.4% in Q1FY11. However, the growth of the agricultural sector recorded an improvement to 3.9% in Q1FY12 from 2.4% in Q1FY11 during Q1FY12, reflecting the healthy *rabi* harvest following the replenishment of groundwater after a favourable monsoon rainfall in 2010-11. An increase in the sown area and a favourable monsoon rainfall in 2011 are likely to boost agricultural output in FY12, although the pace of growth is likely to be moderate given the high base effect.

Table 1: Growth of GDP & Components (in %, constant 2004-05 prices, y-o-y)

	Q1 2010-11	Q1 2011-12
Agriculture & Allied	2.4%	3.9%
Industry	9.1%	5.1%
Services	10.4%	10.0%
GDP at factor cost	8.8%	7.7%
PFCE	9.5%	6.3%
GFCE	6.7%	2.1%
GFCF	11.1%	7.9%
Exports	9.8%	24.3%
less Imports	15.2%	23.6%
GDP at market prices	9.1%	8.5%

Source: Central Statistics Office (CSO), ICRA Estimates

Growth of GDP at market prices (at constant 2004-05 prices), reflecting demand-side factors, moderated to 8.5% in Q1FY12, from 9.1% in Q1FY11. Gross fixed capital formation (GFCF) expanded by 7.9% in Q1FY12, which is likely to reflect the completion of ongoing projects, although the pace of growth declined relative to the 11.1% expansion in Q1FY11. Various challenges including land acquisition, environmental approvals as well as the hardening of interest rates have resulted in a postponement of the capital expansion plans of large Corporates and dampened the pace of infrastructure creation, which would negatively impact investment growth over the coming quarters. The growth of private final consumption expenditure moderated to 6.3% in Q1FY12 from 9.5% in Q1FY11, signalling a weakening of domestic consumption demand, reflecting the impact of persistently high inflation and rising interest rates. Additionally, the pace of growth of government final consumption expenditure slowed to 2.1% in Q1FY12 from 6.7% in Q1FY11. Contrastingly, the pace of growth of both exports and imports improved considerably in Q1FY12 to 24.3% and 23.6%, respectively, which partly reflects higher price levels of both imports and exports. During Q1FY12, GDP at market prices expanded at a faster pace of 8.5% as compared to the 7.7% growth of GDP at factor cost, with indirect taxes less subsidies expanding by nearly 20%.

The Index of Industrial Production (IIP) recorded sluggish 3.9% growth in July-August 2011 relative to the same months in 2010, lower than the 6.8% growth recorded in Q1FY12. This moderation was led

by a de-growth of 5.5% in capital goods in July-August 2011, as compared to a 16.8% expansion in Q1FY12, highlighting the slowdown in investment growth in the recent months. While the pace of growth of basic goods remained steady, led by a healthy performance of electricity generation, that of consumer durables recorded an improved growth rate in July-August 2011 as compared to Q1FY12, which is likely to reflect restocking of inventories. The anticipated favourable agricultural performance and *kharif* output in 2011 may boost the rural incomes, thereby boosting demand for consumer goods to some extent in the coming months. However, the pace of growth of intermediate goods declined in July-August 2011 relative to Q1FY12, suggesting a moderate demand for finished products in the coming months.

The performance of the mining & quarrying sub-sector worsened in July-August 2011, with a de-growth of nearly 1% relative to the same months in 2010 reflecting low output of natural gas from the Krishna-Godavari basin, restrictions placed by the Supreme Court on mining of iron ore in Karnataka as well as heavy monsoon rainfall. The growth outlook for this sector remains bleak given various regulatory and environmental issues that have faced the sector in recent months. The impaired mining activity in recent months has also adversely impacted the pace of growth of other sectors in the economy.

Chart 12: Growth of IIP & Sub-Sectors (y-o-y)

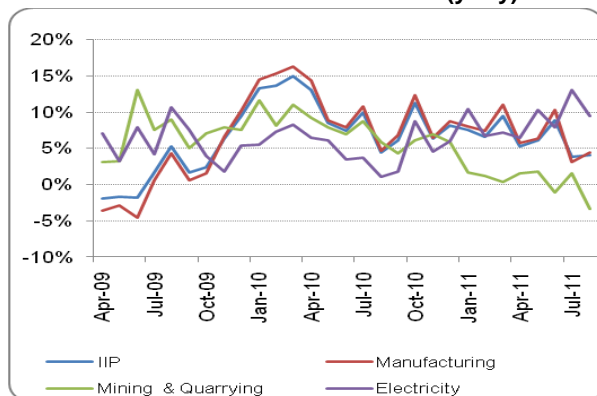
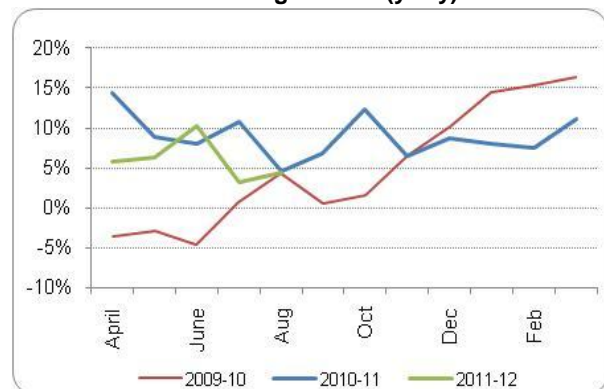


Chart 13: Manufacturing Growth (y-o-y)



Source: CSO

Data released by Government of India (GoI) indicates that the volume of merchandise exports rose by 52% on a year-on-year (y-o-y) basis to reach US\$ 160 billion in H1FY12, led by engineering goods, petroleum products and gems & jewellery; and aided by a diversification strategy to less-established trading partners in Latin America, Asia and Africa. Although the pace of growth on a y-o-y basis remains high, the volume of exports has eased in absolute terms, from around US\$ 29 billion each in June and July 2011 to around US\$ 24 billion each in August and September 2011. The recent depreciation of the Indian Rupee relative to the currencies of several traditional trading partners; the decision by the RBI to extend interest subvention of 2% on rupee export credit for certain labour-intensive sectors (with effect from 1 April 2011 to 31 March 2012); and various export incentives announced by GoI in October 2011 (including duty credit of 1% of FOB value of exports of 50 products under the special bonus benefit scheme, additional duty credit of 1% on exports to 43 countries under the special focus markets scheme, and duty credit of 2% of FOB value of apparel exports to the US and European Union) may help maintain the relative competitiveness of Indian exports to an extent in the near term. However, the prevailing uncertainty related to the sovereign debt and economic prospects of the advanced economies, which continue to account for a sizable share of India's exports, has clouded the outlook regarding the magnitude of exports in the coming months.

Overall, ICRA expects economic growth to moderate to 7.5-7.7% in FY12 from the 8.5% growth recorded in FY11.

Deposits continue to grow faster than RBI’s projection of 17%

After moderate growth in April and May 2011, the pace of deposits growth picked up from June 2011 and aggregate deposits of the Indian Banking system stood at Rs. 57.08 lakh-crore as on September 30, 2011, registering a y-o-y growth of 19.1%. In absolute terms, deposits have increased by Rs. 5.03 lakh-crore since March 2011 (as compared to Rs. 2.25 lakh-crore during the same period in FY11), largely fuelled by the growth in term deposits following several rounds of interest rate hikes by Banks since Q3FY11.

The share of low-cost CASA deposits declined to 36.1% as on June 2011 from 38.7% as on March 2011 and 39.6% as on March 2010. Savings account balances remained steady at 25.1% as on June 2011 compared to 25.9% as on March 2011 and 27.5% as on September 2010. Further, Corporates’ moved their surplus balances to liquid funds and Bank certificates of deposits (CD) given the attractive yields, resulting in a sharp decline in current account balances to 11% as on September 2011 from 12.3% as on March 2011 and 13.0% as on September 2010.

Most Banks, including the larger ones, have increased their peak deposit rates by nearly 175-250 bps in the past 18 months and continue to hold rates at relatively higher levels. Given that other asset classes are likely to generate moderate returns, ICRA expects the overall deposits growth to remain strong at 17-18% in FY12, stimulated by term deposits.

Deposit Growth Trends

Chart 14: Deposits Growth (Financial year-to-date)

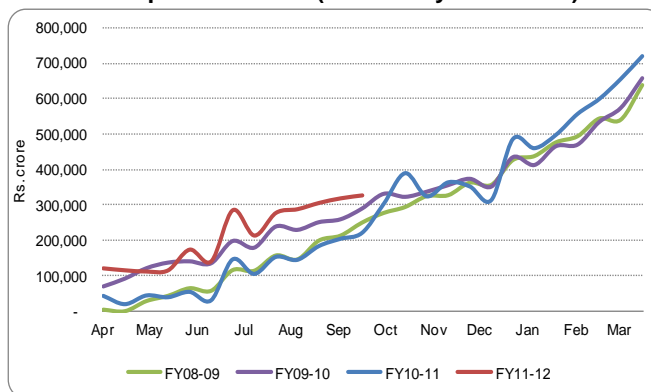
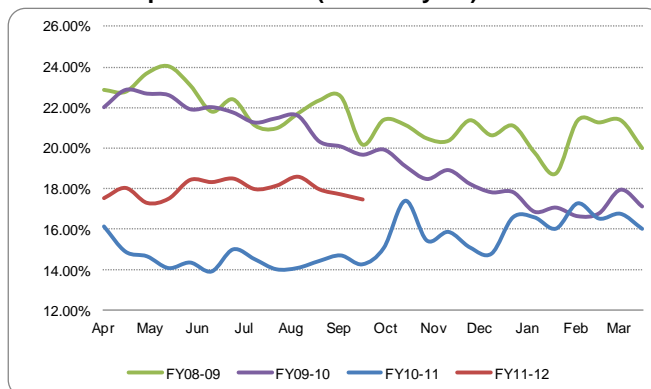


Chart 15: Deposits Growth (Year-on-year)



Source: RBI; ICRA Research

Credit growth remains robust despite hardening interest rates; could moderate in H2FY12

The trend of moderation in credit growth witnessed in Q1FY12 has largely been reversed, with incremental Bank credit of nearly Rs. 2.7 lakh-crore in H1FY12 exceeding the same in H1FY11 (Rs. 2.3 lakh-crore). The y-o-y credit growth remained strong at around 21% as on September 30, 2011, as compared to around 20% as on September 30, 2010. Notwithstanding the spike in quarter-end credit growth, the average growth has remained robust at around 19.5%, significantly higher than the RBI's projection of 18%. However, moderating economic growth and an unyielding interest rate environment, in conjunction with a high base effect are likely to dampen the pace of growth of credit off-take in H2FY12. ICRA expects the full-year credit growth in FY12 to moderate from the current levels to around 18-19%, and remain close to the RBI's baseline projection.

Data released by the RBI regarding deployment of credit to various sectors up to August 2011 indicates that the 2.5% growth of Bank credit so far in FY11³, was primarily driven by credit to industry and retail housing, while credit to services remained flat and agricultural credit declined in the current year. Within industry, a large chunk of the incremental credit extended in the current fiscal has been absorbed by the metals sector (23%) and the infrastructure sector (36% of total incremental credit in FY12), particularly power (31%) and roads (11%) while credit to telecom shrank (11%). The medium and large industrial sectors which grew by 4.5% and 6.2%, respectively, continue to attract a greater share of Bank funding as compared to services and retail loans. While housing credit expanded by Rs. 18,060 crore between April and August 2011 (5.2% growth), data suggests incremental credit off-take for consumer durables has slowed significantly.

Non Food Credit Growth Trends

Chart 16: Credit Growth (Financial year-to-date)

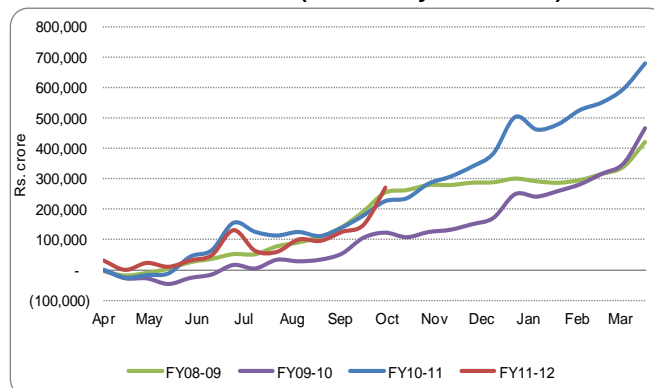
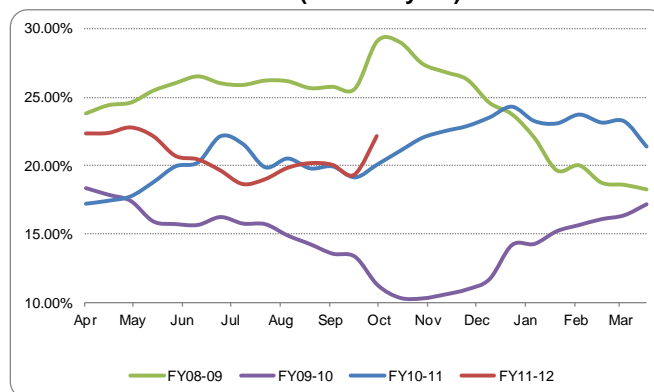


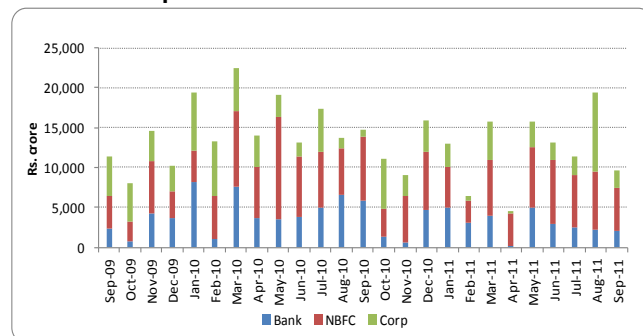
Chart 17: Credit Growth (Year-on-year)



Source: RBI; ICRA Research

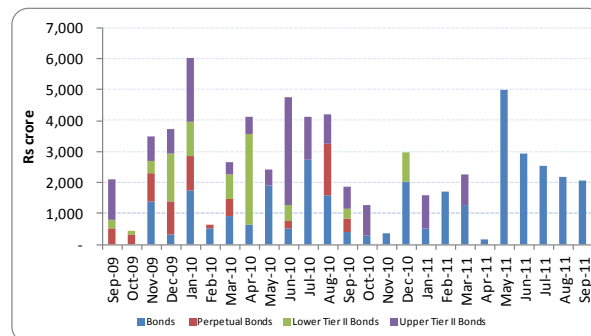
Corporate debt issuances pick up marginally in Q2FY12 with issuances of retail debentures

Chart 18: Corporate Debt Issuances



Source: NSE, BSE, ICRA

Chart 19: Bank Debt Issuances



³ As on August 26, 2011 relative to March 25, 2011

According to ICRA estimates, the bond issuances during Q2FY12 stood at around Rs. 41,000 crore as compared to around Rs. 33,000 crore in Q1FY12 and Rs. 46,000 crore in Q2FY11. Debt issuances by Banks and NBFCs accounted for around 64% of the total issuance during Q1FY12. The bond issuance improved marginally in Q2FY12, boosted by retail bond issuances of over Rs. 4,000 crore by various NBFCs. Long term bond issuances are likely to remain muted as issuers expect rates to soften in the later part of the year and do not want to lock in borrowings at the prevailing high rates. Capital issuances by Banks have been low during the quarter under review while issuances by public sector Corporates helped improve the issuance volumes in Q2FY12.

Corporate bond spreads remain range bound during the quarter under review

The Corporate bond spreads remained range-bound in Q2FY12 after declining in Q1FY12, on the back of less aggressive bulk deposit mobilisations by Banks and moderation in the pace of growth of credit off-take (till mid-August 2011). Several Corporates stayed away from issuing long term bonds on account of the high prevailing rates and their expectations of yields softening in the later part of the year. Instead, Corporates sought to meet their financing requirements by issuing short term commercial papers or availing floating rate long term loans from Banks. Commercial paper outstanding increased from Rs. 80,305 crore in March 2011 to around Rs. 148,800 crore as on August 2011 even as the average cost increased from 9.7% in April 2011 to 11.1% in August 2011.

Chart 20: AAA Corporate Bond Spreads

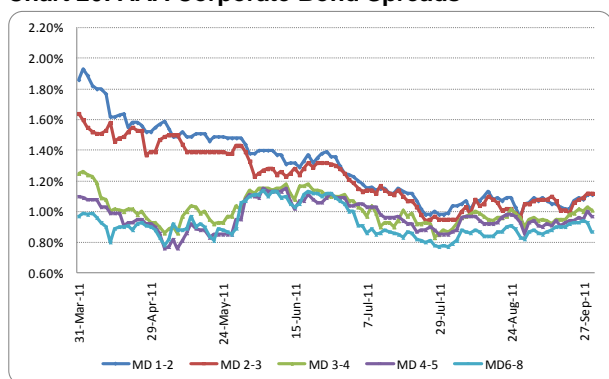
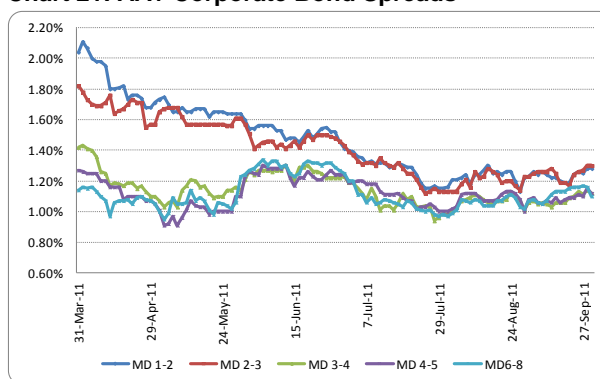


Chart 21: AA+ Corporate Bond Spreads



Source: IMAcS

The spread for AAA rated Corporate bonds with a modified duration (MD) of 3-4 years over G-Secs of the similar duration profile declined from 111 bps at end-June 2011 to 101 bps as end-September 2011, while the spread for MD of 1-2 years declined from 125 bps to 111 bps. Similarly, for AA+ rated bonds, the spread for MD of 3-4 years declined from 123 bps to 112 bps and the spread for MD of 1-2 years declined from 141 bps to 128 bps.

ICRA expects that the RBI may hike the Repo rate by a further 25 bps in the upcoming policy review; accordingly, the Corporate bond spreads (at the shorter end) would remain volatile for some more time before stabilising. The increase in the Government borrowing programme for H2FY12 may lead to crowding out in the bond market, and long term bond issuance are expected to remain muted till there are some signs of easing of interest rates.

Annexure

Table A1: Capital and Financial Market Indicators

Period	Net Growth in Non Food Bank Credit (Rs lakh-crore)	Fresh CP Issuance including rollover (Rs crore)	Fresh Bonds issuances (Rs crore)	Net FII - Debt (US\$ bn)	Equity Issues (IPO+ FPO+ Rights) Issue (Rs crore)	Equity QIP (Rs crore)	Net FII Equity (US\$ bn)	Net FDI (US\$ bn)	Gross ECB (US\$ bn)	Gross FCCB (US\$ bn)
Q1FY10	(0.02)	40,223	30,447	0.16	324	12,232	6.27	6.91	2.64	0.07
Q2FY10	1.09	55,510	39,579	0.83	14,191	11,768	7.10	8.24	4.33	0.28
Q3FY10	1.44	59,101	32,781	1.30	6,932	10,675	5.33	5.61	3.14	3.37
Q4FY10	2.17	45,654	55,195	4.71	32,550	5,093	4.55	4.97	7.48	0.36
Q1FY11	1.56	68,008	46,267	1.37	6,936	6,492	2.33	5.81	4.74	0.57
Q2FY11	0.24	92,486	45,873	4.05	8,833	8,744	11.50	5.23	4.92	0.40
Q3FY11	3.25	129,206	35,900	(0.02)	29,468	5,943	10.99	5.03	5.02	0.32
Q4FY11	1.77	97,718	32,261	2.53	9,922	2,419	(0.52)	3.39	9.78	-
Q1FY12	1.32	143,565	27,734 [#]	0.60	6,998	603	1.15	13.44	7.57	0.49
Q2FY12	1.41	71,060 [*]		0.87	4,680	330	(0.59)	3.93 [^]	7.83 [@]	0.05 [@]

Note: Source NSE, BSE, RBI, Prime Database, ICRA

* Data available only upto August 31, 2011. Hence data not strictly comparable with previous quarters

Based on data disclosed by NSE, BSE as on date. There would be few bond issuances of June 2011 that are not yet listed in BSE/NSE and hence data not strictly comparable with previous quarters.

^ Data available only for August 2011. Hence data not strictly comparable with previous quarters

@ Data available only till August 2011. Hence data not strictly comparable with previous quarters

Table A2: Macro Economic Indicators

	GDP Growth	IIP Growth (quarter ending)	WPI Inflation (quarter ending)	INR-USD rate (quarter ending)
Q1, 2008-09	7.9%	8.5%	10.9%	42.95
Q2, 2008-09	7.7%	10.9%	10.8%	46.94
Q3, 2008-09	5.8%	-1.6%	6.7%	48.45
Q4, 2008-09	5.9%	-5.2%	1.6%	50.95
Q1, 2009-10	6.3%	-1.8%	-0.4%	47.87
Q2, 2009-10	8.6%	1.6%	1.4%	48.04
Q3, 2009-10	7.3%	9.5%	7.1%	46.68
Q4, 2009-10	9.4%	14.9%	10.4%	45.14
Q1, 2010-11	8.8%	7.4%	10.3%	46.6
Q2, 2010-11	8.9%	6.1%	9.0%	44.92
Q3, 2010-11	8.3%	8.2%	9.4%	44.81
Q4, 2010-11	7.8%	9.4%	9.7%	44.65
Q1, 2011-12	7.7%	8.8%	9.5%	44.72
Q2, 2011-12			9.7%	48.92



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