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FINANCIAL MARKETS & BANKING UPDATE VOL. 4: FY2024-FY2025

Corporate bond issuances likely to touch new high in FY2025, even as bank credit growth moderates

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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: Currency 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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2 Growth

3 Inflation

4 Deposit and Credit

5 Money Supply, Liquidity, and Yields

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Highlights – I

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Following the recent liquidity measures and the increased probability of a rate cut in February 2025, the 10-year G-Sec yield will likely trade at 6.5-6.70% in the near term.

FPIs turned net sellers in Q3 FY2025, withdrawing a total of $10.9 billion from Indian markets, against inflows of $20 billion in Q2. This was led by sizeable outflows of ~$12 billion in the equity segment.

- **India's yield curve shifted upwards, steepened at end-December 2024, relative to end-September 2024:** The 10-year G-Sec yield hardened by 10 bps in October and closed at 6.84% as on October 31, 2024, after falling for 26 bps in Q2 FY2025. The movement was driven by the rise in US yields in October 2024, volatility in oil prices, elevated vegetable prices and selling by FPIs. After hardening in October 2024, G-Sec yields remained at an elevated level for most of November 2024. However, benchmark yield softened to 6.75% as on November 30, 2024 on expectations of monetary policy easing by the RBI amid a sharper-than-expected slowdown in GDP growth. Despite hardening of the US 10-year yield during December, the 10-year G-Sec yields closed at only 1 bps higher at 6.76% as on December 31, 2024, as the FIIs turned net buyers in the debt market during the month after a tepid October and November.
- **Corporate bond issuances picked up in Q3 FY2025:** Bond issuance picked up momentum in Q3 FY2025 and stood at Rs. 3.5 trillion (Rs. 3.0 trillion in Q2 FY2025, Rs. 1.8 trillion in Q1 FY2025). Of the total issuance in Q3 FY2025, the share of NBFCs, corporates and banks stood at 46%, 31% and 23%, respectively. Given the strong bond issuance in Q3 FY2025, ICRA has revised its estimate for bond issuances for FY2025 to Rs. 10.8-11.1 trillion from its previous estimate of Rs. 10.4-10.7 trillion, surpassing the previous peak bond issuance of Rs. 10.2 trillion in FY2024. For FY2026, ICRA forecasts the bond issuances at Rs. 11.1-11.7 trillion. Accordingly, the corporate bonds outstanding are expected to increase to ~Rs. 51.9-52.2 trillion by the end of March 2025 and to Rs. 55.3-56.2 trillion by March 2026.
- **India witnessed net FPI outflows of $11 billion in Q3 FY2025, led by the equity segment:** FPIs withdrew $10.9 billion from the Indian markets (equity, debt and hybrid) in Q3 FY2025, after registering net inflows in each of the last six quarters. Against the sizeable inflows of $20 billion in Q2 FY2025, the reversal in aggregate FPI flows in Q3 mainly stemmed from the equity segment (to -$11.9 billion in Q3 FY2025 from +$11.6 billion in Q2 FY2025), amid uncertainty around the US elections and subsequent policies, the stimulus measures announced in China leading to diversion of flows from India, as well as sluggish domestic earnings growth. Besides, the FPI-debt inflows also declined sharply in the quarter (to +$1.0 billion from +$7.9 billion). Looking ahead, the upcoming Budget, movements in the USD/INR pair and US treasury (UST) yields, and tariff and rate cut-related developments in the US would drive FPI flows. Overall, ICRA pegs the net FPI inflows at $0-5 billion in FY2025.

Highlights – II

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FDI equity flows to India surged to $37.0 billion for 8M FY2025 and are likely to cross the $45.8 billion recorded in FY2024 and settle between $45-50 billion in FY2025.

Q2 FY2025 was recorded as one of the heaviest quarters for overseas investment activity by Indian companies in recent times.

ICRA has revised its estimates for ECB approvals for FY2025 to $37-43 billion from $40-45 billion due to higher market yields for overseas borrowing and increased cost of hedging.

India's GDP growth is likely to rebound to 6.8% in Q3 FY2025 from 5.4% in Q2, with early data showing improvement in industrial output, and service-related indicators; GDP growth is likely to print at 6.5% each in FY2025-2026.

- **Gross FDI equity flows to India during FY2025 set to surpass FY2024:** During 8M FY2025, FDI equity flows to India stood at ~$37.0 billion compared to $30.6 billion in the corresponding period last year (up 24% YoY). FDI equity flows to India are likely to cross the $45.8 billion recorded in FY2024 and settle between $45-50 billion in FY2025. Nevertheless, a downside may arise due to the heightened valuation concerns of Indian companies and increased volatility in the exchange rate. Also, the Gross FDI by India (excluding reinvested earnings) in Q2 FY2025 stood at $6.3 billion making it one of the heaviest quarters for overseas investment by India Inc.
- **Net FDI flows turn adverse due to repatriation/disinvestment from India:** Net FDI outflows from India grew wider to $4 billion during Q3 FY2025 (until Nov-24) from $2.2 billion in Q2 FY2025. On aggregate India witnessed net inflows of just $0.5 billion in 8M FY2025 compared to $8.5 billion in 8M FY2024 ($10.1 billion in FY2024). The sharp drop in the Net FDI flows is a result of the repatriation/ disinvestment from India which rose to $39.6 billion in the even period from $29.7 billion in corresponding period last year.
- **ECB approvals likely to slow down despite decent traction in 8M FY2025:** ECB approvals (net of refinancing) during 8M FY2025 aggregated to $28.8 billion, slightly higher than $27.9 billion in the corresponding period last year. Despite the rate cut by the ECB, and the US Federal Reserve, global market yields continued to harden, raising the cost of overseas borrowing. In addition, the sharp rupee depreciation in December 2024–January 2025 and increased cost of hedging would impact the pace of ECB approvals.
- **India's GDP growth set to rise in Q3 FY2025:** Kharif foodgrain output is estimated to improve in 2024-25, while the prospects for rabi crop are favourable, with the YoY increase in sowing for rice and wheat. Along with a low base, these trends are expected to boost agri-GVA growth to 4.0% in Q3 FY2025 from 2.7% in H1. Additionally, industrial output growth picked up to 4.4% during October–November 2024 from 2.7% in Q2 FY2025, supported by the festive season; although it remained lower than the 5.5% expansion seen in Q1 FY2025, partly reflecting the subdued mining activity, as well as the dip in electricity growth. On the services sector front, the YoY performance of as many as nine of the available 12 services-related indicators improved in the first two months of Q3 FY2025 over Q2. Based on these trends, ICRA estimates GDP growth to rebound to 6.8% in Q3 FY2025 from the 7-quarter low of 5.4% in Q2 FY2025. However, the outlook for economic activity for Q4 appears mixed, with the looming threat of tariffs by the US and volatility in the USD/INR pair souring sentiments. Overall, ICRA projects GDP to grow by 6.5% each in FY2025 and FY2026.

Highlights – III

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CPI inflation surged to a 5-quarter high of 5.6% in Q3 FY2025, led by the food and beverages inflation print.

The recent liquidity measures introduced by the RBI have boosted the prospects of a rate cut in Feb 2025.

Liquidity conditions deteriorated in Q3 FY2025, amid dollar sales by the RBI and uptick in CIC; however, the Central Bank has announced several measures like forex buy/sell swap, OMOs of G-secs and longer-tenure VRRs, which are expected to improve liquidity conditions in the immediate term.

- **CPI inflation rose to a 5-quarter high of 5.6% in Q3 FY2025:** The headline CPI inflation inched-up to a 5-quarter high of 5.6% in Q3 FY2025 from a 20-quarter low of 4.2% in Q2 FY2025. Notably, food and beverages (F&B) inflation surged to a 5-quarter high of 8.5% in Q3 (vs. 6.2% in Q2 FY2025), driven by vegetables, and oils and fats, with the former recording a double-digit print for the sixth consecutive quarter. Amid the easing in prices of most food items in January 2025, ICRA expects the F&B inflation to moderate to a 5-month low of ~6.0-6.5% from 7.7% in December 2024, which would help soften the headline CPI inflation print to 4.5-4.7% in the month. While adequate reservoir levels, healthy growth in kharif foodgrain output, and favourable trends for sowing of rabi wheat and rice, reduce the risk related to food grains and some other crops, the volatility in vegetable and edible oil prices, and higher global commodity prices owing to rising global macro uncertainties imbues caution regarding the inflation outlook for the near term.
- **Likelihood of a rate cut in February 2025 MPC review has improved:** Given the benign outlook for January 2025, a 25 bps rate cut by the MPC in its February 2025 meeting cannot be ruled out, to accord priority to growth over inflation. The recent liquidity measures introduced by the RBI have boosted the prospects of a rate cut in Feb 2025.
- **Liquidity conditions set to improve in immediate term:** Liquidity conditions deteriorated in Q3 FY2025, with the average systemic liquidity surplus easing to Rs. 0.8 trillion (+0.3% of NDTL) from Rs. 1.2 trillion (+0.5% of NDTL) in Q2 FY2025, led by sizeable dollar outflows and the increase in the CIC, even as the sharp decline in the GoI's cash balances provided some reprieve during the quarter. Owing to tighter liquidity conditions, the RBI conducted 19 VRRs in Q3 FY2025, infusing a total of Rs. 10.6 trillion, with 14 of these occurring in December 2024, to offset the stress on account of quarter-end tax outflows. Looking ahead, sustained capital outflows and the seasonal uptrend in currency in circulation could continue to exert pressure on systemic liquidity during the quarter. Nevertheless, the RBI has announced several measures to manage stressed liquidity conditions, including a buy/sell USD/INR swap auction, OMOs of G-secs, and 56-day VRR auction, which would augment liquidity by ~Rs. 1.4-1.5 trillion. Besides, it would continue to conduct overnight and longer tenure VRR operations in the immediate term, which along with the aforesaid measures, would aid in reducing the size of deficit by the end of February 2025, compared to the average levels seen so far in January 2025 (Rs. 2.0 trillion till January 26).

Highlights – IV

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YoY deposit growth is expected at 10.7-11.2% in FY2025 and 10.5-10.9% in FY2026. Incremental deposits are projected at Rs. 22.0-23.0 trillion in FY2025 and Rs. 23.8-24.8 trillion in FY2026 (including HDFC merger).

Incremental credit expansion is projected at Rs. 17.2-18.0 trillion in FY2025 and Rs. 17.6-18.8 trillion, translating to a YoY growth of 10.5-11.0% in FY2025 and 9.7-10.3% in FY2026.

- **Deposit accretion in Q3 FY2025 weakest since Q1 FY2021**: The deposit accretion in Q3 FY2025 was significantly weak at Rs. 1.4 trillion (Rs. 6.3 trillion in Q2 FY2025, Rs. 4.7 trillion in Q3 FY2024). As a result, the deposit accretion in 9M FY2025 was tepid at Rs. 15.9 trillion (Rs. 20.4 trillion in 9M FY2024). The deposits outstanding of the banking system rose to Rs. 220.6 trillion (+9.9% YoY growth) as on December 27, 2024, from Rs. 200.8 trillion as on December 29, 2023 (+13.2% YoY growth). While deposit accretion in Q3 FY2025 (till December 27, 2024) was weak, it witnessed an uptick in the subsequent fortnight and ICRA expects the same to remain healthy in Q4 FY2025. As a result, ICRA has revised its estimate upwards to 10.7-11.2% for FY2025 (incremental deposits of Rs. 22.0-23.0 trillion) over its earlier estimate of 10.3-10.7% for FY2025 (incremental deposits of Rs. 21.0-22.0 trillion). For FY2026, the deposit accretion is expected at Rs. 23.8-24.8 trillion (10.5-10.9% growth) and outstanding deposit (including the impact of the HDFC merger) is estimated at Rs. 226.8-227.8 trillion by March 2025 and at Rs. 250.6-252.6 trillion by March 2026.
- **Incremental credit flow remains moderate**: Incremental non-food bank credit (NFBC) expansion stood at Rs. 4.6 trillion in Q3 FY2025 (till December 27, 2024) and was weaker than Rs. 5.9 trillion in Q3 FY2024 (till December 29, 2023) but exceeded the Rs. 4.3 trillion recorded in Q2 FY2025 (till October 04, 2024). Including HDFC Ltd., credit outstanding stood at Rs. 177.4 trillion as on December 27, 2024 (11.5% YocY over Rs. 159.2 trillion as on December 29, 2023, +2.7% QoQ at Rs. 172.8 trillion as on October 04, 2024). The credit expansion of Rs. 22.1 trillion (excluding the HDFC merger) in FY2024 was the highest ever credit offtake for any year, far outpacing the Rs. 18.2 trillion expansion recorded in FY2023. Credit expansion is expected to eventually come off these levels as a result of high credit-to-deposit ratio and implementation of proposed changes in the liquidity coverage ratio (LCR) framework. Accordingly, ICRA estimates incremental expansion at Rs. 17.2-18.0 trillion in FY2025 and Rs. 17.6-18.8 trillion in FY2026. Accordingly, credit outstanding is expected at Rs. 181.3-182.1 trillion by March 2025 (YoY growth at 10.5-11.0%) and Rs. 198.9- 200.9 by March 2026 (YoY growth of 9.7-10.3%).

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Thank You!