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Macroeconomics | First cut

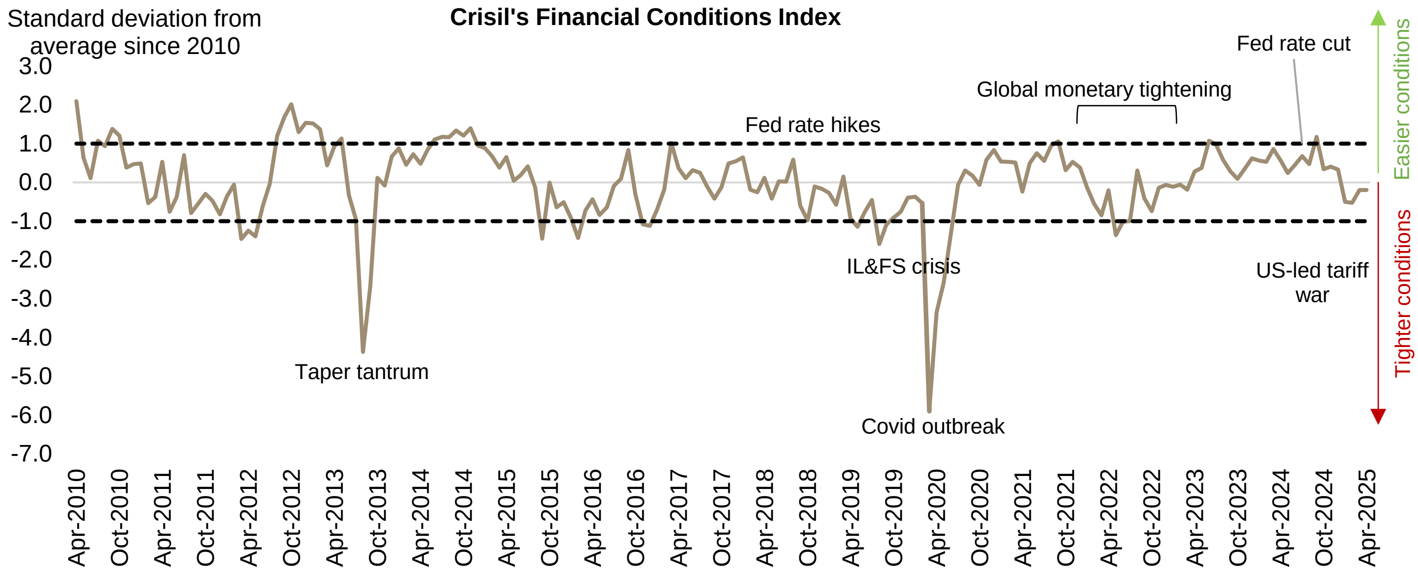
Financial conditions stable

May 2025

Lower interest rates supportive, market volatility exerts pressure

- Crisil's Financial Conditions Index (FCI) remained stable at -0.2 in April, unchanged from March. The FCI is a monthly gauge constructed based on parameters across money, debt, equity and foreign exchange markets, along with monetary policy and bank lending conditions
- A negative FCI value indicates tighter financial conditions compared to trend (or the long period average measured since April 2010). The FCI entered the negative zone in January but has remained within the stated comfort zone of one standard deviation from the long period average
- The impact of two consecutive rate cuts (in February and April) by the Reserve Bank of India's (RBI) and surplus systemic liquidity led by increased government spending and open market operations, supported financial conditions in April, as they led to a sharp decline in broader interest rates across the economy. Several key rates stood below their pre-pandemic averages
- That said, three key factors kept the FCI in the negative zone. First, foreign portfolio investors (FPIs) turned net-sellers in April in the debt market, driven by increased uncertainty and a narrowing spread between United States (US) and Indian yields. Second, market volatility was high due to global market turbulence following the US announcement of reciprocal tariffs. Third, bank credit growth slowed to its weakest pace since March 2022
- External risks, mainly driven by uncertainty, remain elevated given the reciprocal tariffs the US would impose after three months. This has reduced the predictability about the US Federal Reserve's (Fed) easing path, contributing to global market volatility. However, we believe the RBI's rate cuts and ample foreign exchange reserves will support domestic financial conditions this fiscal

Conditions eased marginally in April



Note: Higher value indicates easier financial conditions and vice versa. The index within dotted lines (one standard deviation) represents conditions within the comfort zone

Source: Crisil

Factors that were supportive in April

- **Policy rate cut:** The RBI's Monetary Policy Committee cut key policy rates by 25 basis points (bps) at its April policy review, which, coupled with surplus systemic liquidity, helped lower broader interest rates across the economy. This is the second rate cut in a row in the MPC's policy review meetings. Policy transmission has picked up following the improvement in systemic liquidity in April.
- **Systemic liquidity conditions improved significantly** on-month, driven by increased government spending. The RBI net-absorbed Rs 1.4 lakh crore (0.6% of net demand and time liabilities, or NDTL), compared with net-injection of Rs 1.24 lakh crore (0.5% of NDTL) in the previous month. The RBI continued to conduct open market operations to purchase government securities (G-secs) to support liquidity, though the quantum moderated from the previous month (Rs 0.6 lakh crore vs Rs 1.4 lakh crore)
- **Money market rates declined sharply** owing to the RBI's rate cut and surplus systemic liquidity. On-month**,** the rates of the six-month certificate of deposit, six-month commercial paper and 91-day Treasury bill eased 84 bps (to 6.75% on average), 78 bps (to 7.09%) and 52 bps (to 5.96%), respectively. The weighted average call money rate stood at 5.95%, down 32 bps on-month and close to the newly set repo rate of 6%. The aforementioned rates are now below their pre-pandemic five-year averages
- **Key bank lending rates moderated.** Auto loan rates softened 10 bps and housing loan rates eased 19 bps
- **The rupee appreciated 1.2% to average 85.6 per dollar,** supported by a weaker dollar**.** That said, FPI outflows prevented further gains in the rupee

- **Indian equity markets bounced back,** with benchmark equity indices S&P BSE Sensex and Nifty 50 gaining 2.9% and 3% on average, respectively. Although the indices registered losses at the start of the month following the US announcement of reciprocal tariffs on India on April 2, markets rallied after the 90-day pause on the tariff imposition. The return of FPIs to equity markets in the second half of the month and positive domestic macroeconomic developments such as the RBI's rate cut and lower inflation supported markets
- **Domestic bond yields eased,** driven by the RBI's rate cut, lower crude oil prices, improved liquidity conditions and softer domestic inflation. That said, FPI outflows in debt capped further easing in yields. On average, the yield on the 10-year benchmark G-sec declined to 6.4% (vs 6.67% in the previous month)
- Trade war concerns, fears of a US slowdown and expectations of higher supplies drove down global crude oil prices. Brent crude oil prices averaged $67.8 per barrel (vs $72.6 in the previous month), nearing a four-year low

Factors that exerted pressure

- **FPIs turned net-sellers**, withdrawing $2.3 billion from Indian markets (vs inflow of $3.8 billion in the previous month). Notably, the debt market saw net outflow of $2.2 billion (vs inflow of $4.5 billion in the previous month). The equity segment saw mild inflow of $0.5 billion, as sentiments improved in the second half of the month following the easing of trade war concerns
- **Volatile equity markets:** Market volatility surged. The NSE volatility index (VIX) averaged 16.8 (vs 13.4 in the previous month and 14.7 average in the previous 12 months), an 11-month high
- **Bank credit growth moderated** to 10.3% on-year (vs 11% in the previous month)

  Sectoral data (available until March) shows credit growth has slowed in several key categories in fiscal 2025. Credit growth in services stood at 12.4% in March (vs 21.2% average in fiscal 2024), personal loans at 11.6% (vs 18.6%), agriculture at 10.4% (vs 18.2%)

More rate cuts expected this fiscal

Softer inflation will create elbow room for the RBI to cut rates further this fiscal as inflation eases further.

Lower inflation should be driven by the food component. A robust rabi crop, the India Meteorological Department's forecast of an above-normal monsoon, and a high base effect will help ease food inflation. Non-food inflation is expected to remain benign due to soft crude oil and commodity prices.

Downside risks to growth have risen. Slower global growth led by weaker trade growth, and a possible downside from higher US reciprocal tariffs could hurt India's exports. Heightened business uncertainty is a downside risk for investments.

S&P Global expects the Fed to cut rates by 50 bps in 2025. That said, trade war concerns have increased uncertainty regarding the Fed's monetary policy, which could keep financial conditions volatile.

Against this backdrop, we expect the RBI to cut rates by 25-basis points in the monetary policy review in June.

Table: How financial conditions are evolving across segments

		Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25	Mar-25	Apr-25
Policy rate	Repo rate (%)	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.25	6.25	6.0
	Repo rate, inflation-adjusted (%)	1.7	1.7	1.4	2.9	2.8	1.0	0.3	1.0	1.3	2.2	2.6	2.9	2.8
Liquidity conditions	Net absorption(-)/injection(+) under LAF (% of NDTL)	-0.1	0.6	0.2	-0.4	-0.7	-0.4	-0.6	-0.6	0.3	0.8	0.7	0.5	-0.6
Money market	Call money rate (%)	6.5	6.6	6.6	6.5	6.5	6.6	6.5	6.5	6.6	6.6	6.4	6.3	5.9
	91 day T-bill (%)	6.9	6.9	6.8	6.7	6.6	6.6	6.5	6.5	6.5	6.6	6.4	6.5	6.0
	CP 6-month rate (%)	7.9	7.9	7.9	7.8	7.8	7.8	7.7	7.7	7.7	7.9	7.9	7.9	7.1
Debt market	10-year G-Sec (%)	7.2	7.0	7.0	7.0	6.9	6.8	6.8	6.8	6.7	6.8	6.7	6.7	6.4
	Term premium (%)	0.7	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.2	0.3	0.4	0.4	0.3
	AAA bond spread' (%)	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.4	0.3	0.4	0.5	0.5
	AA bond spread" (%)	2.0	2.1	2.1	2.1	2.3	2.3	2.0	2.1	2.2	2.2	2.5	2.7	2.5
Lending rates	MCLR (1 year) (%)	8.9	8.8	8.9	8.9	8.9	9.0	9.0	9.0	9.0	9.0	9.1	9.0	9.0
	Auto loan rate (%)	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.6	9.7	9.3
	Housing loan rate (%)	9.3	9.3	9.3	9.3	9.2	9.2	9.2	9.2	9.2	9.2	9.0	9.0	8.8
Credit availability	Bank credit growth (y-o-y,%)	15.3	16.1	13.9	13.7	13.6	13.0	11.6	10.6	11.2	11.4	11.0	11.0	10.3
Money supply	M3 growth (y-o-y %)	10.9	12.1	9.7	10.0	10.2	10.8	11.1	11.1	9.3	9.6	9.6	9.6	9.6
Equity market	Sensex (%*)	17.0	15.5	18.2	21.8	20.2	22.5	17.6	13.5	13.9	8.5	6.3	3.9	5.8
	NSE VIX	11.7	20.2	15.6	13.5	14.9	13.3	13.9	15.3	14.0	15.9	14.5	13.4	16.8
Forex market	Rs/USD (m-o-m %)	0.5	0.0	0.1	0.1	0.4	-0.1	0.3	0.4	0.7	1.5	0.9	-0.5	-1.2
Foreign capital	Net FPI (USD bn)	-1.9	-1.5	5.0	5.8	3.0	11.2	-11.5	-2.5	3.1	-9.0	-2.8	3.8	-2.3
Global conditions	S&P500 (%*)	19.1	21.0	23.6	24.5	21.5	23.1	24.7	25.3	24.8	22.0	21.2	12.6	5.2
	US 10Y Treasury yield (%)	4.5	4.5	4.3	4.2	3.9	3.7	4.1	4.4	4.4	4.6	4.5	4.3	4.3
	Brent ($/barrel)	90.1	82.0	82.6	85.3	80.9	74.3	75.7	74.4	73.8	79.2	75.2	72.6	67.8

Favourable

Neutral

Adverse

*Notes: ^Spread over the repo rate; term premium is the 10-year G-sec's spread over the repo rate; spread over 10-year G-sec; spread over five-year G-sec; *percentage change with respect to a two-year moving average; a positive percentage rupee change implies depreciation against the US dollar, and vice versa; credit data for May-June 2024 excludes the impact of the merger of a bank with non-bank*

Sources: RBI, National Securities Depository Ltd, US Department of the Treasury, CEIC, Crisil

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