panorama

August 2024

Key Insights:

The RBI maintains the status quo as robust economic growth allows for inflation prioritisation

- Developed market central banks, except for the BoJ, are shifting toward accommodative monetary policy
- The Reserve Bank of India has held the repo rate steady since Feb'23, as inflation remains above target
- The RBI expects headline inflation to remain above the target for at least the next four quarters
- RBI surveys suggest that both households and firms expect inflation to rise in the coming quarters
- Inflation is primarily driven by vegetables; excluding vegetables, it has stayed below the 4% target since Jan'24

RBI is concerned about banks' reliance on short-term non-retail deposits and other liabilities

- Banks may need to increase deposit rates to attract household financial savings (retail deposits)
- The banking sector's credit-to-deposit ratio remains historically high
- The ratio should improve as the government reduces its balances with the RBI by increasing spending
- However, an increase in currency demand in H2 and OMO sales by RBI could further deteriorate the ratio

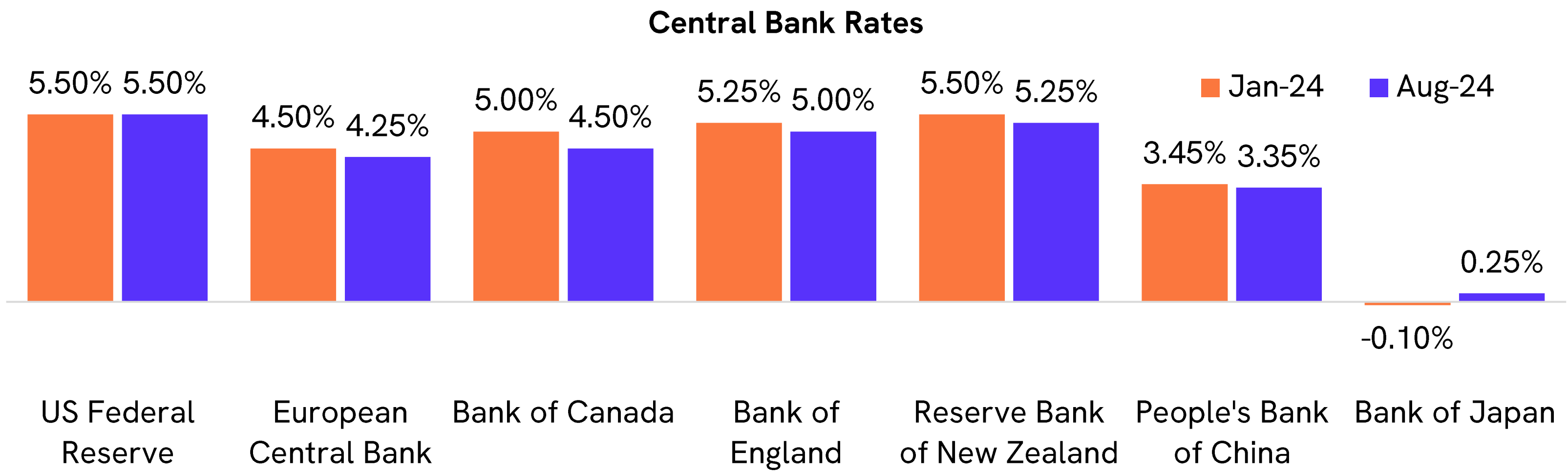
Government securities supply-demand dynamics have turned favourable for the debt market

- The Centre targets a fiscal deficit of 4.9% of GDP for FY25, aiming to reduce it below 4.5% by FY26
- The supply of Indian government securities is budgeted to be lower in FY25
- However, demand is expected to remain robust due to inclusion in global bond indices
- Anticipated monetary policy easing by RBI is also supportive of the debt market

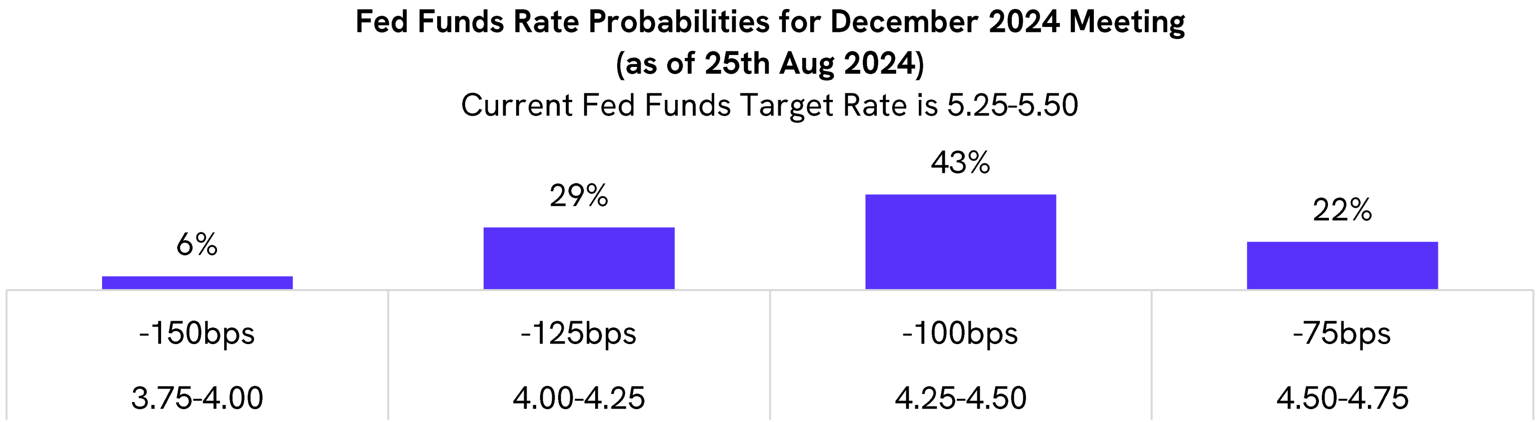
India Monetary Policy

Central banks are shifting toward accommodative monetary policy

Markets are anticipating aggressive rate cuts by the US Fed due to recent disappointing economic data



Many central banks in developed markets, except for the Bank of Japan, are now easing monetary policy as inflation slowly returns to the target, and economic growth decelerates



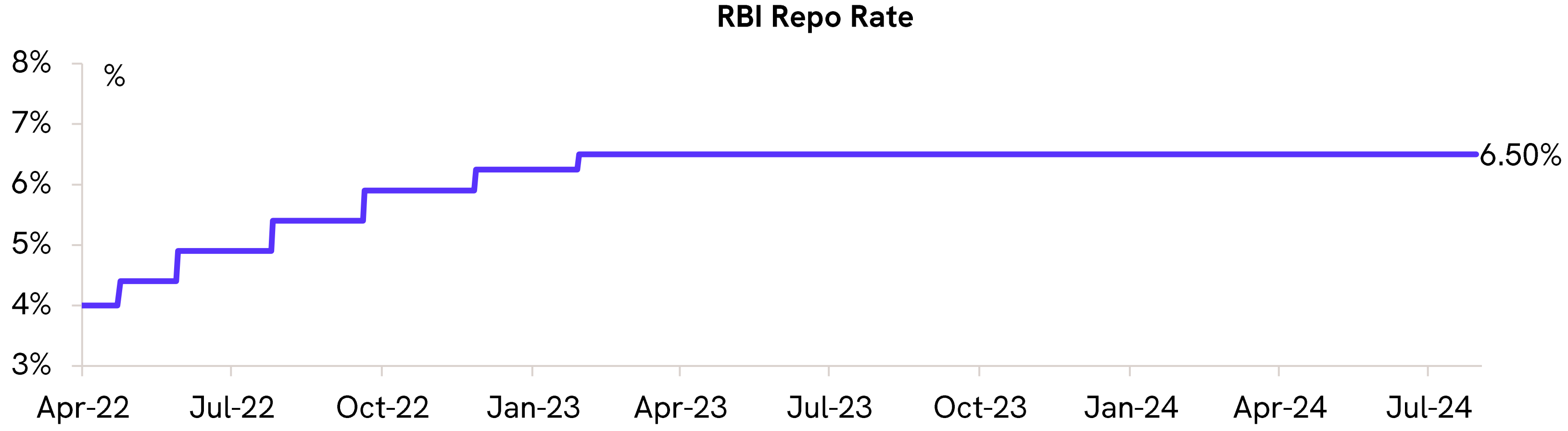
Markets are now pricing in aggressive rate cuts of 100 basis points in 2024 by the US Fed, as recent data suggest a cooling labor market and a weakening economy

Source: Bloomberg, CME Fed Watch, 360 ONE Asset Research

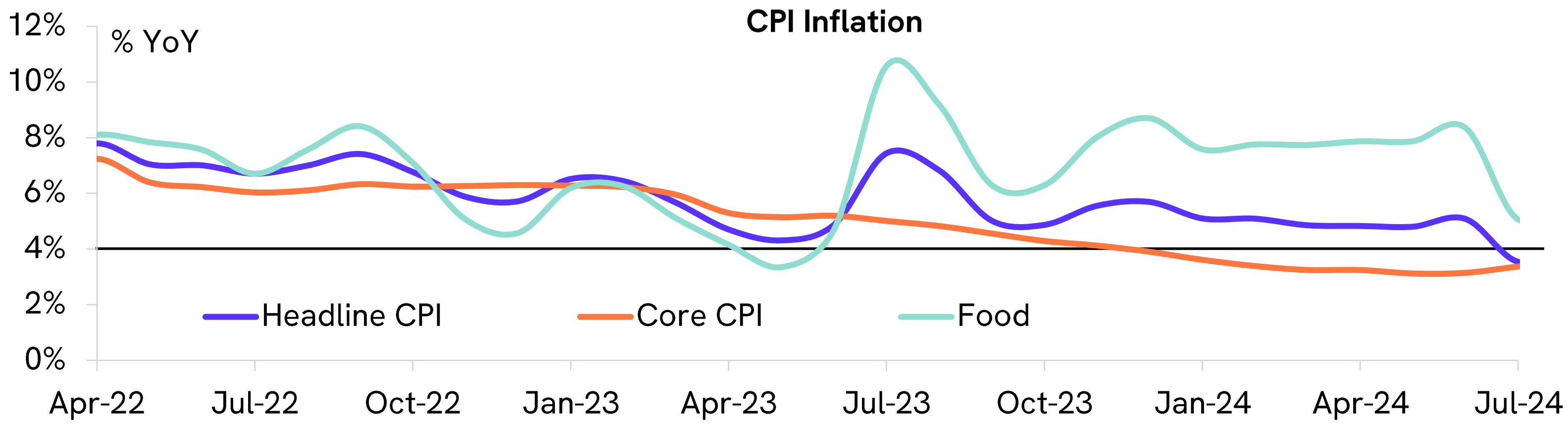
Note: European Central Bank – Main Refinancing Operations Rate, People's Bank of China – One-Year Loan Prime Rate

RBI has maintained the status quo on rates since February 2023

Despite the underlying inflation, as measured by the Core CPI, remaining below the 4% target



The RBI has kept the repo rate at 6.5% since February 2023



Underlying inflation, as measured by core inflation (which excludes volatile food and fuel components), has been trending below the 4% target in India since December 2023

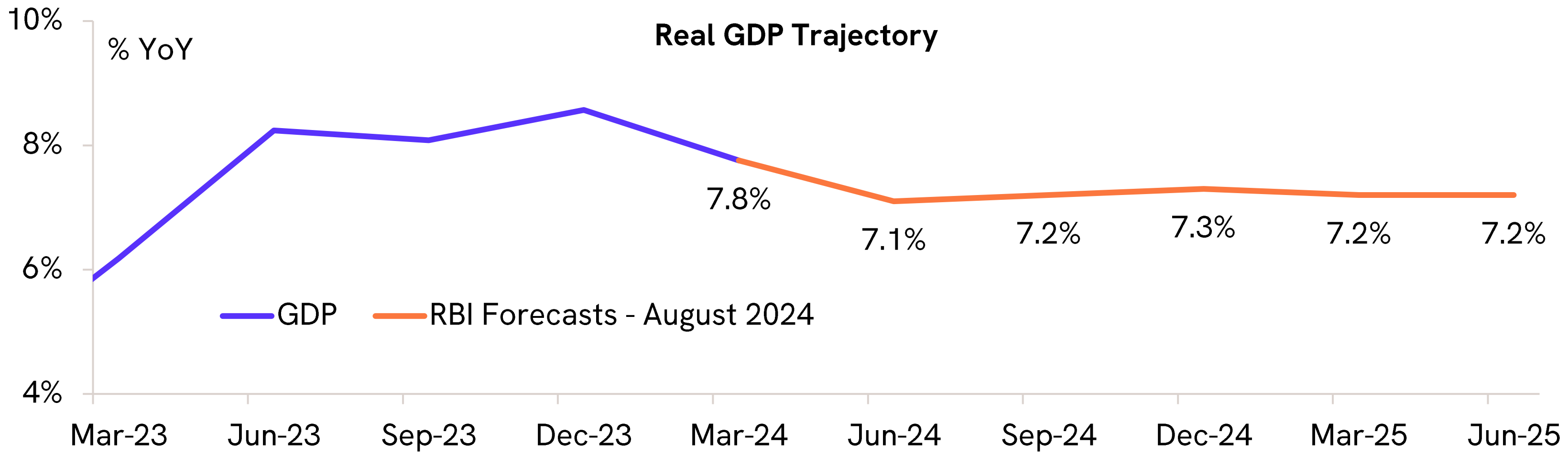
The RBI has opted to maintain policy rates as headline inflation remains above the target due to higher food inflation

Note that the dip in headline CPI below 4% in July 2024 is due to the base effect and will reverse as the base effect fades

Source: FRED, CMIE, 360 ONE Asset Research

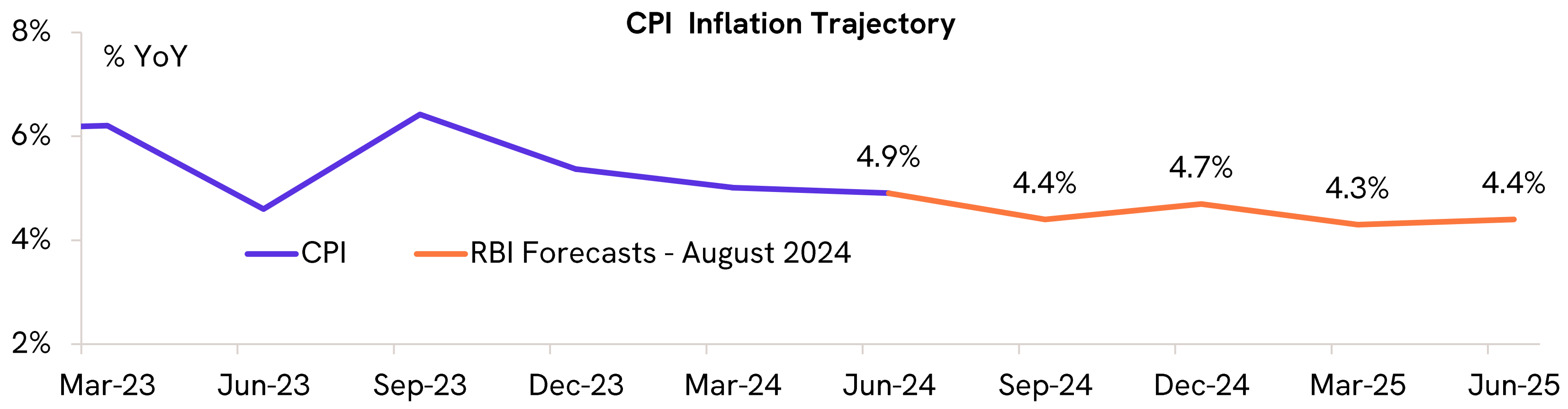
Strong economic growth allows for the prioritization of inflation control

The RBI anticipates that headline inflation will stay above the 4% target for the next four quarters



The RBI forecasts FY25 GDP growth at 7.2% YoY

Strong economic growth provides the RBI with the policy space to focus on inflation



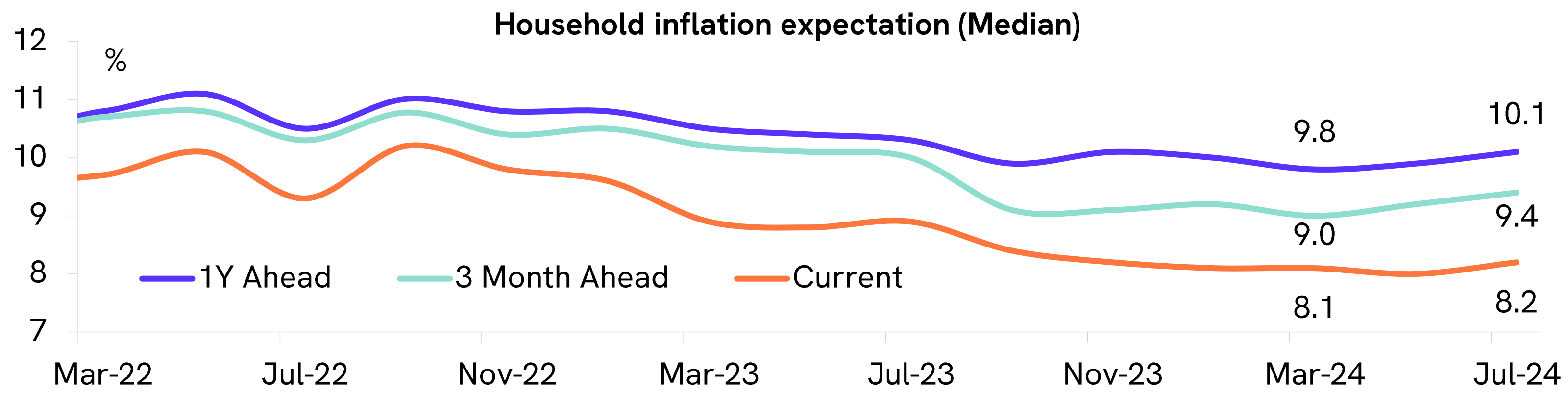
The RBI expects headline inflation to remain above the target for at least the next four quarters

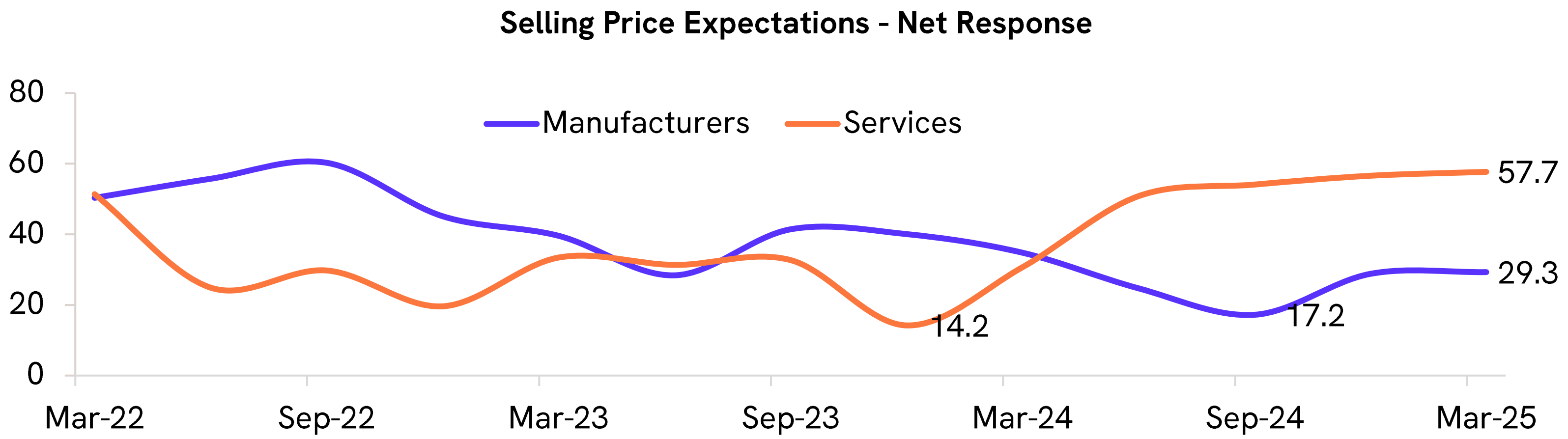
The RBI is awaiting clear visibility of inflation durably aligning with the 4% target before considering a rate cut

Source: RBI, MOSPI, 360 ONE Asset Research

Household inflation expectations inch up on higher food inflation

Manufacturing and services firms expect selling prices to rise in the coming quarters





Household inflation expectations, after showing a moderating trend until March 2024, have edged up due to high food inflation

The RBI remains concerned that persistently high food inflation and unanchored inflation expectations—if they materialize—could spill over into core inflation through a rise in wages driven by cost-of-living considerations

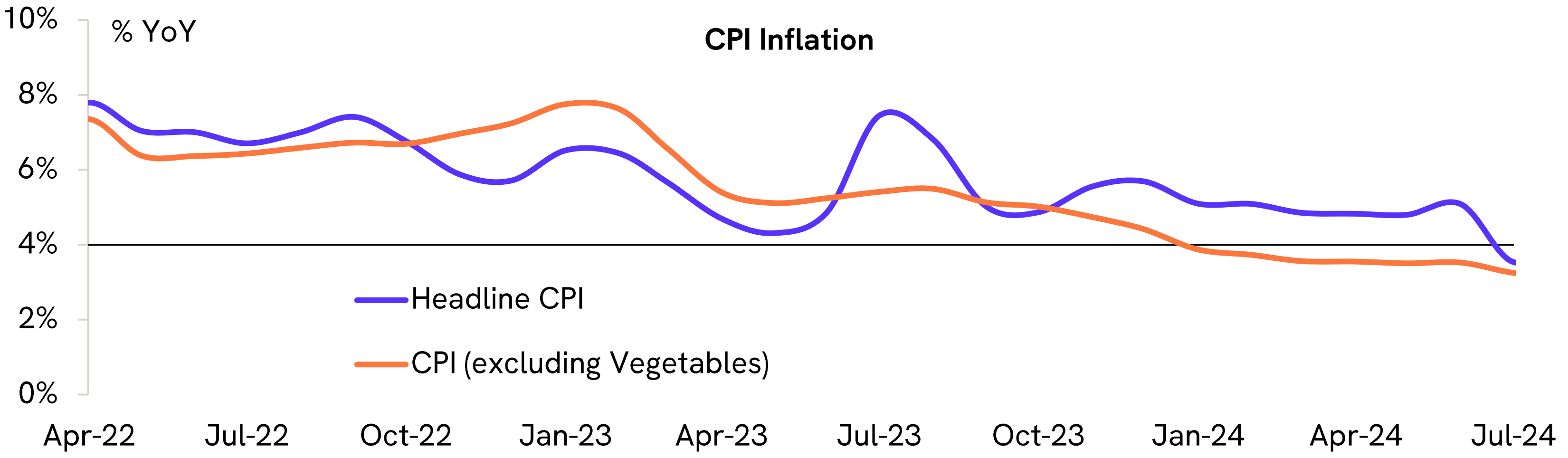
RBI surveys suggest that both manufacturing and service firms expect selling prices to be higher in the coming quarters

Source: RBI, 360 ONE Asset Research

Note: Net Response is the difference between the percentage of respondents reporting an increase in selling price and those reporting a decrease in selling prices

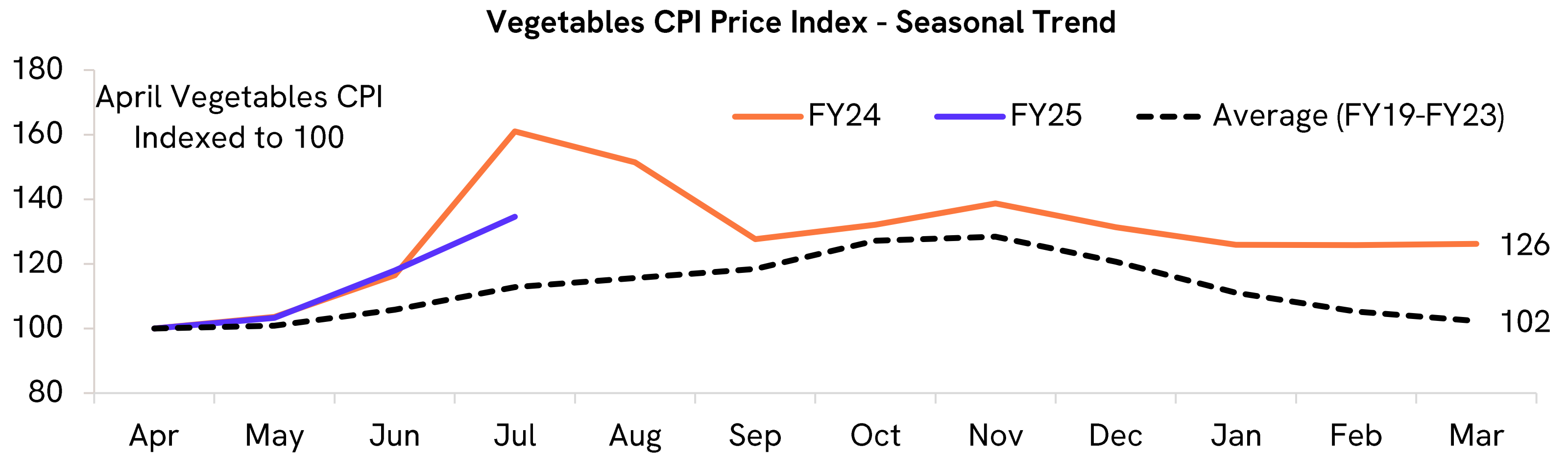
Headline Inflation driven by food, in particular vegetables

The CPI excluding vegetables has remained below the 4% target since January 2024



Vegetables are the primary contributors to elevated headline inflation

Excluding vegetables, inflation has remained below the 4% target since January 2024



Vegetable prices tend to fall seasonally during the November-December period as fresh kharif produce arrives in the market

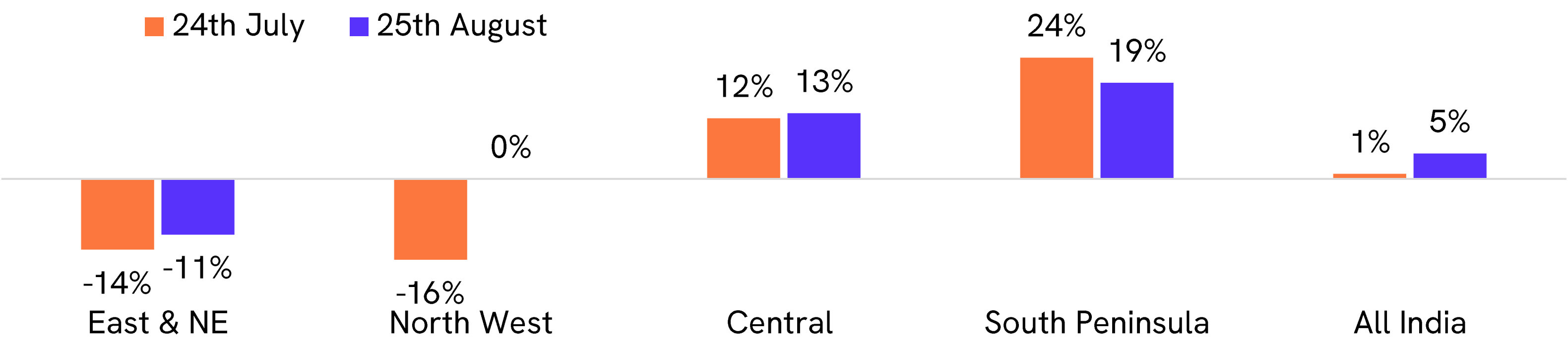
However, the extent of corrections depends on multiple factors, including the strength and distribution of the monsoon, unseasonal rains, and other climatic conditions

Source: MOSPI, 360 ONE Asset Research

The distribution of monsoon rainfall has become less uneven in August

Only 13% of the area has experienced a deficient monsoon (till 25th Aug), brightening the outlook for food inflation

% Deviation from Long Period Average - Cumulative



The monsoon's spatial distribution remains uneven, although the degree of this unevenness has lessened in August

Overall, the monsoon is 5% above the long period average (as of 25th August)

As of 25th August	Number of Subdivisions	% Area of Country
Large Excess	2	10%
Excess	7	17%
Normal	23	60%
Deficient	4	13%
Large Deficient	0	0%
No Rain	0	0%

4 subdivisions out of 36, accounting for 13% of the area, have experienced a deficient monsoon

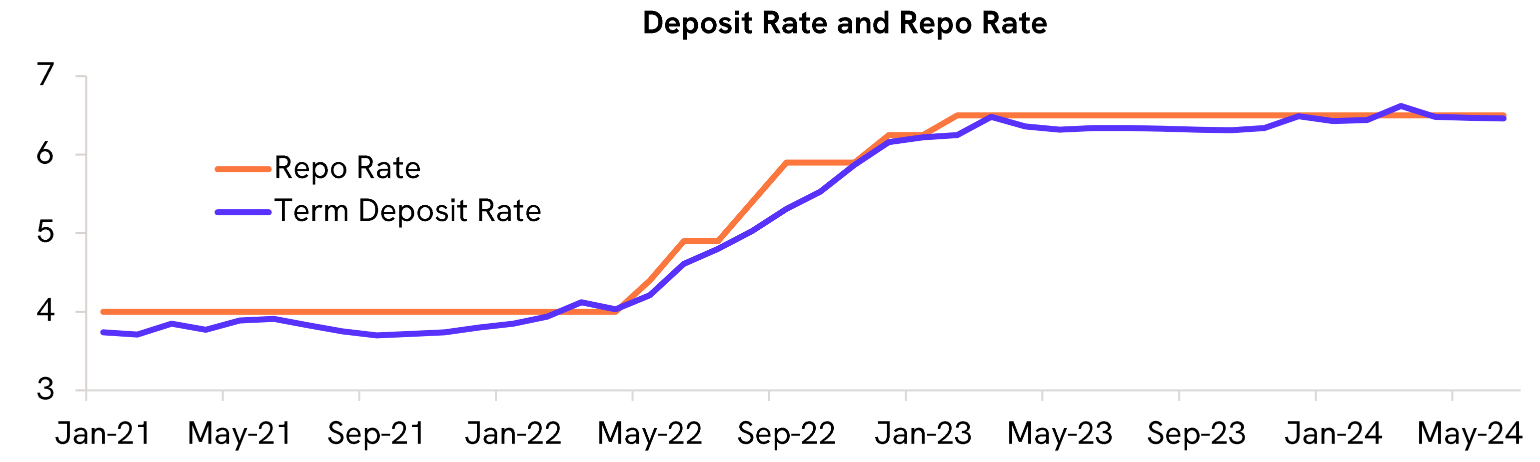
A normal and well-distributed monsoon would lower food inflation and open up space for monetary policy easing

We expect the RBI to implement 50 basis points of rate cuts in FY25

Source: IMD, CMIE, 360 ONE Asset Research

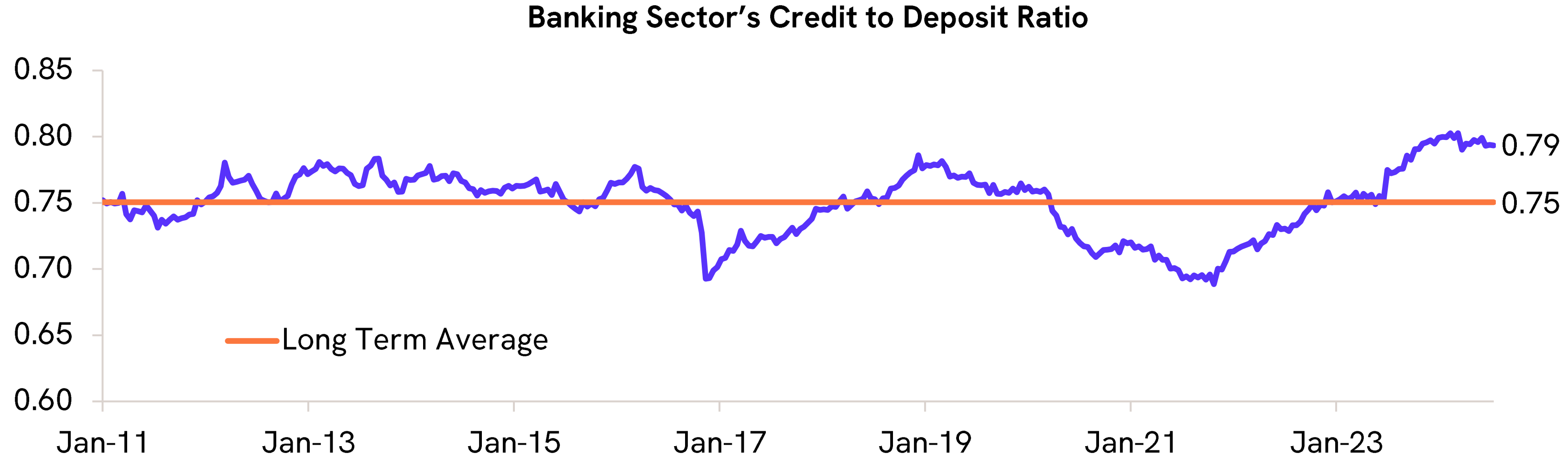
RBI concerned about banks' reliance on short-term non-retail deposits

The banking sector's credit-to-deposit ratio remains historically high



In the August MPC meeting, the RBI expressed concerns about banks increasingly relying on short-term non-retail deposits and other liability instruments to meet the incremental credit demand, and it urged banks to focus more on mobilizing household financial savings

Banks may need to increase deposit rates further to attract household financial savings



The banking sector's credit-to-deposit ratio remains skewed

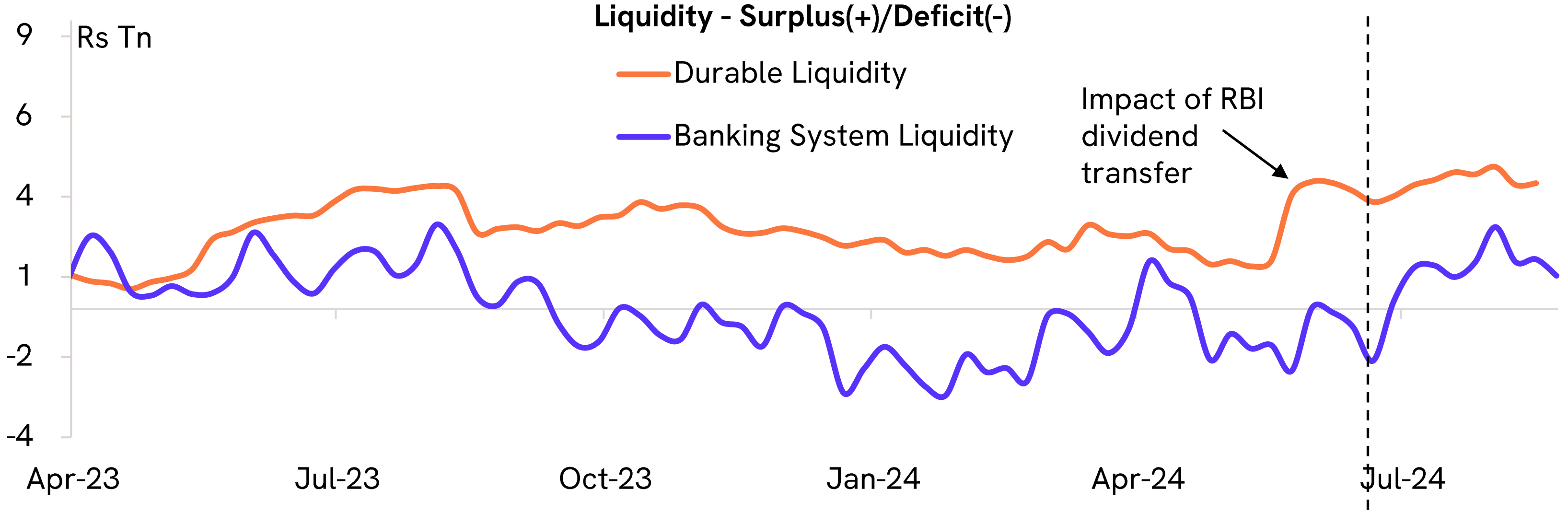
The ratio, at 0.79, is significantly higher than the long-term average of 0.75

Source: RBI, 360 ONE Asset Research

Note: Term Deposit Rate refers to Weighted Average Domestic Term Deposit Rates (Fresh Rupee Term Deposits)

Durable system liquidity remains in heavy surplus

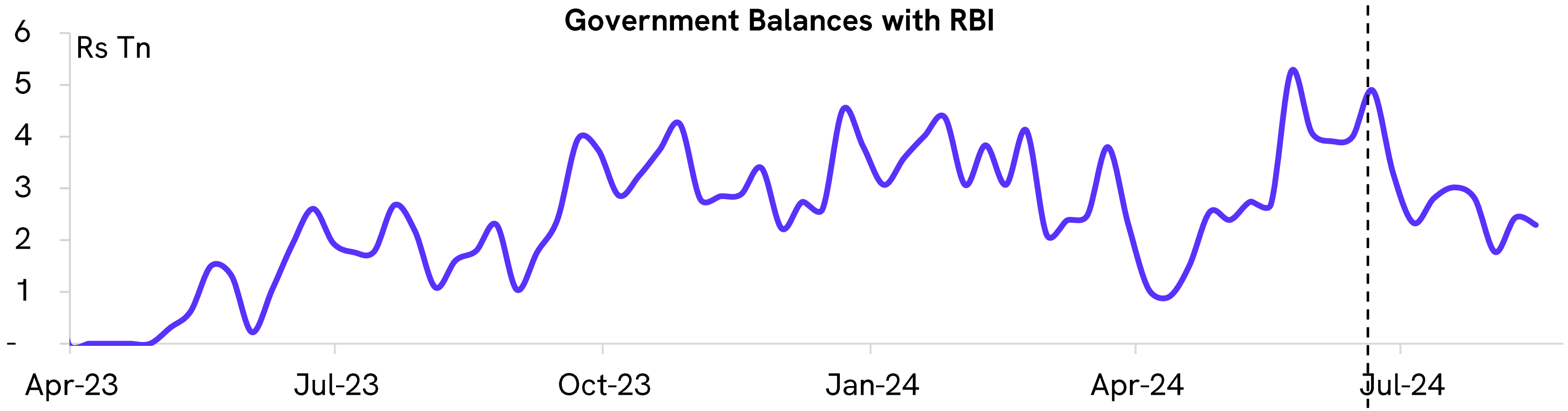
The drawdown in government balances with the RBI has resulted in a recent improvement in banking system liquidity



Durable Liquidity = Banking System Liquidity + Government Balances with RBI

Durable system liquidity remains in ample surplus as the RBI transfers a hefty INR 2.1 trillion dividend to the government

The banking system's liquidity has also improved as government spending picks up



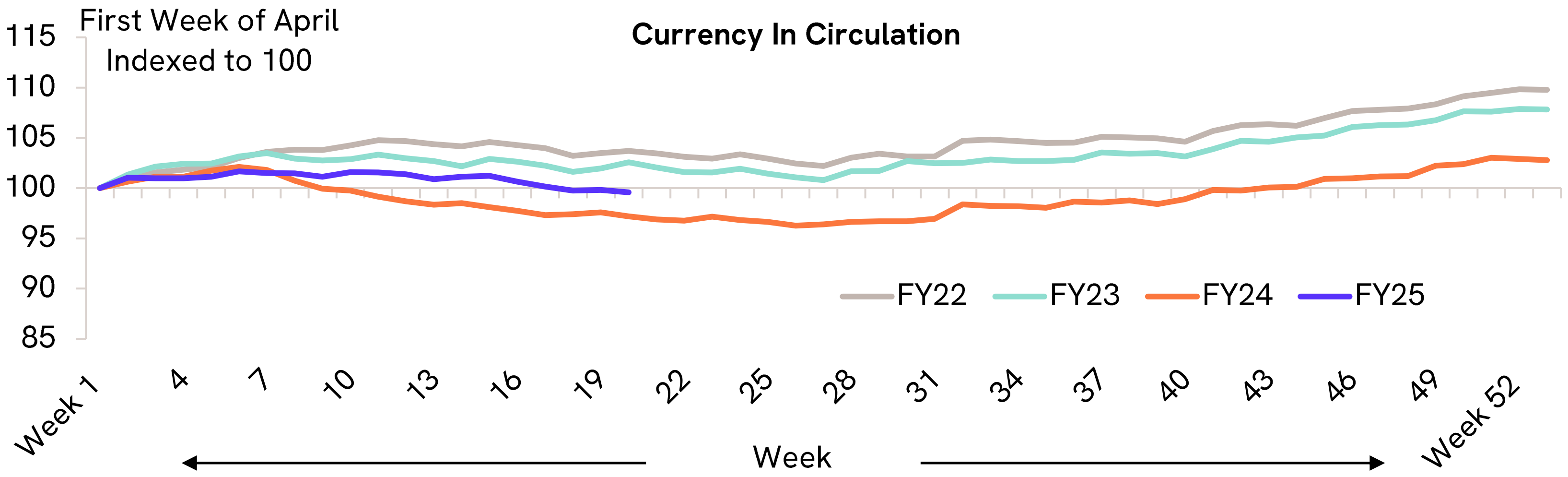
The government's balances with the RBI have come down as government spending picked up post-election, leading to an improvement in banking system liquidity

The credit-to-deposit ratio should improve as the government further reduces its balances with the RBI by increasing spending

Source: CMIE, 360 ONE Asset Research

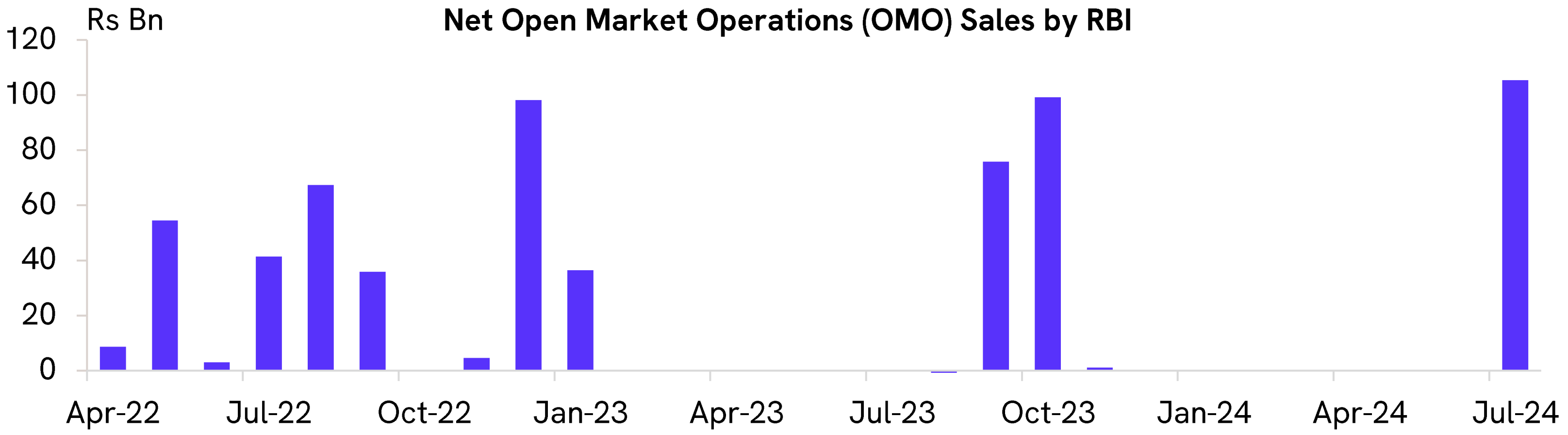
An increase in currency demand during H2 may drain bank deposits

The RBI is also conducting open market sales of government securities to drain excess liquidity from the system



Currency in circulation is expected to pick up in the second half of FY25

This will drain the banking system's liquidity, reduce bank deposits, and may further skew the credit-to-deposit ratio



The RBI is also conducting open market sales of government securities to drain excess liquidity from the system

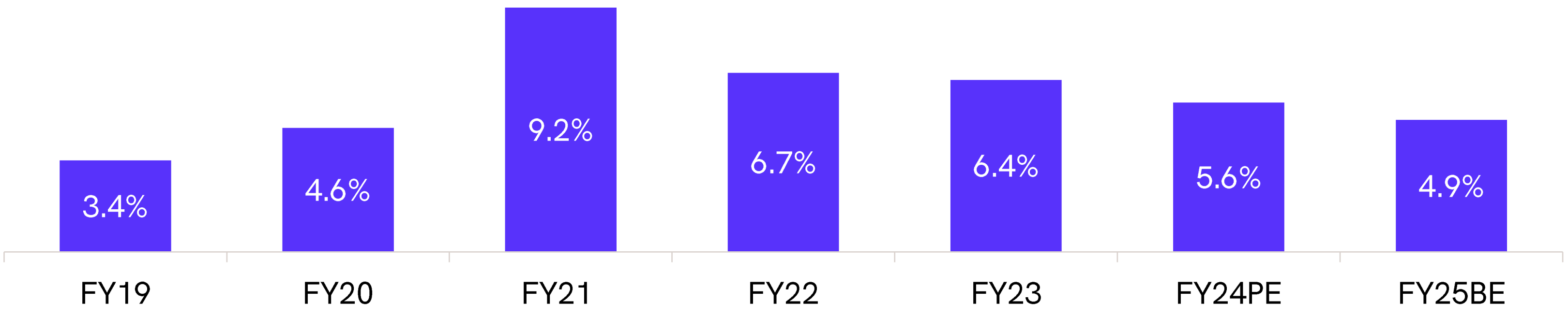
Net OMO sales by RBI could further deteriorate the credit-to-deposit ratio

Source: CMIE, 360 ONE Asset Research

Fiscal consolidation bodes well for the debt market

The fall in the fiscal deficit in FY25 is driven by a higher RBI dividends and controlled revenue expenditure

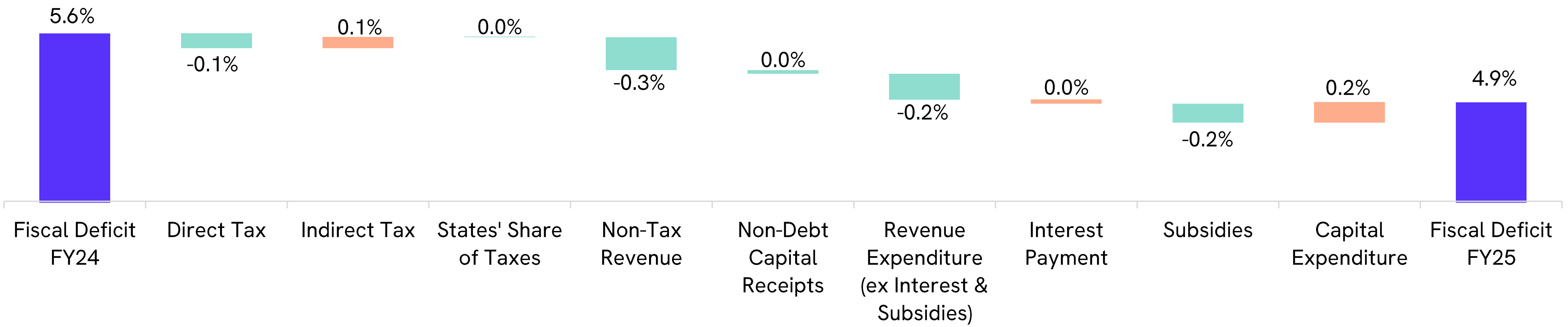
Fiscal Deficit (% of GDP)



The central government targets a fiscal deficit of 4.9% of GDP in FY25 and remains committed to reducing it to below 4.5% by FY26

The fall in the fiscal deficit in FY25 is driven by an increase in non-tax revenue (higher RBI dividends) and controlled revenue expenditure (including subsidies)

Fiscal Deficit (% of GDP) - Key Drivers

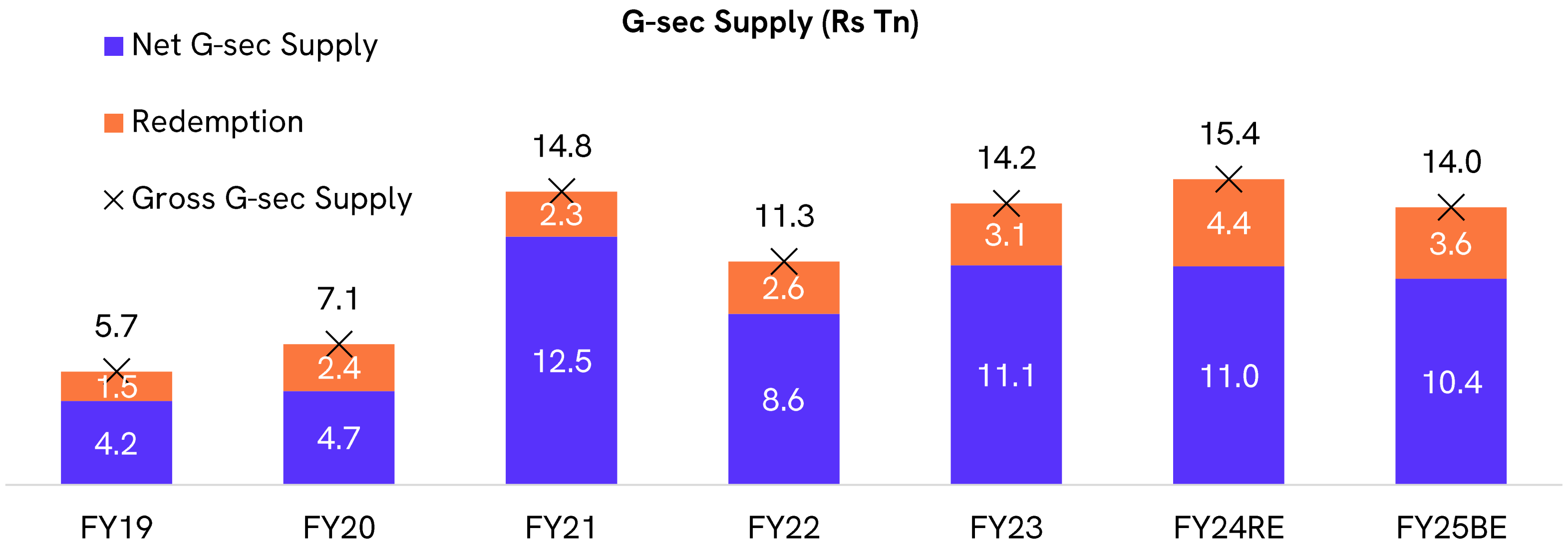


Source: Budget Documents, CGA, 360 ONE Asset Research

Note: PE – Provisional Estimates, BE – Budget Estimates

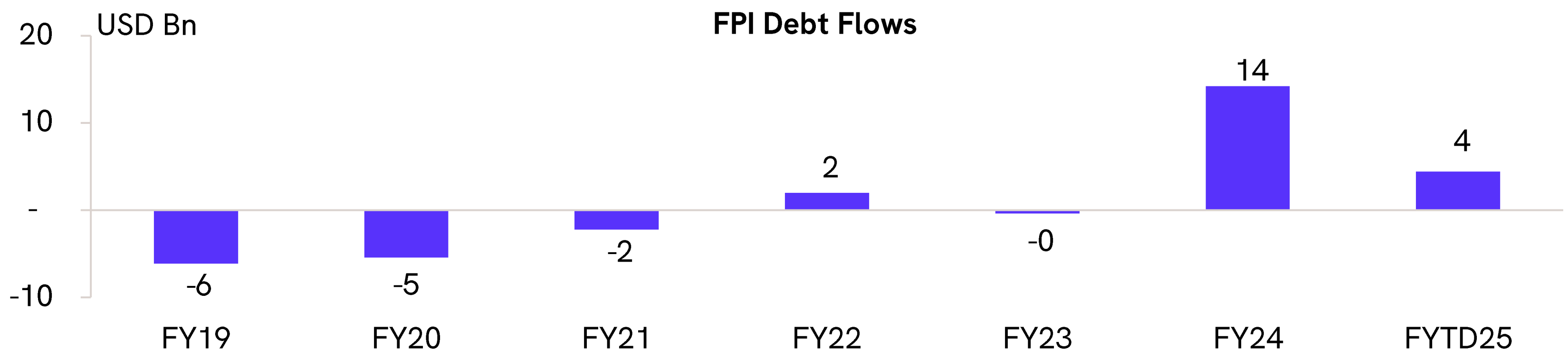
Supply Demand dynamics turn favorable for the debt market

Lower G-sec supply is complemented by higher demand due to index inclusion and anticipated monetary easing



The Indian G-sec supply is budgeted to be lower in FY25 in both gross and net terms

The decrease in government borrowing for FY25 suggests potentially lower yields on government bonds



FPI debt flows in FY25 are expected to be strong due to the inclusion of Indian government securities in the JP Morgan Emerging Market Bond Index suite, making the supply-demand dynamics for G-secs quite favourable

Anticipated monetary policy easing by RBI is also supportive of the debt market

Source: Budget Documents, NSDL, 360 ONE Asset Research

Note: FYTD25 Debt Flows till 31st July 2024. RE – Revised Estimates, BE – Budget Estimates. G-sec supply numbers have been adjusted for borrowings for providing back-to-back loans to States and UTs for GST compensation cess shortfall in FY21-22 and repayment from GST compensation fund in FY24-25

Disclaimer

This document constitutes confidential and proprietary material and may not be reproduced or further distributed in part or full to any other person without the written permission of 360 ONE AMC. This document is the property of 360 ONE AMC and must be returned to 360 ONE AMC or its affiliates upon request. This document is provided for assistance only and is not intended to be used for taking investment decisions or otherwise. This document is not investment, legal, tax, or accounting advice. The recipients should also inform themselves, and should take appropriate advice, on the legal requirements and shall not rely on this document for any subscription, purchase, holding, exchange, redemption or disposal of any investments. The opinions expressed herein are the personal opinions of the author. Past Performance is not an indicator/guarantee of future returns. Investment in securities are subject to market risk. Whilst every care has been taken in preparing this document, 360 ONE AMC and its affiliates and agents to the fullest extent permitted by applicable law disclaim any liability or responsibility for any error or omission or inaccuracy or mistake of any nature or any consequences of the use of the material/ information displayed on this document. Notwithstanding the aforesaid, nothing set out above shall exclude liability for any undertaking, representation, warranty or other assurance made fraudulently. The information given in this document is not exhaustive and is subject to change without notice.

asset
360ONE