

Economy

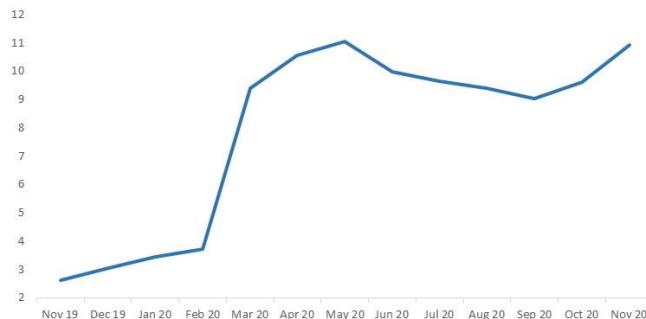
Financial conditions ease further; highest since May 2020

- ▶ **Financial conditions improve significantly in Nov 2020; highest since May 2020:** Our proprietary Financial Conditions Index (FCI) shows that financial conditions improved to their highest score since May 2020. Significant improvement in money market and stock market drove the overall improvement in financial conditions. Increase in interbank liquidity, subsequent fall in money market rates below reverse repo and robust stock market performance on the back of positive Covid-19 vaccine development news drove the improvement in overall financial conditions. Our calculation shows that Financial Conditions Score improved to 10.94 in Nov 2020 from 9.61 in Oct 2020.
- ▶ **Aggregate demand conditions gain sequentially:** Aggregate Demand score is based on two key indicators viz. M3 money supply and non-food bank credit. We estimate that non-food bank credit growth during Nov '20 came in at 5.9% y/y, the highest since Jul 2020. Non-food bank credit growth during Q1 and Q2FY21 was 6.4% and 5.5% respectively. For the first two months of Q3FY21, we estimate average non-food credit growth at 5.6%. The other component of AD score viz. M3 money supply also recorded good growth in Nov 2020. M3 money supply grew 12.5% y/y in Nov 2020, up from 11.6% in the preceding month. Aggregate Demand Score increased to 0.55 in Nov 2020 from 0.05 in Oct 2020.
- ▶ **Dollar buying creates abundant liquidity and pushes money market score to series-high:** Money market score increased to its highest since Apr 2011, the first observation in the series. The improvement in money market conditions was driven by sharp increase in interbank liquidity and commensurate fall in money market rates. Average daily absorption in interbank market increased to Rs 6.37trn during Nov 2020 sharply up from Rs 5.27trn in the preceding month. Consequently, interbank call money rate stood at 3.06% during Nov 2020, broadly unchanged from 3.05% during the preceding month. CBLO rate, on the other hand, fell sharply during the month – 2.83% in Nov 2020 from 3.13% in Oct 2020. The sharp improvement in liquidity is due to the RBI's dollar buying to rein in the rupee to keep exports competitive. Fall in money market rates below reverse repo has compromised the sanctity of reverse repo as the floor of LAF corridor. In the Dec 2020 monetary policy, the MPC also vowed to keep the stance accommodative at least in FY21 and FY22. Hence, we expect money market conditions to remain benign in the near future. Overall, Money Market Score improved to 3.67 in Nov 2020 from 2.84 in Oct 2020.
- ▶ **Equity market conditions improve sharply on positive news on vaccine development; buying by foreign investors:** Market continued to watch news on Covid-19 vaccine development keenly. Hopes of breakthrough on the vaccine front and good performance by high frequency indicator led to Nifty index averaging 12602 in Nov 2020 up from 11790 in Oct 2020. India VIX fell moderately to 21.01 in Nov from 21.58 in Oct. Joe Biden's victory in US Presidential election led to sharp improvement in US VIX to 25 in Nov from 29.44 in Oct. Overall, Equity Market Score improved to 4.83 in Nov 2020 from 3.67 in Oct 2020.
- ▶ **India bond yields fall sharply at the short end; US yields increase on vaccines news, Yellen nomination:** Ample liquidity and expectations that RBI will take measures to keep financial conditions benign led to sharp fall in bond yields especially at the short end of the curve. India 1-yr bond yield fell 12bps in Nov 2020 to average 3.4% while 5-yr bond yield fell 9bps to 5.12%. 1-yr and 5-yr AAA yields also fell 20bps and 18bps respectively during the month. However, rising yields in the US played spoilsport. US yields increased on positive news on vaccine front, Biden victory and nomination of former Fed Chair Janet Yellen as president-elect Biden's nominee for Treasury Secretary. Overall, Debt Market Score fell to 4.15 in Nov 2020 from 4.53 in Oct 2020.
- ▶ **Forex conditions remain broadly unchanged:** Rupee depreciated a tad (74.27 in Nov vs 73.47 in Oct 2020) during the month. However, 1-month and 3-month forward premia declined modestly while 6-month forward premia increased. FX Market Score remained broadly unchanged at 2.69 in Nov 2020 from 2.63 in Oct.

* FCI is based on 24 high-frequency indicators. Since the values are standardized, they change slightly every month. Hence, scores mentioned for Nov 2020 in this issue could be slightly different in next issue.

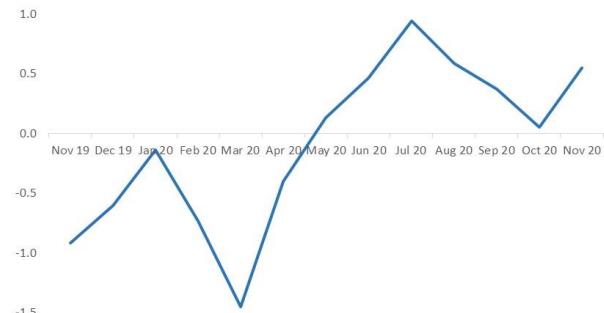
Financial Conditions Index and its components

Chart 1: Financial Conditions Index



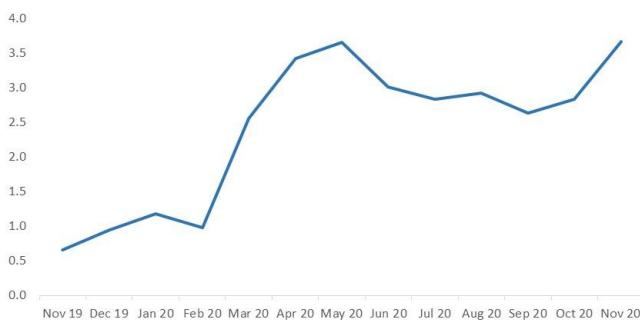
Source: Bloomberg, I-Sec Research

Chart 2: Aggregate demand conditions



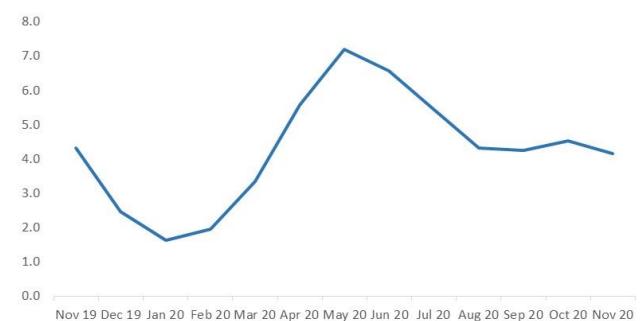
Source: Bloomberg, I-Sec Research

Chart 3: Money market conditions



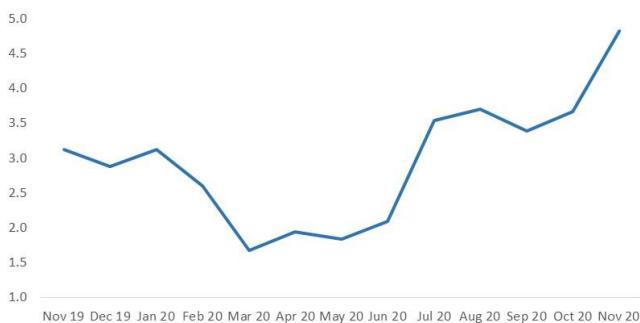
Source: Bloomberg, I-Sec Research

Chart 4: Debt market conditions



Source: Bloomberg, I-Sec Research

Chart 5: Equity market conditions



Source: Bloomberg, I-Sec Research

Chart 6: Forex market conditions

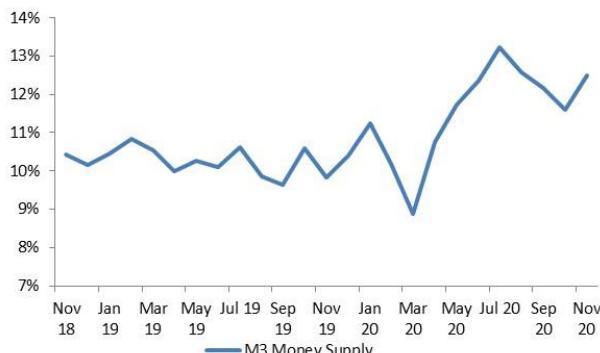


Source: Bloomberg, I-Sec Research

Constituents of sub-indices and their movement

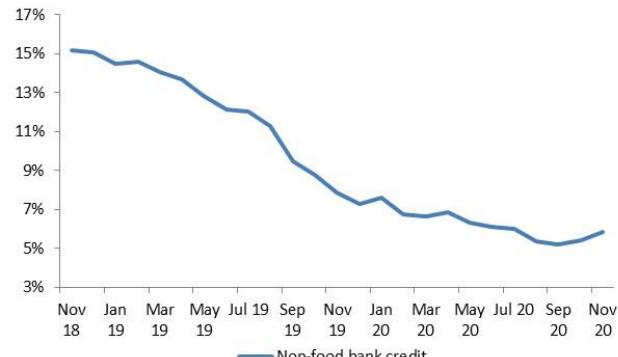
Aggregate demand conditions

Chart 7: Money supply growth (% y/y)



Source: Bloomberg, I-Sec Research

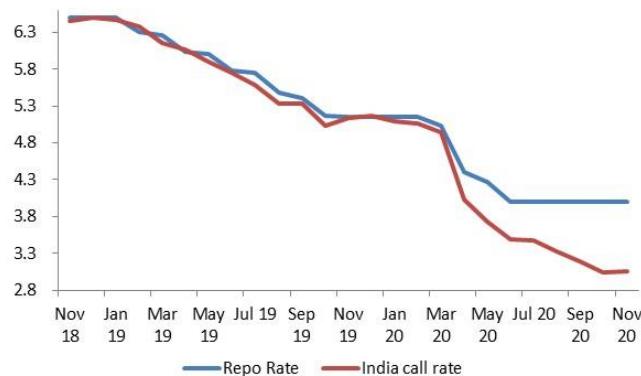
Chart 8: Non-food bank credit growth (% y/y)



Source: Bloomberg, I-Sec Research

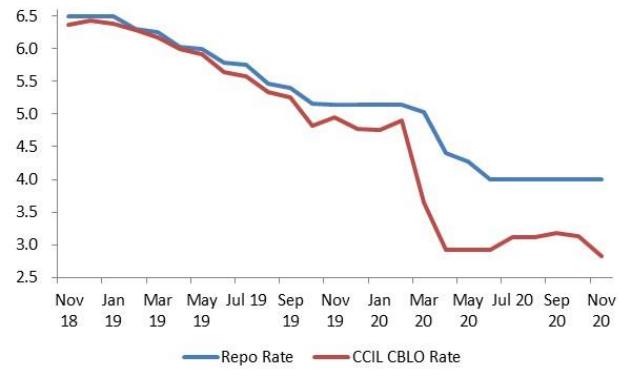
Money market conditions

Chart 9: Spread between repo and call rate



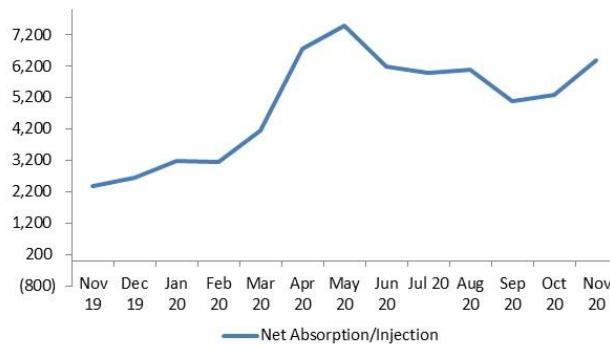
Source: Bloomberg, I-Sec Research

Chart 10: Spread between repo and CBLO rate



Source: Bloomberg, I-Sec Research

Chart 11: Interbank liquidity (Rs trn)



Source: Bloomberg, I-Sec Research

Debt market conditions

Chart 12: Spread between 1yr gilt & AAA bond

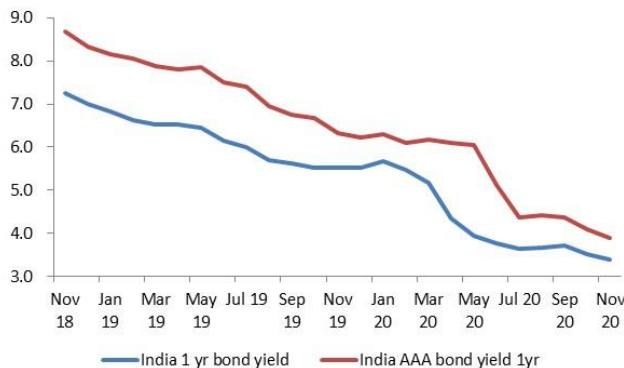


Chart 13: Spread between 5yr gilt & AAA bond

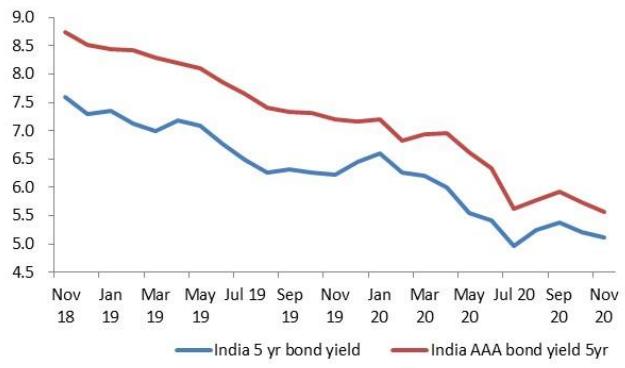


Chart 14: Spread between 10yr gilt & AAA bond

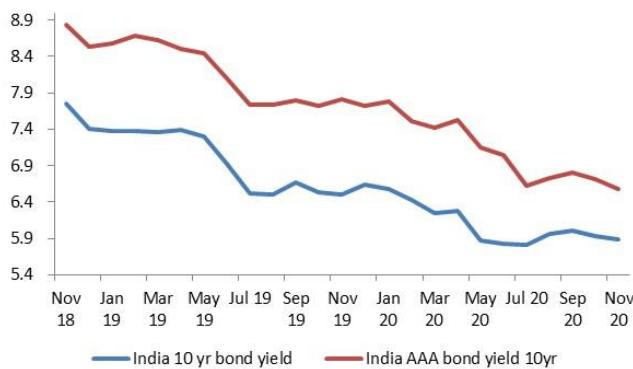


Chart 15: Spread between 5yr India & US bond

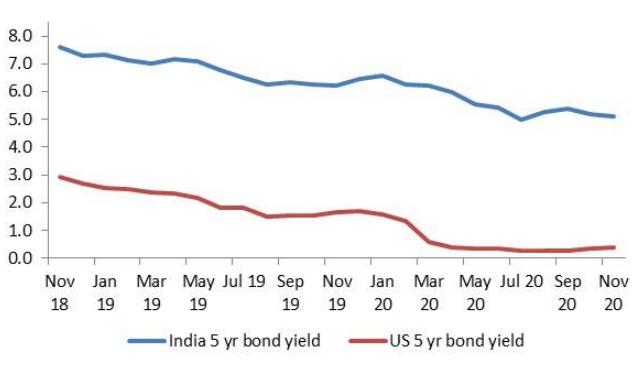


Chart 16: Spread between 10yr India & US bond

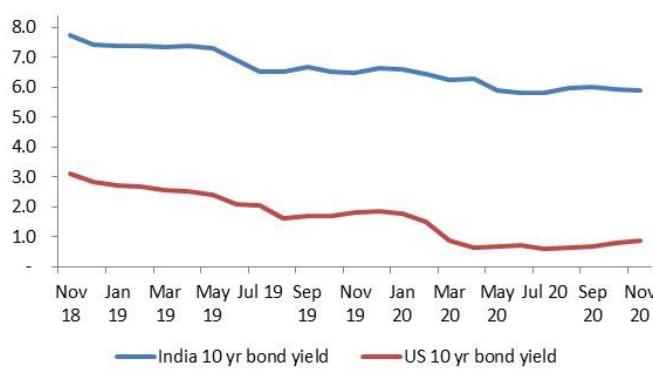
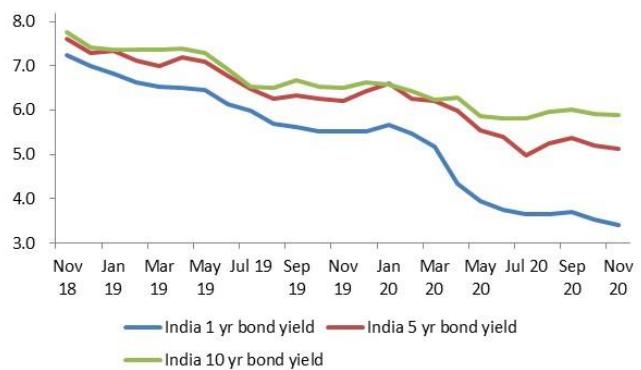
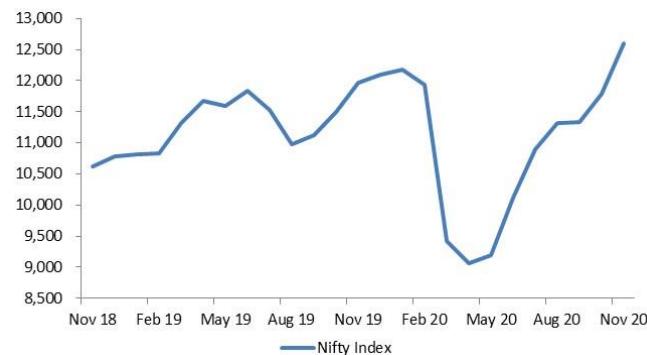


Chart 17: India 1yr, 5yr, 10yr gilt yields



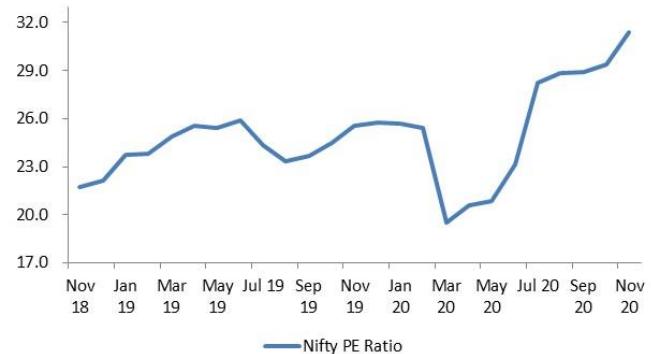
Equity market conditions

Chart 18: Nifty Index (monthly average)



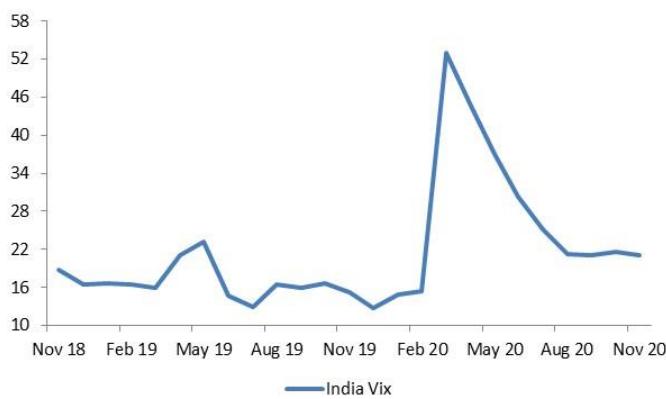
Source: Bloomberg, I-Sec Research

Chart 19: Nifty PE (monthly average)



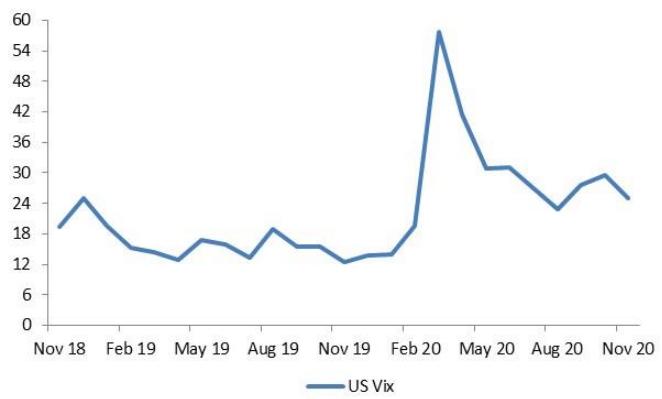
Source: Bloomberg, I-Sec Research

Chart 20: India VIX



Source: Bloomberg, I-Sec Research

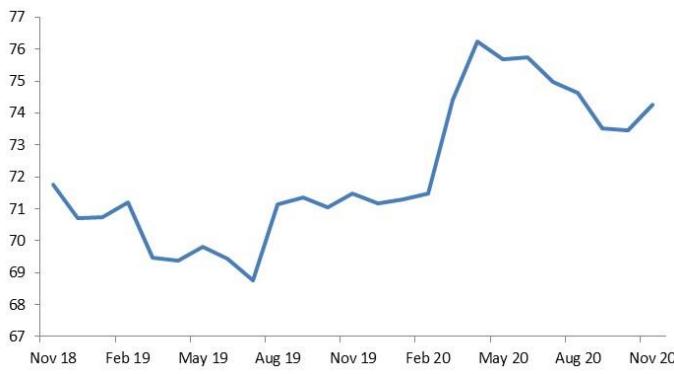
Chart 21: US VIX



Source: Bloomberg, I-Sec Research

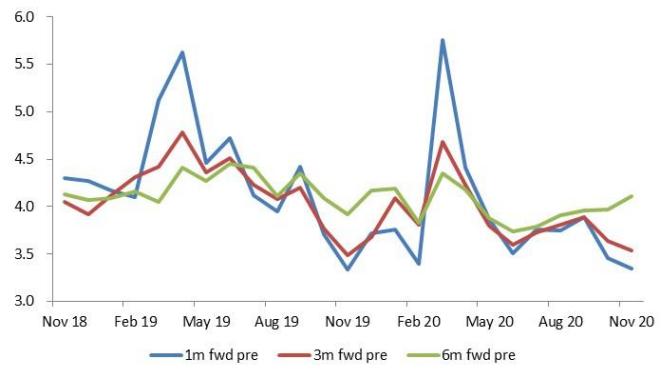
Forex market conditions

Chart 22: USDINR



Source: Bloomberg, I-Sec Research

Chart 23: Forward Premia



Source: Bloomberg, I-Sec Research

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