ICRA

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Challenging year ahead for bond issuances amid rising yields

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HIGHLIGHTS

ICRA expects fresh bond issuances to remain muted at Rs. 7.0-7.5 trillion in FY2023 and bonds outstanding to rise by 3-4% in FY2023 to Rs. 41-42 trillion by March 31, 2023

Large borrowing programme, geopolitical risks and inflationary pressures expected to harden yields in H1 FY2023

Protracted geopolitical tensions, elevated commodity prices, heightened volatility in global financial markets, and fresh waves of Covid-19 could lead to broader risk aversion towards EM assets and result in FII outflows in H1 FY2023

FDI inflows in FY2022 largely expected to remain in line with FY2021 level

Slowdown in FDI outflows witnessed in H2 FY2022 even while remittances under LRS are back to pre-Covid-19 level

ECB approvals witness strong YoY rise in 11M FY2022, although they continue to lag FY2020 levels

Bond issuances were lower by ~19% in FY2022 at Rs. 6.75 trillion vis-à-vis Rs. 8.33 trillion in FY2021 (Rs. 6.53 trillion in FY2020, Rs. 6.83 trillion in FY2019). The volume of bonds outstanding rose by 11.2% YoY to Rs. 40.2 trillion as on March 31, 2022. We expect fresh bond issuances at Rs. 7.0-7.5 trillion in FY2023, translating to a YoY growth of 4-11%, and the volume of bonds outstanding to grow by a muted 3-4% to Rs. 41-42 trillion by March 31, 2023. Elevated crude oil prices combined with the surge in FII/FPI capital outflows continue to exert pressure on the INR-USD exchange rate, which could exacerbate the inflationary pressures. Against this backdrop, a large borrowing programme for the GoI is likely to keep the yields on an upward trajectory and we accordingly expect the benchmark 10-yr G-Sec yield to trade in the range of 7.0-7.5% in H1 FY2023. The risk of protracted inflationary pressures and yield volatility is likely to keep investors concerned about mark-to-market losses, which could impact issuances.

- **Net FII outflows surged to a record high of $15.5 billion in Q4 FY2022, driven by equity segment:** The net outflows of the FII segment (equity, debt and hybrid) surged to an all-time high of $15.5 billion in Q4 FY2022 (+$7.6 billion in Q4 FY2021) from $5.9 billion in Q3 FY2022 (+$21.1 billion in Q3 FY2021) following the emergence of the Russia-Ukraine conflict and the faster-than-anticipated policy normalisation by the US Fed. The segment subsequently witnessed net outflows of $2.8 billion during April 1-26, 2022, driven by the trends in the equity segment (-$2.1 billion). Going forward, protracted geopolitical tensions, elevated commodity prices, heightened volatility in global financial markets, and fresh waves of Covid-19 could lead to a broader risk aversion towards EM assets and result in FII outflows. Overall, we expect the FIIs to remain on the sidelines in H1 FY2023 till the headwinds subside.

- **FDI inflows in FY2022 largely to remain in line with FY2021 levels:** FDI inflows maintained a steady pace with combined inflows at $55.5 billion in 11M FY2022, which was lower (-4.8%) than the inflows of $58.3 in 11M FY2021. Furthermore, for the TTM ending February 2022, FDI inflows stood at $58.6 billion, which was 6.4% lower than $62.6 billion for the TTM ending February 2021.

- **Contrasting trends with FDI outflows slowing down while remittances under LRS are back to pre-Covid-19 level:** Gross FDI outward flows stood at $13.6 billion in 11M FY2022 compared to $9.8 billion in 11M FY2021, despite witnessing a slowing trend during Q3-Q4 FY2022, largely supported by the strong flows witnessed in Q1 FY2022. In contrast to the FDI outflows that are linked to entities investing abroad, remittances were higher at $17.6 billion in 11M FY2022 compared to $11.1 billion in 11M FY2021. This was also above the pre-Covid level of $17.4 billion in 11M FY2020, driven by normalisation of travel and maintenance of Indians abroad.

- **ECB approvals expand in 11M FY2022:** The aggregate gross ECB approvals rose by 30% to $33.6 billion in 11M FY2022 from $25.8 billion in 11M FY2021, although the same lagged the approvals of $44.6 billion witnessed in 11M FY2020. Similarly, net of

YoY growth in India's real GDP expected to moderate to 3.0-4.0% in Q4 FY2022, resulting in 8.5% YoY growth in FY2022; GDP growth expected to moderate to 7.2% in FY2023 due to ongoing geopolitical tensions

ICRA expects CPI inflation to print well above the MPC's upper limit of 6.0% in the near term, given the rise in fuel and edible oil prices

ICRA expects WPI inflation to remain elevated at 13.5-15.0% in April 2022, partly depending on the trajectory of crude oil prices and further revisions in petrol and diesel prices

Considerable likelihood that rate hike cycle will begin as early as June 2022 if next CPI inflation print does not cool off significantly from March 2022 level

refinancing, approvals rose by 30% to $27.4 billion in 11M FY2022 from $21.1 billion in 11M FY2021 while trailing $42.0 billion in 11M FY2020. The YoY expansion in approvals was driven by the sharp increase in the refinancing of rupee loans, working capital requirements, refinancing of older ECBs as well as on-lending.

- **India's real GDP growth expected to moderate to 3.0-4.0% YoY in Q4 FY2022:** The impact of the third wave of the Covid-19 pandemic on contact-intensive services in the first half of the quarter and the expected adverse impact of the spike in commodity prices fuelled by geopolitical tensions on corporate margins in the second half of the quarter are expected to have hurt growth in Q4 FY2022. As a result, we expect the YoY growth in the real GDP to moderate to 3.0-4.0% in Q4 FY2022 from 5.4% in Q3 FY2022, lower than the NSO's implicit projection of a 4.8% rise. The YoY expansion in the real GDP is, therefore, forecast at 8.5% for FY2022 (against the NSO's projection of 8.9%), which this entails a mild rise of 1.3% relative to the FY2020 level. The surge in commodity prices has led to the tempering down of growth expectations for FY2023, despite the forecast of a normal monsoon and an expected revival in the contact-intensive services segment. We expect the GDP growth to moderate 7.2% in FY2023.

- **CPI inflation expected to print well above the MPC's upper limit of 6.0% in the near term:** The YoY combined CPI inflation rose to 6.3% in Q4 FY2022 from 5.0% in Q3 FY2022, breaching the upper threshold of the MPC's medium-term target band of 4%+/-2% after a gap of four quarters. This was mainly driven by food and beverages (to +6.3% in Q4 FY2022 from +3.0% in Q3 FY2022) and clothing and footwear (to +9.0% from +7.9%). Going forward, the increase in fuel and edible oil prices and the sequential price hikes for a larger share of the items in the CPI basket vis-à-vis the respective pre-pandemic monthly averages, that were seen during February-March 2022, are likely to impart stickiness to the inflation trajectory, keeping the YoY prints elevated in the near term.

- **WPI inflation to remain elevated at 13.5-15.0% in April 2022, despite the high base:** In contrast to CPI inflation, the YoY WPI inflation eased to 13.8% in Q4 FY2022 from 14.3% in Q3 FY2022, driven by manufactured non-food products (to +10.2% from +12.2%), fuel and power (to +33.5% from +40.4%), crude petroleum and natural gas (to +57.1% from +67.3%), minerals (to +20.0% from +20.5%) and manufactured food products (to +9.0% from +10.7%). Despite the high base (+10.7% in April 2021 vs. 7.9% in March 2021), we expect WPI inflation to remain elevated at 13.5-15.0% in April 2022 due to the hardening in crude oil and commodity prices during the month.

- **Considerable likelihood of rate hike cycle beginning as early as June 2022:** With the MPC signalling an imminent stance change, there is considerable likelihood that the rate hike cycle will begin as early as June 2022, if the next CPI inflation print does not cool off significantly from the March 2022 level. We now expect to see 50-75 bps of rate hikes by the end of Q2 FY2023, followed by a pause in H2 FY2023, and another 50 bps of hikes in FY2024.

- **Liquidity surplus eased in Q4 FY2022; expected to moderate further through FY2023:** The average daily liquidity surplus under the LAF eased to Rs. 6.54 trillion in Q4 FY2022 from Rs. 7.49 trillion in Q3 FY2022, while remaining substantial. The increase in the currency with the public and forex sales by the RBI led to the reduction in the liquidity surplus in Q4 FY2022, though this was partially offset by the drawdown of government cash balances. Further, in the April 2022 policy review, the MPC changed the

Incremental deposits of banks pegged at Rs. 12.0-13.0 trillion for FY2023, translating to YoY growth of 7.3-7.9%

ICRA expects credit growth to remain at 8.9-10.1% in FY2023, with incremental NFBC pegged at Rs. 10.5-12.0 trillion

wording of the comments on the stance and highlighted that the liquidity overhang of Rs. 8.5 trillion would be withdrawn in a gradual and calibrated manner over a multi-year time frame. Given the central bank's commentary, we expect systemic liquidity surplus to moderate through the course of FY2023.

- **Deposit growth slows in Q4 FY2022:** The incremental deposits in the banking system rose by Rs. 2.2 trillion in Q4 FY2022, which was lower than the expansion of Rs. 6.5 trillion in Q3 FY2022 and Rs. 6.3 trillion in Q4 FY2021. The lower accretion could be attributed to the unusually high deposit accretion in Q3 FY2022, leading to the relatively lower build-up in Q4 FY2022. Besides this, the currency with the public (CWP) witnessed a sequential rise of Rs. 1.6 trillion in Q4 FY2022 (against an increase of Rs. 1.2 trillion in 9M FY2022), which, in turn, weighed down the deposit accretion during the quarter. Furthermore, the incremental deposit build-up in FY2022 in the banking system stood at Rs. 13.5 trillion on March 25, 2022, translating to a YoY growth of 8.9%, which was lower than the YoY growth of 11.4% in FY2021. The overall deposit base grew to Rs. 164.7 trillion as on March 25, 2022 from Rs. 162.4 trillion as on December 31, 2021 and Rs. 151.1 trillion as on March 26, 2021. Incremental deposits are estimated at Rs. 12.0-13.0 trillion for FY2023, which will translate to a YoY deposit growth of 7.3-7.9% (8.9% in FY2022 and 11.4% for FY2021).

- **Credit growth momentum strengthens:** Non-food bank credit (NFBC) stood at Rs. 118.4 trillion as March 25, 2022, up from Rs. 115.9 trillion as on December 31, 2021, translating to incremental credit of Rs. 2.4 trillion in Q4 FY2022 (against Rs. 1.8 trillion in Q4 FY2021). Given the high base of the previous quarter (Rs. 7.0 trillion in Q3 FY2022), incremental NFBC recorded a sequential dip. The YoY credit growth improved to 9.7% as on March 25, 2022 from 9.3% as on December 31, 2021 and was meaningfully higher than 5.5% as on March 26, 2021. ICRA estimates the YoY credit growth at 8.9-10.1% for FY2023, with incremental NFBC between Rs. 10.5 trillion and Rs. 12.0 trillion (incremental credit of Rs. 10.5 trillion in FY2022).

Abbreviations

AUM: Assets Under Management

BSNL: Bharat Sanchar Nigam Limited

CASA: Current and Savings Account Ratio

CAD: Current Account Deficit

CD: Certificates of Deposit

CDSL: Central Depository Services (India) Limited

CEA: Central Electricity Authority

CIC: Currency in Circulation

CP: Commercial Paper

CPI: Consumer Price Index

CMB: Cash Management Bills

CRR: Cash Reserve Ratio

CSO: Central Statistics Office

CWP: Cash with Public

CY: Calendar Year

DII: Domestic Institutional Investors

DIPP: Department of Industrial Policy and Promotion

ECBs: External Commercial Borrowings

EM: Emerging Markets

FAR: Fully Accessible Route

FCCBs: Foreign Currency Convertible Bonds

FCI: Food Corporation of India

FDI: Foreign Direct Investment

FII: Foreign institutional Investment

FPI: Foreign Portfolio Investment

FPO: Follow on Public Offer

FSB: Fully Serviced Bonds

FY: Financial Year

G-Sec: Government Securities

GDP: Gross Domestic Product

GFCE: Government Final Consumption Expenditure

GFCF: Gross Fixed Capital Consumption

GoI: Government of India

GST: Goods and Services Tax

GVA: Gross Value Added

HFC: Housing Finance Company

IDBI: The Industrial Development Bank of India

IIP: Index of Industrial Production

IPO: Initial Public Offer

IMD: Indian Meteorological Department

INR: Indian National Rupee

JV: Joint Venture

LAF: Liquidity Adjustment Facility

LIBOR: London Interbank Offered Rate

LPA: Long Period Average

LRS: Liberalised Remittance Scheme

MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act

MPC: Monetary Policy Committee

MSCI: Morgan Stanley Capital International

MSF: Marginal Standing Facility

NABARD: National Bank for Agriculture & Rural Development

NDTL: Net Demand & Time Liabilities

NBFC: Non-Banking Financial Company

NSDL: National Securities Depository Limited

OMO: Open Market Operations

PFCE: Private Final Consumption Expenditure

PSB: Public Sector Bank

PVB: Private Sector Bank

QoQ: Quarter on Quarter

RBI: Reserve Bank of India

RDB: Rupee Denominated borrowings

SIAM: Society of Indian Automobile Manufacturers

SIDBI: Small Industries Development Bank of India

SCB: Schedule Commercial Bank

SDL: State Development Loans

SLR: Statutory Liquidity Ratio

TLTRO: Targeted long-term repo operations

T-Bill: Treasury Bill

TTM: Trailing Twelve Months

UAE: United Arab Emirates

$: United States Dollar

VRR: Voluntary Retention Route

WPI: Wholesale Price Index

YTD: Year to Date

LTRO: Long-term repo operations

WoS: Wholly Owned Subsidiary

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ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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