i4 MARKETS INDEX

The Financial Conditions Index by ICICI Bank

ICICI Bank Global Markets

What is the i4Markets index telling us?

ICICI Bank's i4Markets Index or the Financial Conditions Index (FCI) indicated incipient signs of heightened volatility after an easy run over FY2021. The severity of the second wave of the pandemic in India, rising global commodity and agriculture produce prices, and supply chain disruption due to localised lockdowns weighed on market sentiment and price performance.

The Monetary Policy Committee's (MPC's) penchant to support durable growth while keeping inflation concerns on the backburner temporarily, and the move to a state-based guidance from a time-based exit has elongated the "low for longer" outlook for policy rates. Furthermore, the reaffirmation for "orderly evolution of the yield curve" by the RBI, and interjection to address supply concerns through various traditional and non-traditional tools has provided tailwinds to the bond market. The newly launched Government Security Acquisition Programme (GSAP 1.0; held in Apr 2021 and announced for May 2021), with an upfront commitment on a quarterly basis, has substantially eased concerns on demand-supply dynamics in the sovereign space. This has further been aided by abundant and surplus systemic liquidity, wherein the average net liquidity absorption under RBI LAF facility was INR 5.8 tn during Apr 2021. The yield on the benchmark 10Y G-Sec bond eased by 15 basis points during April.

In equity markets, after registering record inflows over the past six months, foreign portfolio inflows turned modestly negative amid rising economic uncertainty due to the pandemic. However, the net fund flow from domestic institutional investors more-than-compensated the FPI outflows providing a floor to the market. Moreover, the resilience and positive surprise in corporate earnings has also supported markets from a valuation standpoint. Overall, the headline indices closed with a modest weakness of 0.5% during the month of April. In primary markets, the slew of Initial Public Offerings (IPOs) by Indian companies to raise funds has seen overwhelming investors interest.

In the FX market, the sharp initial bout of weakness in the Rupee during the first half of April was arrested by intermittent RBI intervention and weakness in the Dollar index. However, an elevated merchandise trade deficit, FPI outflows and excessive long INR positioning continue to exert a depreciating bias for the Rupee. The Rupee weakened by 1.3% during April against the US Dollar.

Sumedha Dasgupta
sumedha.dasgupta@icicibank.com

Kaushal Aryan
kaushalkumar.aryan@icicibank.com

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While overall financial conditions tightened somewhat in April, we believe the bias for accommodative conditions remains amid monetary policy support, ample system liquidity, healthy corporate earnings and adequacy of foreign exchange reserves. Given the base case scenario that the second wave of the pandemic will peak out over the next few weeks in line with global experience, worries on the growth front will also gradually recede, buoying investment.

Financial conditions saw a mild tightening in April led by foreign fund outflows

- i4Markets Index for April showed a reading of -1.05, compared to -1.07 in March
- Re-iteration of the accommodative stance by RBI/MPC and reaffirmation for "orderly evolution of the yield curve" through various tools such as OMOs, OTs, VRRRs etc. while maintaining ample system liquidity helped conditions in the bond and money markets over April. The announcement of GSAP 1.0 to the tune of INR 1.0 tn for Q1FY22 (of which INR 250 bn has already been conducted by the RBI in April) also eased supply side concerns leading to bull flattening of the yield curve. Thus, bond and money market FCIs eased to -1.29 (vs. -1.20 in March) and -1.07 (vs. -0.92 in March) respectively. While possible cost-push inflation pressures may temporarily emerge due to the pandemic in India, the RBI's signals to anchor yields amid comfortable liquidity conditions, and periodic announcements of the GSAP will support these markets
- Conditions in the equity markets tightened in April as compared to March, as concerns grew over the local pandemic situation. Over the month of April, FPIs pulled out ~USD 1.5 bn from the equity markets, causing the equity market FCI to tighten to -1.04 in April (vs. -1.37 in March). The pullback was, however, minimal as compared to the ~USD 7.0 bn worth of inflows seen over Q4 FY2021. Healthy earnings result and IPOs by Indian companies will continue to attract funds into equity markets, given a strong growth outlook for India within the EM basket
- Forex market conditions reflected the weakening in the Rupee in early April, as the USDINR averaged 74.6 in April vs. 72.8 in March. The forex market FCI moved to -0.05 in April vs. -0.38 in March. However, the weakening bias in domestic currency has been arrested somewhat amid intermittent intervention by the RBI and plausible moderation in merchandise trade deficit in the near term on the back of lower imports given the local pandemic situation.

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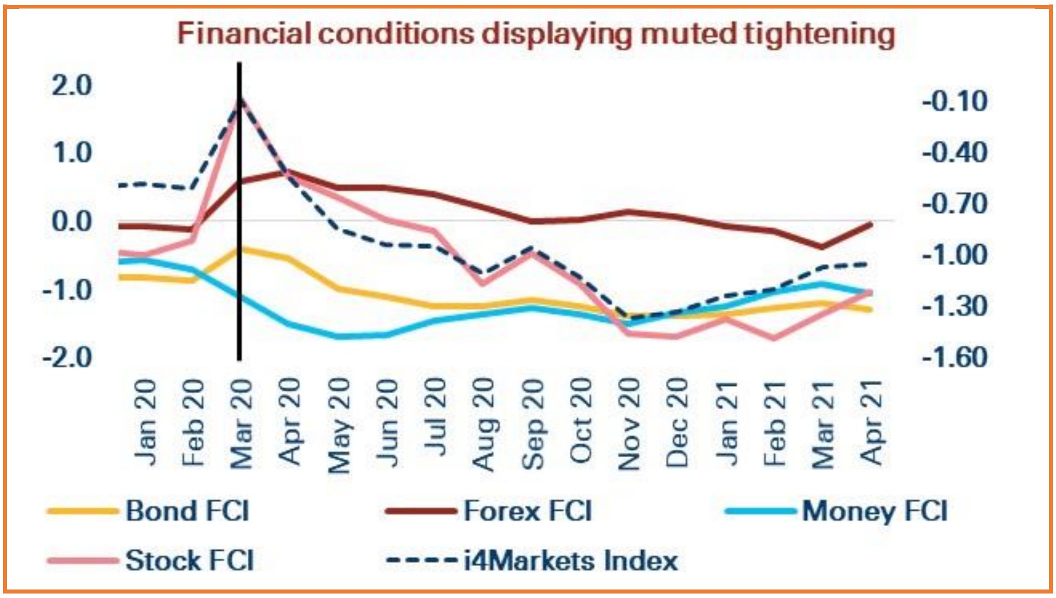

*RHS axis is inverted
Source: CEIC, Bloomberg, ICICI Bank Research

ICICI Bank: ICICI Bank Towers, Bandra Kurla Complex, Mumbai- 400 051. Phone: (+91-22) 2653-1414

Economic Research Group		
Shivom Chakravarti	Senior Economist—Global Markets	shivom.chakravarti@icicibank.com
Sumedha Dasgupta	Economist	sumedha.dasgupta@icicibank.com
Kaushal Aryan	Research Analyst	kaushalkumar.aryan@icicibank.com
Aniket Gaikwad	Research Analyst	aniket.gaikwad@icicibank.com
Asha Sasikumar	Research Analyst	asha.sasikumar@icicibank.com
Jyoti Sharma	Research Analyst	sharma.jyoti@icicibank.com
Tanisha Ladha	Research Analyst	tanisha.ladha@icicibank.com
Nihal Kumar	Research Analyst	nihal.kumar@icicibank.com
Sarbartho Mukherjee	Research Analyst	sarbartho.mukherjee@icicibank.com

Treasury Desks			
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