



# India Financial Conditions Watch

June 2017





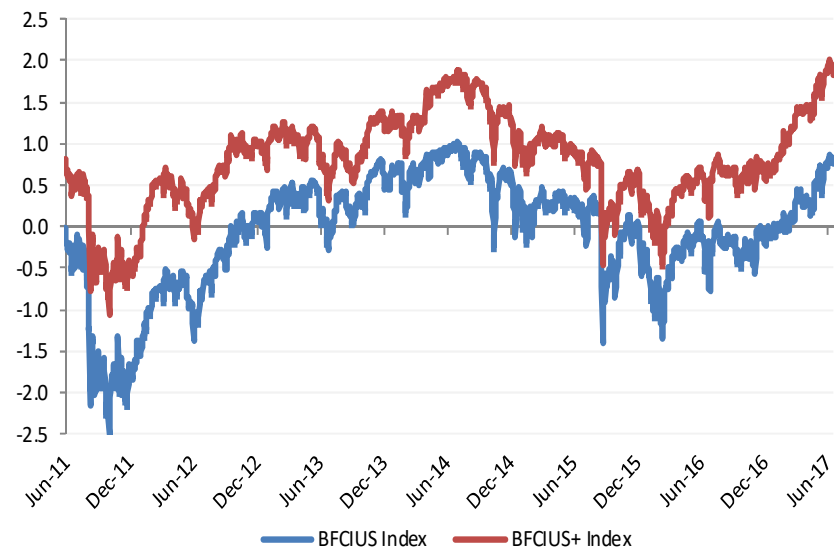
# Bloomberg Financial Conditions Index

- The Bloomberg U.S. Financial Conditions Index (BFCIUS Index) reflects conditions in the U.S. money market, bond market and equity markets.
- The values of this index are Z-scores, a statistical measure representing the number of standard deviations that current financial conditions lie above or below the average of the January 1994-June 2008 period.

## BFCIUS and BFCIUS+ - Components & Weights

	--- Weights ---	
	BFCIUS	BFCIUS+
<b>Money Market</b>		
Ted Spread	11.1%	6.7%
Commerical Paper/T-Bill Spread	11.1%	6.7%
Libor-OIS Spread	11.1%	6.7%
	<b>33.3%</b>	<b>20.0%</b>
<b>Bond Market</b>		
Baa Corporate/Treasury Spread	6.7%	4.0%
Muni/Treasury Spread	6.7%	4.0%
Swaps/Treasury Spread	6.7%	4.0%
High Yield/Treasury Spread	6.7%	4.0%
Agency/Treasury Spread	6.7%	4.0%
	<b>33.3%</b>	<b>20.0%</b>
<b>Equity Market</b>		
S&P 500 Share Prices	16.7%	10.0%
VIX Index	16.7%	10.0%
	<b>33.3%</b>	<b>20.0%</b>
<b>Asset Bubbles</b>		
Nasdaq/S&P 500 Ratio		10.0%
S&P Homebuilders/S&P 500 Ratio		10.0%
		<b>20.0%</b>
<b>Equilibrium Yield Gap</b>		
5-Yr. Treasury Yield less Nom. GDP Growth		10.0%
Real Baa Corporate Yield less Average		10.0%
		<b>20.0%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>

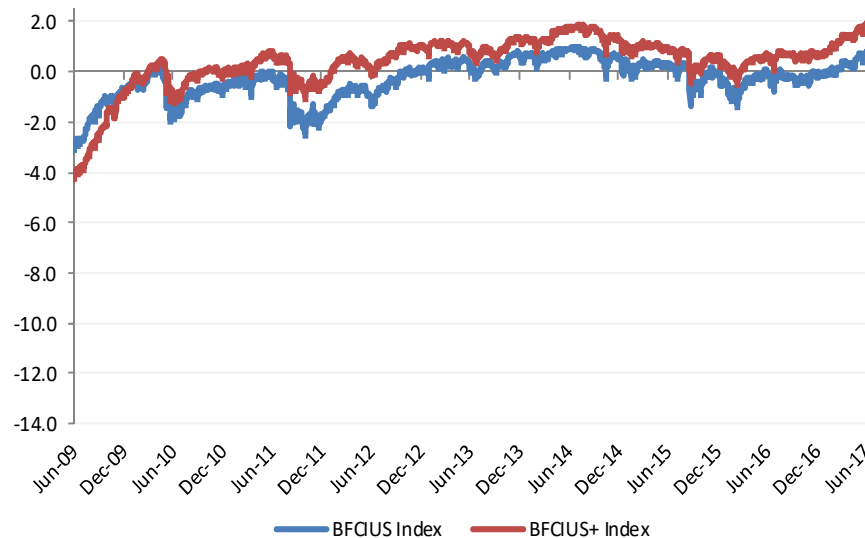
## BFCIUS and BFCIUS+



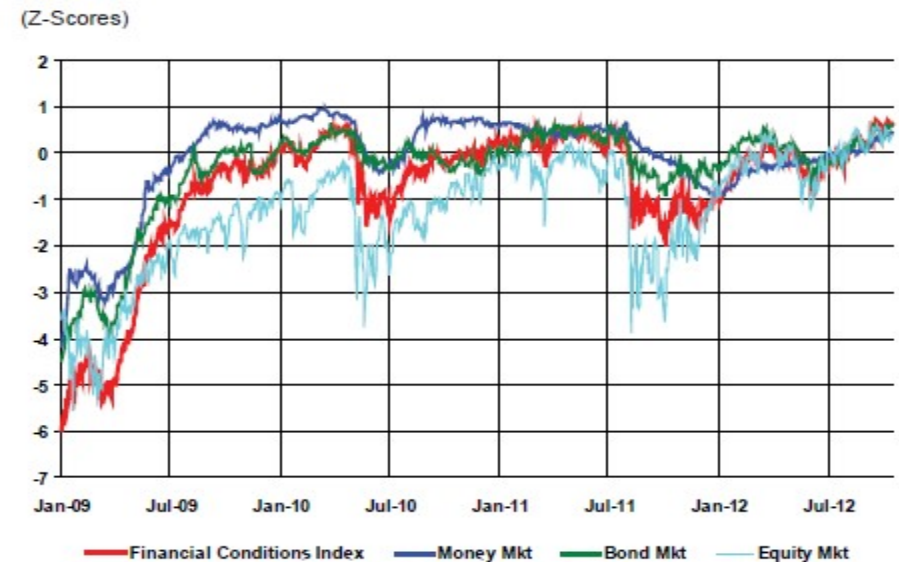


# Financial Conditions Index - US

Bloomberg Financial Conditions Index - U.S.



Contributions of BFCIUS Index Components



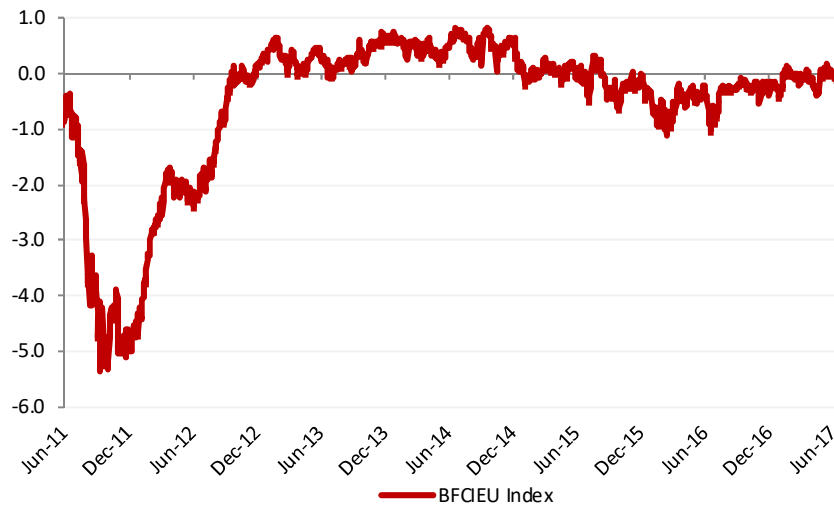
- Central bank policy in the U.S. has been accommodative at times when Financial conditions have deteriorated- QE1, QE2, Operations Twist and QE3.
- In Jan and Feb 2016, the BFCIUS deteriorated and went negative as global growth concerns grew due to a slowing China and the Federal Reserve hiked rates and changed its ZIRP after 7 years in Dec 2015.
- There was increased volatility during U.S elections but thereafter the BFICIUS+ has remained positive as markets are anticipating a significant relaxation of various regulations across the board under the new administration.
- The robust employment picture in the U.S has allowed the FED to increase rates twice this year without significant market impact and there is a good possibility of a third increase later this year.

Source: Bloomberg, Trust Research



## Financial Conditions Index – EU and AXJ

Bloomberg Financial Conditions Index - EU



Bloomberg Financial Conditions Index - AXJ



- Similarly, the ECB has been committed to unconventional monetary policy when financial conditions have dipped. The ECB announced LTRO 1 in Dec-11, LTRO 2 in Feb-12, and made a commitment to the OMT in Jul-12.
- The ECB and BOJ also made further commitments to monetary easing in 2016, with BOJ taking rates negative in Feb-16 and the ECB increasing its QE program by €20 Bn in Mar-16. This led to a pull back in global risk assets as both the BFCIEU and FCIAXJ index rebounded in Mar-16.
- Although it remains marginally negative, the BFCIEU has shown improvement from its recent past and therefore we do not expect additional accommodation by the ECB. Similarly Japan has also been showing improvements and thus the BOJ is not expected to increase its stimulus beyond its current level. At the current juncture the market is actually watching whether the ECB will start to withdraw some of its stimulus measures.

Source: Bloomberg, Trust Research



# Constructing the Financial Conditions Index for India

- The Financial Conditions Index for India, as the BFCIUS, needs to reflect conditions in the Indian money market, bond market and equity market.
- The values of the FCIINR are Z-scores,  $[(x_i - \mu)/\sigma]$ , which is a statistical measure for the number of standard deviations that current variables lie above or below the average. We have taken the relevant period for the average for India to be from 1/1/01 to 31/12/15<sup>1</sup>.
- While constructing the FCIINR, we have selected the following variables and weights to reflect the conditions of the Indian money market, bond market and equity market.

Indian Financial Conditions Index <sup>2</sup>	
	FCIINR Weight
<b>Indian Money Market</b>	
MIBOR/OIS Spread	11.1%
Commercial Paper/T-Bill Spread	11.1%
Rupee forward premium	11.1%
	33.3%
<b>Indian Bond Market</b>	
INR Corp AAA/10Y G-Sec Spread	11.1%
INR 10Y G-Sec/ 10Y U.S. Treasury Spread	11.1%
India CDS Rate	11.1%
	33.3%
<b>Indian Equity Market</b>	
BSE 500	16.7%
India VIX Index of Volatility	16.7%
	33.3%
<b>Total</b>	<b>100.0%</b>

1 For some variables, the relevant time series is available only for a shorter periods of time.

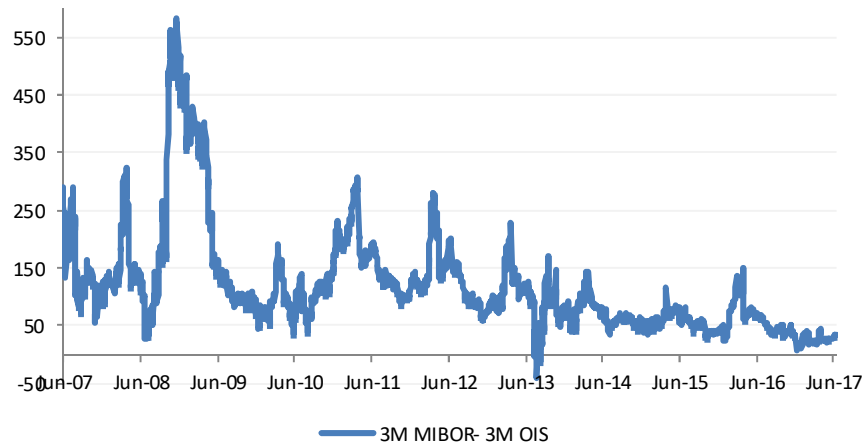
2 We have not constructed the methodology of the Index. We have based it on the Bloomberg Financial Condition Index U.S.



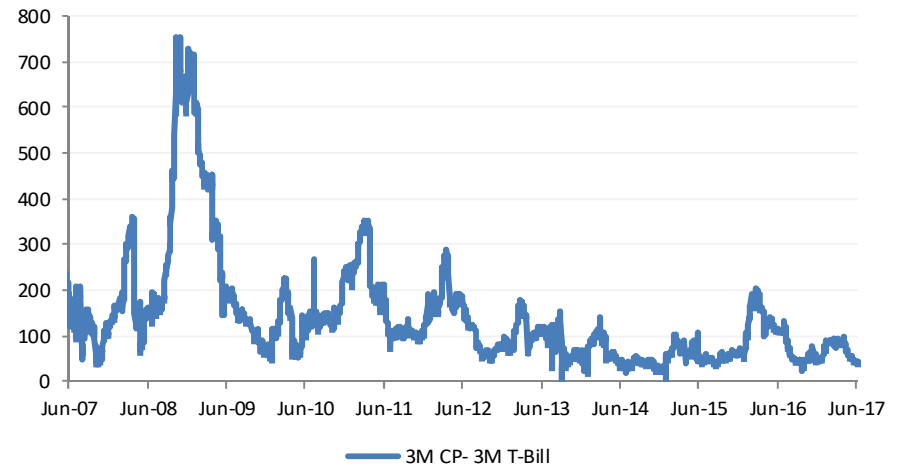


# Indian Money Market

3M MIBOR less 3M OIS Spread (bps)



3M CP less 3M T-bill Spread (bps)



3M Rupee Forward premium (%)



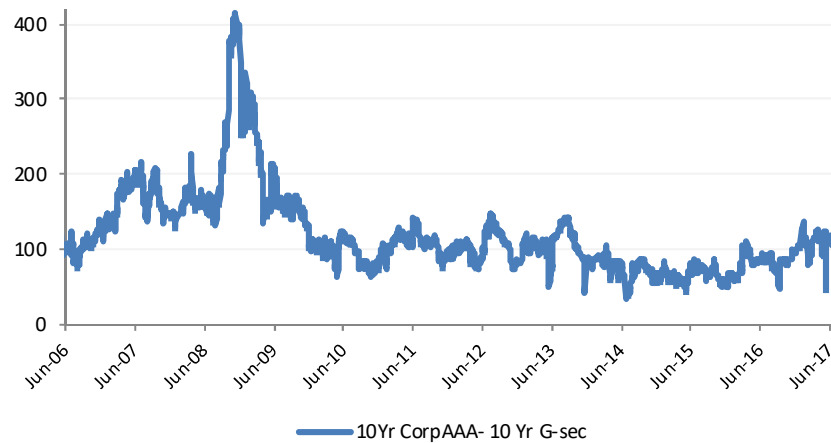
- Based on the construction of the BFCIUS, we have used the following corresponding measures from the Indian money markets:
  - The 3M MIBOR and 3M OIS Spread
  - The 3M CP and 3M T-bill Spread
- Plus, to capture the highly traded interest rate future market, we also have included the 3M Rupee forward premium

Source: Bloomberg, Trust Research

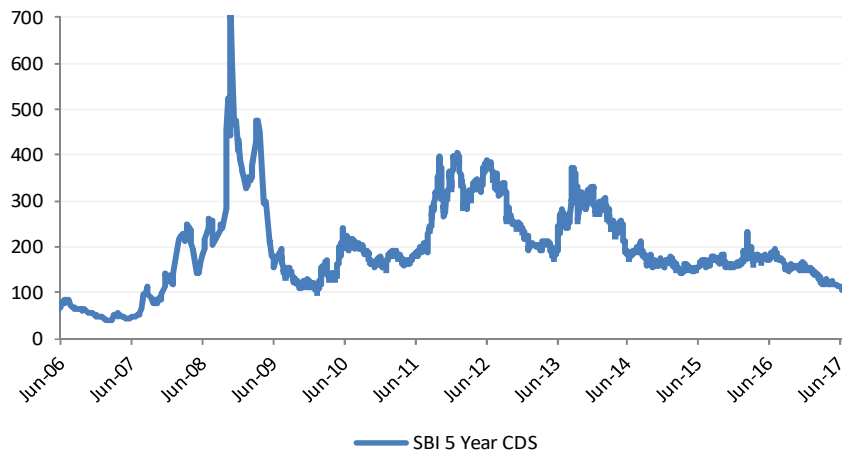
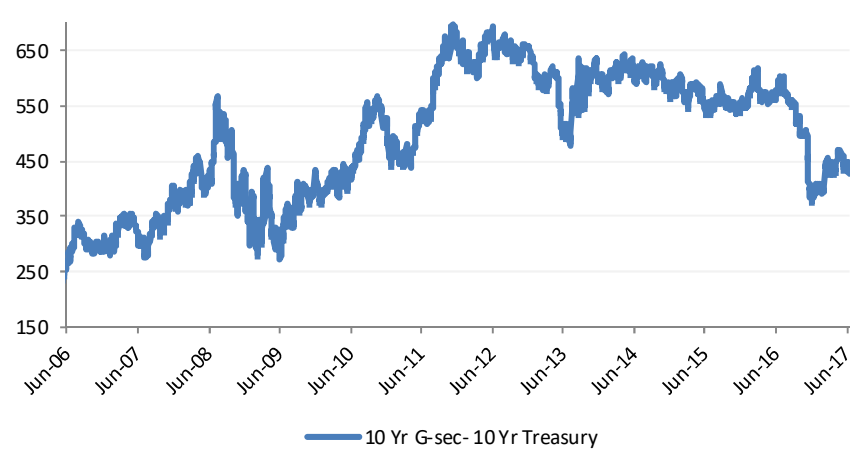


# Indian Bond Market

10Yr Corp AAA less 10Yr G-Sec (bps)



10Yr G-Sec less 10Yr U.S. Treasury Spread (bps)



- Based on the construction of the BFCIUS, we have used the following corresponding measures from the Indian bond markets:
  - The 10Yr AAA to G-Sec Spread
  - The 5 Yr SBI CDS (proxy for the Indian sovereign)
- Plus, to capture India specific variables, we have included the 10 Yr. Indian G-Sec to the 10 Yr. U.S. treasury spread

Source: Bloomberg, Trust Research

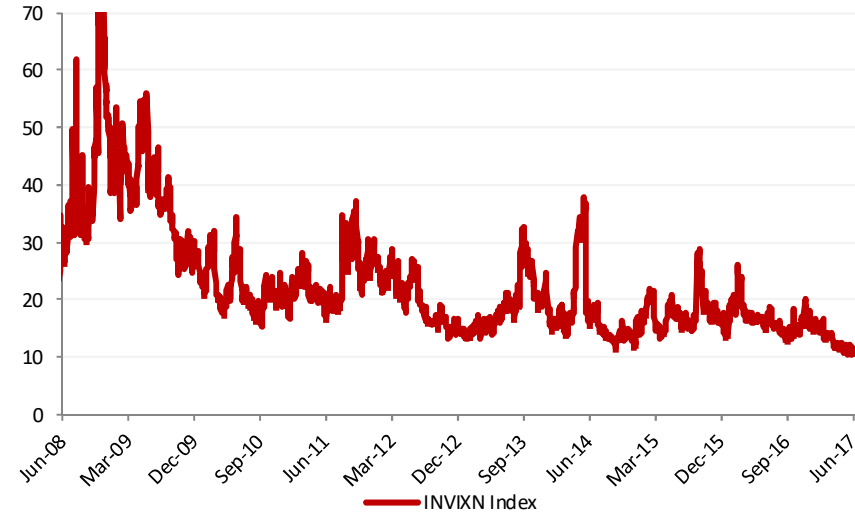


# Indian Equity Market

BSE 500 Index



India VIX



- To capture the Equity portion of the Financial Conditions Index- India, we have taken the following variables:
  - The BSE 500 Index – corresponding to the S&P500 Index in BFCIUS and to ensure we don't limit the equity index only to the large caps
  - The India Vix Index as a measure of volatility in the equity markets

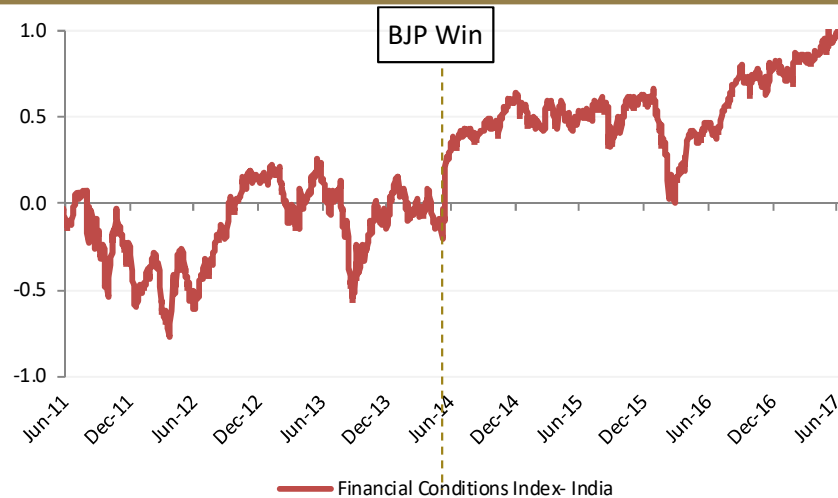
Source: Bloomberg, Trust Research



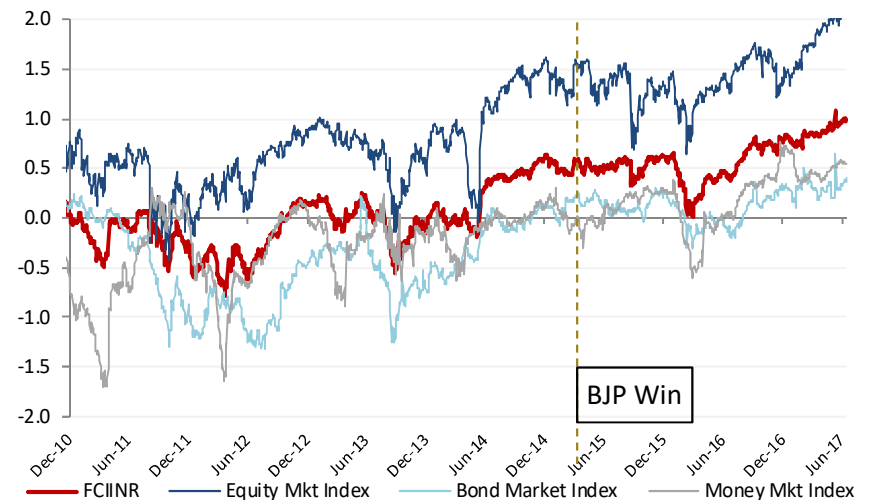


# Financial Conditions Index - India

Financial Conditions Index – India (FCIINR)



Contributions of FCIINR Index Components



- Our Trust India Financial Conditions index has remained consistently positive since the May 2014 BJP win in the general election due to expectations of a more business friendly government.
- The FCIINR briefly declined and hit the Zero level in Feb-2016 as all three index components declined due to increased volatility in the global markets as risk assets sold off. This was consistent with our report at the time where we had predicted greater global volatility. Some of these global concerns have abated while others remain.
- Domestically, since May 2016 the FCIINR has improved significantly as the RBI's started providing sufficient liquidity to the market through its liquidity operations lifting all financial markets. This trend accelerated after the UP assembly election where the markets expectation of the government's ability to carry out reforms grew. Expectations of good monsoon and moderating inflation also contributed to the bond market rally. Currently the FCIINR is at historical highs.
- Going forward, we expect the FCIINR to remain positive given the benign inflation environment, and relatively strong macro fundamentals. However, both domestic and global concerns still remain. Globally geopolitical risks remain high and domestically bank NPAs continue to pose significant challenges for the Indian economy. The FCIINR will be impacted by such events but we expect it to remain positive in calendar year 2017.

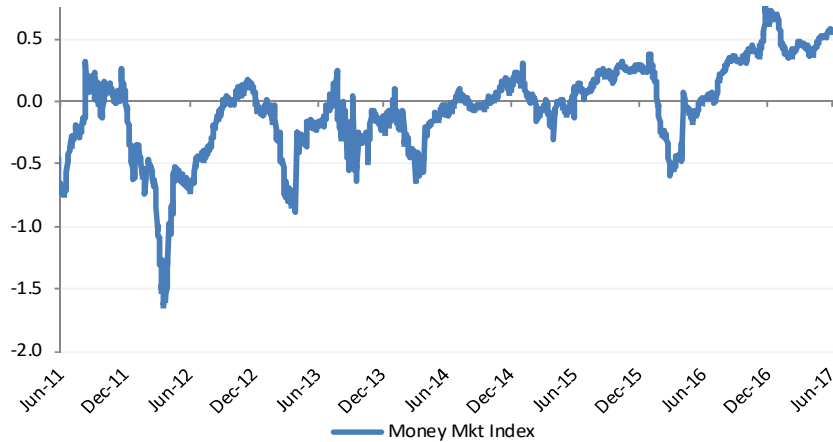


# Appendix

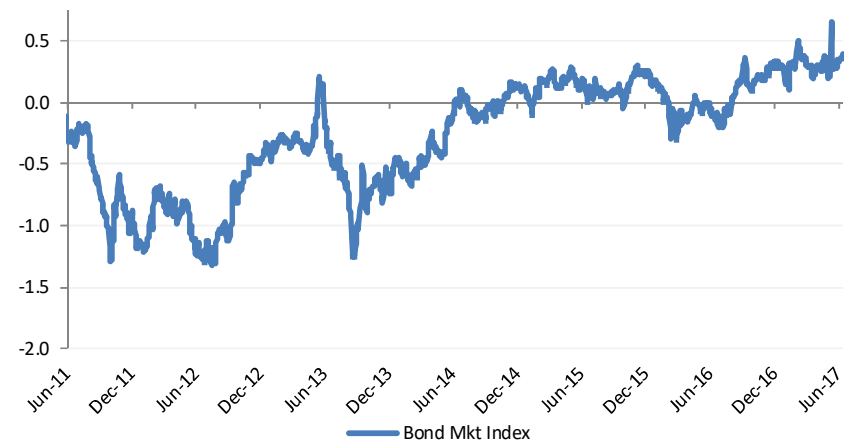


# Financial Conditions Index - India

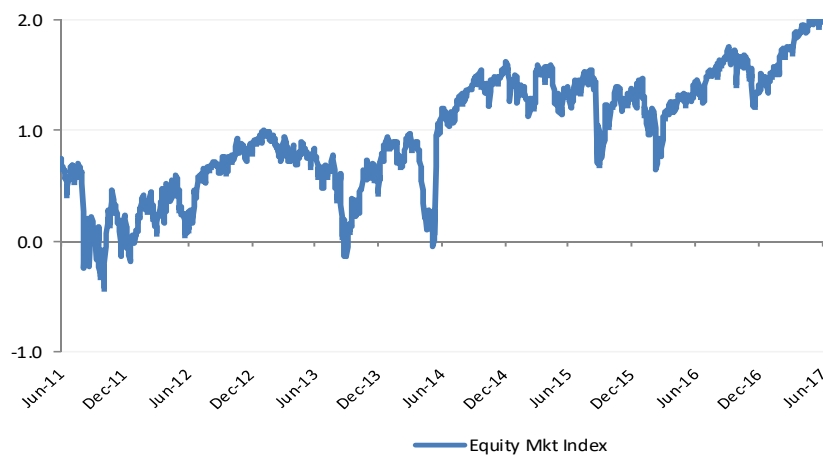
Financial Conditions Index- Money Mkt Component



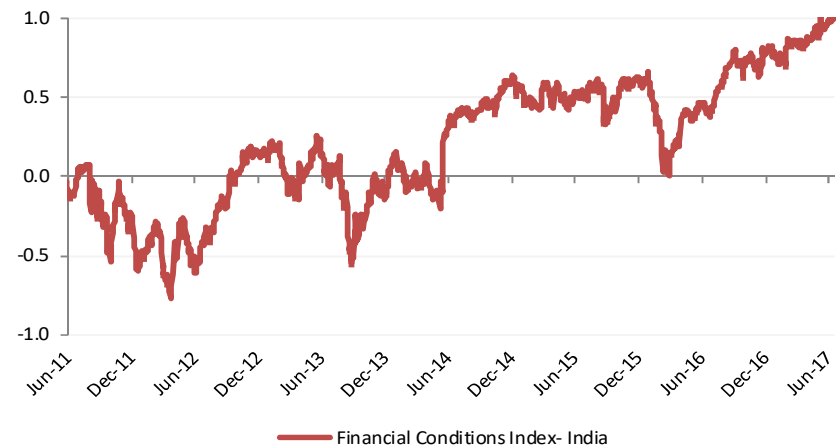
Financial Conditions Index- Bond Mkt Component



Financial Conditions Index- Equity Mkt Component



Financial Conditions Index - India (FCIINR)



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Thank You



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