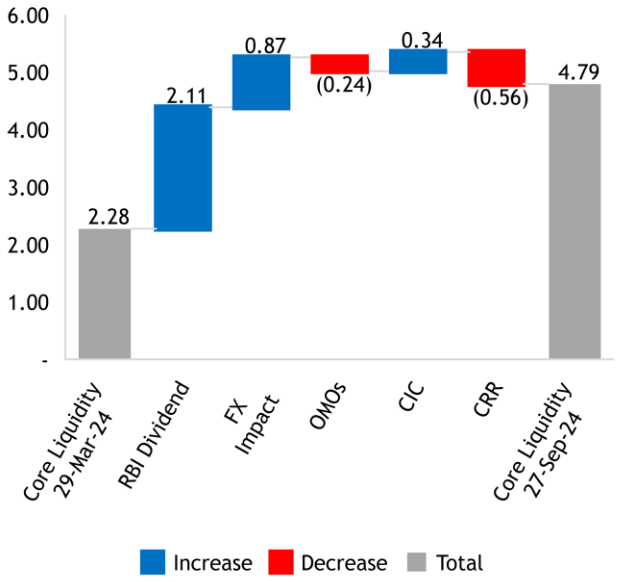
INR Liquidity: Fx outflows make the pathway difficult

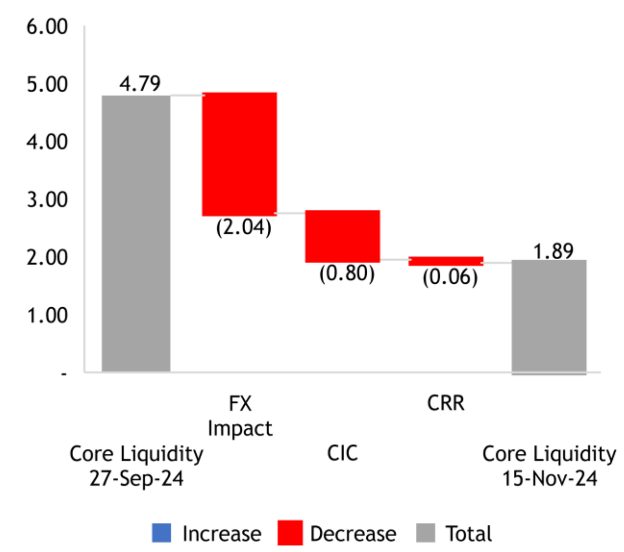
28th Nov 2024

Fig 1: Drivers of Liquidity during H1FY25; (Rs.in lakh crore)



Source: CEIC, RBI, UBI Research

Fig 2: Drivers of Liquidity during Oct-Nov-24; (Rs.in lakh crore)



Source: CEIC, RBI, UBI Research

Banking system liquidity has switched to a deficit this week after staying in surplus for past couple of months. More importantly, while core liquidity stays in surplus of c.Rs 1.9 lakh crore, it is down by close to Rs. 3 lakh crore since end September. The market participants attribute the liquidity withdrawal to GST outflows amounting to Rs.1.6-1.8 lakh crore in conjunction to the impact of Fx outflows totaling more than USD 25bn in last 2 months as per our estimates. In order to support the Systemic Liquidity, last week RBI conducted 3 VRRs (Variable Rate Repo) auctions of Rs.25,000 Crore each and has announced another VRR auction today. Despite this, the WACR (Weighted Average Call Rate) - Repo rate spread has shot up by more than 20bps. Overall, Fx outflows is a key risk to liquidity and short-term rates outlook as the global market volatility may persist in the coming months with Trump joining office on 20th January 2025. We may watch out for liquidity measures like OMOs & buybacks from the Central Bank even a likely sharp pickup in Govt. spending may provide a salutary effect to liquidity.

Background: H1-FY25 liquidity dynamics

- Core System Liquidity at the end of previous Financial Year 2023-24 was at Rs.2.28 lakh crore (as on 29th Mar'24). Advance tax and GST collections were on drain to the liquidity on monthly basis. Post historical date of 28th Jun'24, when Indian Bonds were included in the JPM Bond Index, the liquidity remained in surplus considering positive flows in Indian Bond Market and closed the H1FY25 at a surplus of Rs.4.79 lakh crore.
- RBI dividend bounty of Rs.2.11 lakh crore made the govt. balance jumped to above Rs.5.2 lakh crore in May-24, which came down as govt spending kicked in post elections. The real push in govt expenditure came in after the Budget was presented on 23rd Jul-24 as we closed Q2FY25 c.Rs.3 lakh crore.
- RBI conducted OMO sales of Rs.0.11 lakh crore in Jul-24, Rs.0.08 lakh crore in Aug-24 and Rs.0.06 lakh crore till date, taking the total to Rs.0.24 lakh crore in FY2024-25 till date. Along with OMO sales, RBI conducted VRR and VRRR to keep system liquidity in check.
- The main drivers of liquidity during H1FY25 are:
    - *RBI dividend of Rs.2.11 lakh crore.*
    - *Forex flows impact was positive due to inflows from both equity and bond index inclusion*

As H2FY25 unfolds, liquidity taking a U-turn weighed down by Fx outflows

- Even as system liquidity slipped into deficit for the first time since 25th Sep-24 on build-up of govt. balance and Fx outflows, the Core liquidity slipped sharply to lower levels last seen in mid-April-24.
- The government balance was c.Rs.3.0 lakh crore by the end of Sep-24 and during Oct-Nov, the government has utilized WMA facility of RBI, thereby spending c.4.0 lakh crore in matter of 45 days (available data is up to 15th Nov-24). The slow rate of expenditure up till Sep-24 might have pushed govt to spend more in Q3FY25 and hence utilize WMA facility.
- During Oct-Nov-24, the FPIs have been aggressively selling in Indian equities. In Oct-24, the FPIs have sold Rs.94,017 Crore in equity segment and Rs.3,632 in debt segment. In Nov-24, till date, FPIs sold Rs.12,030 Crore of equities and Rs.3,522 Crore worth of debt securities. These outflows has led USD/INR to depreciate to record highs beyond Rs.84.50/$.
- As per latest data available, the forex reserves have fallen from peak of USD 705 Bn (as of 27th Sep-24) to USD 658 Bn (as of 15th Nov-24). This marks a downfall of USD 47 Bn since Sep-24 and USD 18 Bn in a week's time, as it is likely that Fx reserves were utilized to curtail volatility in USD/INR which in-turn is weighing on the system liquidity.
- The core liquidity as of 15th Nov-24 is surplus of Rs.1.89 lakh crore which has fallen from a surplus of Rs.4.79 lakh crore as of 27th Sep-24. This downfall in liquidity is being linked to GST tax payouts in conjunction to Fx impact due to FPIs outflows. Further, since 15th Nov-24 the FPIs sell off in Indian markets have slowed down, thus stabilizing USD/INR movement.

What if 2022 scenario repeats itself?

- During FY2022-23, the DXY moved up by 16.8% during Apr-22 to Nov-22 whereas the USD/INR has moved up 13.6% in the same period. FPIs outflows in equity & debt market the Fx Reserves had decreased by USD 48 Bn during Apr to Nov 2022. However, in the current context, given sharp spike in global market volatility on Trump trade effects, the concomitant impact of Dollar strength on Rupee has been capped.
- If the market dynamics seen in 2022, when risk sentiment globally came under pressure on Russia-Ukraine war effects, repeat itself this year, we may see further depreciation in Rupee by 2-3% with another round of FX outflows which may bring pressure on liquidity.
- Overall, Fx outflows is a key risk to liquidity and short-term rates outlook as the global market volatility may persist in the coming months with Trump joining office on 20th January 2025.
- In this regard, we may watch out for liquidity measures from the RBI like OMOs & buybacks apart from relying more on forward/futures to defer liquidity impact of steps to limit Fx volatility.
- Meanwhile, Govt balance with RBI may stay a source of support to liquidity as on an annual basis a drawdown from Rs.1.7 lakh crore as of March 2024 to a budgeted Rs.0.4 lakh crore as of March 2025 is expected.

Fig 3: FY 2023 scenario vis-à-vis current FYTD

Particulars	DXY	USD/INR	% Tracked
% Change during Apr-22 to Nov-22	▲16.8% *(High:114.8; Low: 98.3)*	▲13.6% *(High: 83.4; Low: 73.4)*	0.81
% Change during Apr-24 to Nov-24	▲7.9% *(High:108.0; Low: 100.1)*	▲ 2.7% *(High: 84.7; Low: 82.5)*	0.35

Particulars	Fx Reserves (USD Bn)
Change during Apr-22 to Nov-22	(48)
Change during Apr-24 to Nov-24 (till 15th Nov)	+20

Source: Cogencis, NSDL, CEIC, UBI Research

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Fig 4: Govt. Spending in H2 likely to support systemic liquidity unless Fx flows plays spoilsport

Liquidity sub components					Sources of core liquidity					
Rs bn.	Systemic liquidity balance	Govt. balance with RBI	LTRO	Core liquidity	Spot FX intervention	OMO	LTRO	RBI dividend	CIC	CRR deposits
FY19	-992	1,227	-	235	-1,119	2,992	-	499	3,095	316
FY20	3,463	506	1,251	5,220	3,120	1,149	1,251	1,760	2,997	-534
FY21	5,004	2,326	821	8,150	5,105	3,133	-430	571	4,193	1,466
FY22	7,183	354	867	8,404	1,346	2,140	47	991	2,770	1,719
FY23	1,510	-487	732	1,755	-2,173	-350	-135	307	2,429	453
FY24	544	1,722	71	2,337	3,395	-185	-661	874	1,370	871
FYTD (15th Nov)	2,006	(119)	-	1,886	-1,201	-241	-39	2,110	463	617

Source: RBI, CEIC, UBI Research

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