17th Feb 2025

Fig.1: India yield curve movement ; (%)

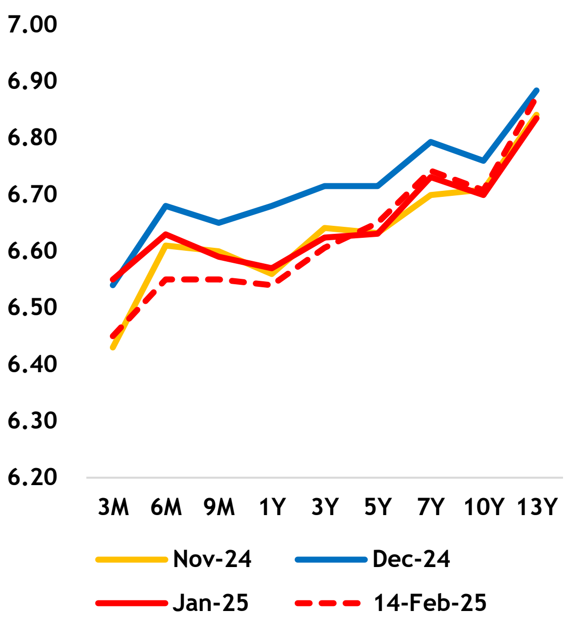
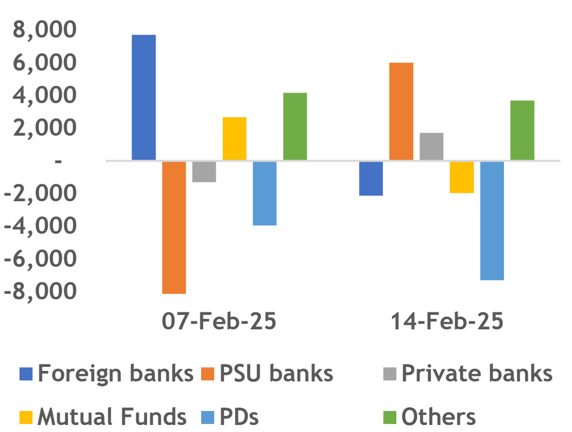


Fig.2: Market Activity turned around as Foreign Banks became sellers and PSU Banks became buyers; (Rs. In Crore)



Source: Bloomberg, UBI Research

US economic data made investors swing between expectation of softening & hardening of rates. An uptick in consumer inflation and a slow down in retail sales has made the Fed policy outlook uncertain. Further, the Dollar index fell to 9 week low as traders raised bets that Fed may cut rates two times this year. Fed minutes are due for release this week. Domestically, in India, the 10-year bond yields has not moved much remaining close to 6.70% post MPC rate cut decision. RBI has executed slew of liquidity measures over last week and doubled up two OMO purchases (from Rs.20,000 Crore to Rs.40,000 Crore), strengthening its commitment made in the MPC to provide sufficient system liquidity.

US Traders bet on Fed policy outlook

- The US dollar ended the week trading on a softer footing and closed 1.21% lower, below the crucial 107.00 level, recording its second consecutive week of losses and fourth week of losses out of the last five. Despite the US inflation data coming hotter than market expectation and markets pulling back rate cut expectation the US dollar failed to maintain its upward momentum. The two triggers for weaker US dollar was Trump delaying the implementation of reciprocal trade tariff and optimism over a potential peace deal for Ukraine and Russia.
- The overheating worries after US CPI did drove the UST yields higher, denting risk sentiment in the process but after US President Trump directed his administration to evaluate reciprocal tariffs, but he stopped short of imposing immediate measures this lead to fall in yields across the curve, where US10Y fell by 9bps but overall the weekly performance remained flat with 0.33% loss.

India CPI print 4.31% for Jan'25 (Refer our report)

- The headline inflation clocked 4.31% in January'25, registering a sharp decline from 5.22% in Dec'24 and close to our projection of 4.20% (please refer our Data preview Jan'25) vis-a-vis consensus estimate of 4.50%. More importantly, Core CPI, in line with our expectations, inched up to 3.66% on back of spurt in gold prices from 3.58% in Dec'24.
- Food inflation in January'25 softened to 5.68% after staying above 7% mark consistently for four months. M/m food inflation was down to -2.43% as against our projection of - 2.51%. This was attributed to sharp slide seen in vegetables CPI which slipped to 11.35% vs 26.56% seen in Dec'24 while on a sequential basis, it was down 15.7% as expected. IMD has predicted below normal rainfall during Feb'25 in the country, especially north India posing an upside risk to the vegetable prices and food inflation.
- Our Feb'25 and March'25 CPI estimates are currently tracking c.4% and Q4-FY25 is also tracking at about same level and is below the MPC's projection of 4.4%. Consequently, we maintain our call of another 25bps repo rate cut in April. Given the heightened global volatility and its impact on macros, we are closely watching for impact of various factors on inflation:
  - rupee depreciation (4% FYTD – 5% Rupee move drives annual inflation up by 35bps),
  - spurt in global metal prices as an aftermath of the tariff hikes by Trump and
  - firming gold prices on inflation.

RBI on tenterhooks to tackle deficit liquidity

- On 27th Jan'25, RBI announced slew of measures as follows:
- VRR Auctions: RBI has been conducting daily VRR since 16th Jan'25 and two long tenor VRR (March crossing) of Rs.1.25 lakh crore (56 day of Rs.50,000 crore and 49 day of Rs.75,000 crore).
- Repo rate cut: MPC has cut 25bps in Feb'25, thereby bringing the overnight rate down to 6.25% from 6.50%
- Foreign Exchange Swap : Fx Buy/Sell Swap of USD 5Bn for a tenor of 6 months executed on 31st Jan'25 where Bids came in at USD 25.59 Bn against the notified amount of USD 5Bn.
- Open Market Operations (OMO) purchases: RBI has conducted OMO purchases totaling Rs.0.99 lakh crore, which includes both screen based of Rs.38,815 Crore and notified amount of Rs.60,020 Crore. An additional Rs.40,000 Crore purchase is scheduled in this week on 20th Feb'25.
- Headline liquidity has got relieved from the peak seen in Jan'25 of Rs.3.1 lakh crore after month end spending, OMO purchases and Fx Swap done by RBI. Indirect impact of USD sales on liquidity offset by doubling OMO purchases amount in two auctions and introduction of 49 day VRR.

Core Liquidity eases – CIC took advantage

- The Forex Reserves have risen by $7.65 Bn from $630.61 Bn (as of 31st Jan'25) to $638.26 Bn (as of 07th Feb'25). This was a week when Rupee saw sharp depreciation with reversal seen in the week ended 14th Feb'25 probably reversal of this fx reserve gain is likely.
- CDs outstanding has hit a new high of Rs.5.19 lakh crore (as of 07th Feb'25). The 3M T-bill and CD spread has reached more than 100 bps mark, we expect this to be capped as RBI continues its liquidity easing measures.
- Since Sep-24 till 07th Feb'25, the fx impact on system liquidity is estimated to be Rs.4.8 lakh crore. Post upward pressure, Rupee has witnessed a sharp appreciation in the previous week biggest weekly rise in 7 months, which can further escalate the system liquidity deficit, as the benefits from RBI's liquidity measures are set off by the seasonal change in CIC.

Fig.3: Drivers of Core Liquidity from Sep-24 to Feb-25; (Rs. In Lakh Crore)

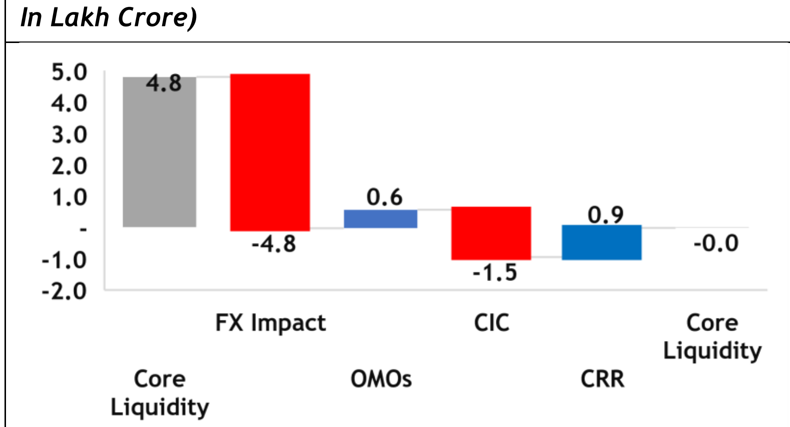
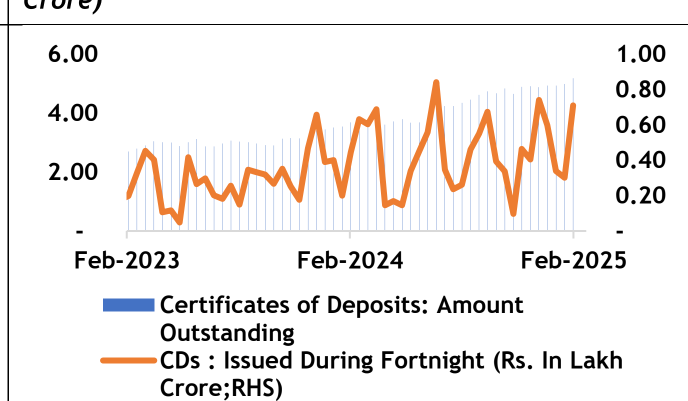


Fig.4: CDs outstanding hit a new high; (Rs. In Lakh Crore)



Source: CEIC, UBI Research

By:
Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Dhiraj Kumar
dhirajkumar@unionbankofindia.bank

Banking Research Team	
Kanika Pasricha **Chief Economic Advisor**	**kanika.pasricha@unionbankofindia.bank**
Suneesh K	suneeshk@unionbankofindia.bank
R Gunaseelan	gunaseelan@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank