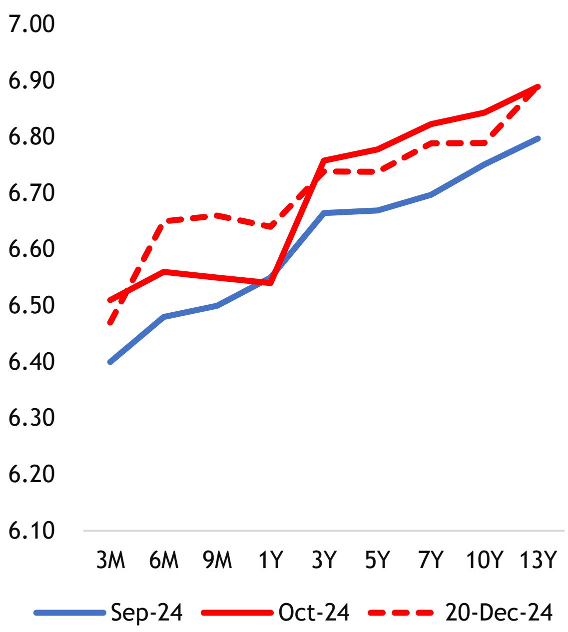
India FI Weekly: Liquidity in deficit despite CRR cut

21st Dec 2024

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



Source: Bloomberg, UBI Research

Liquidity has fallen into deficit in the current week despite CRR cut which became effective from 14th Dec. Also, the WACR (Weighted Average Call Rate) has remained elevated, above 6.50% leaving 06th & 07th Dec'24.The new Governor in its maiden address to media emphasized on being alert and agile to beat new challenges. He also asserted that to ensure growth stability in policy and continuity is very important. Post MPC, the 10 year G-Sec was range bound 6.65%-6.75%, however after Fed's decision on 18th Dec'24 which signaled a measured pace for future rate reductions, the India 10 year broke out of the range to settle at 6.78%. US 10 year also nudged towards 4.60%, its highest since April and up almost 100bps since the Fed's easing cycle began in Sept'24.

US 10 year yield going up despite rate cuts

- The US Central Bank cut rates by 25bps as expected to 4.25-4.50% with one dissent Hammack who favoured no rate cut. The dot plot now indicates only two cuts in 2025 vis-a-vis four cuts in September.
- In the monetary policy statement, the Fed said that the economy continued to expand at a "solid pace," while reaffirming that the job gains have slowed down and the unemployment rate has "moved up" but remained low. Additionally, the central bank noted that inflation has made progress toward the 2% target level, but it is still "somewhat elevated."
- The cautious commentary with respect to inflation trajectory by Powell jolted stocks, drove bond yields and Dollar higher. US 10 year has moved towards 4.60%, its highest since April and up almost 100bps since the Fed's easing cycle began in Sept'24 and settled the week at 4.53%.

India CPI again below six!

- The CPI for the month of Nov'24 slid from 14-month high of 6.21% in Oct'24 and came in at 5.5%, broadly in line with our and consensus estimate of 5.4%. Food inflation eased to 8.2% from 9.7% last month, with a broad-based decline seen across sub-segments except for edible oils. A sharp seasonal drop in vegetable prices gave a much-needed breather to the headline CPI even though a slow down in the rally of gold prices did less to give relief to the Core CPI.
- Consequently, we maintain our call for start of a shallow 50bps rate cut cycle from Feb'25. On balance, we believe, FX pressures along with sustained inflation may limit degrees of freedom for monetary policy easing.
- Further, on the fiscal front market is expecting a lower than target fiscal deficit for FY25 (below 4.9%) and FY26 (below 4.5%) which shall support yields.

Trade Deficit out of the park

- November trade deficit widened to a record high USD 37.84bn versus USD 27.9bn last month led by spike in imports to unforeseen USD 70 bn (27% y/y) while exports were lower at USD 32bn (-5% y/y). Trade deterioration primarily led by gold imports (~175 tonnes) to record deficit of USD 14.4bn. While this may be one off trend, the extent of spike poses upside risk to our FY25 CAD estimate of 0.9% of GDP. Also, wider non oil non gold deficit seen m/m oil deficit narrowed.
- A positive that got eclipsed is the USD 18 Bn of net services surplus which is the peak so far. Despite global volatility, this segment continued to provide cushion to trade deficit with increasing GCC presence in India.

Fx curbing degrees of freedom of MPC

- Currently, the system liquidity has gone into deficit of Rs.1.50 lakh crore due to Advance Tax & GST outflows. A 0.25 bps CRR cut being implemented from 14th Dec'24 had released Rs.0.58 lakh crore to the Banks. However, it merely compensates Fx impact due to which core liquidity has come off by more than Rs.3 lakh crore in the current quarter on account of depreciation of USD/INR.
- Post MPC, Central Bank has conducted VRRs in various tenors of 3 days, 4 days, 7 days & 14 days in order to ease liquidity. Despite these measures, the WACR (Weighted Average Call Rate) has remained above 6.50% during the current week. We believe that more liquidity measures may be announced in order to manage system liquidity.
- The fall in Fx reserves continued in Dec'24 with USD 5.22 Bn fall (till 13th Dec'24) which brought the balance to USD 652.87 Bn as on the week ended 13th Dec'24. The depreciating rupee beyond Rs.85/$ level and its impact on domestic liquidity may curb degrees of freedom of MPC in terms of rate cuts.
- After two months of consistent selling by FPIs in equity, they have turned buyers in December 2024. Till date they have bought Rs.22,582 Crore of equity and Rs.11,201 Crore under debt segment.
- The deficit liquidity in the middle of the month may make the quarter ending task difficult for Banks as the fight for deposit continues. The outstanding CDs is at Rs.4.88 lakh crore with issuance of Rs.0.74 lakh crore during the fortnight ended 13th Dec'24. This issuance shall further balloon as banks may rush to raise funds on account of quarter end requirements.

Fig.2: Call rates remains elevated despite CRR cuts as System Liquidity turned to deficit; (Rs.in lakh crore)

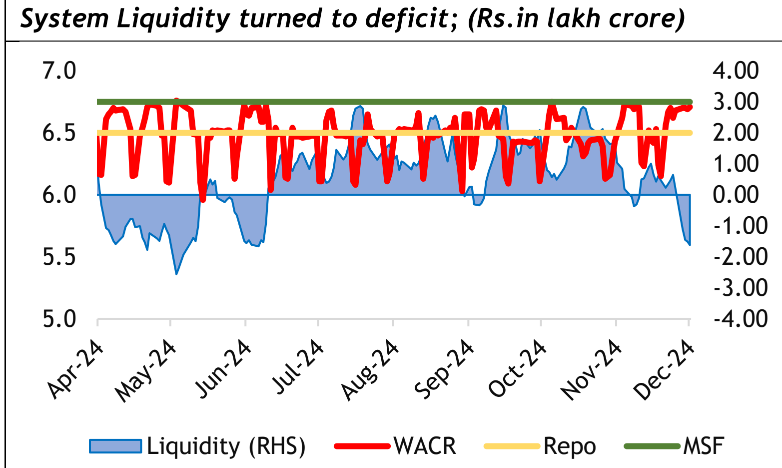
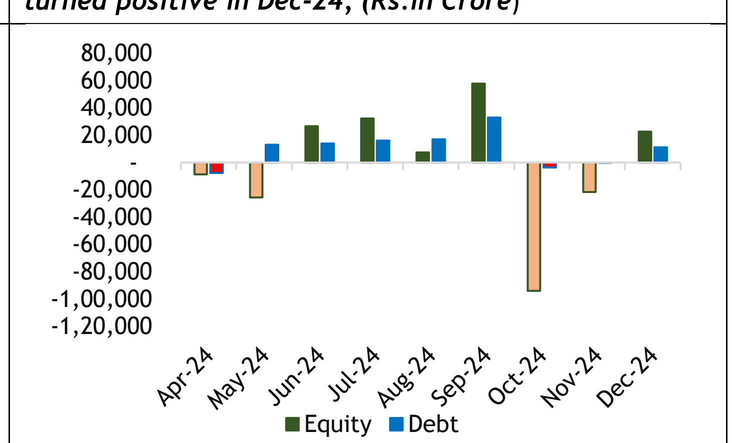


Fig.3: Monthly FPI flows in Equity & Debt Segment turned positive in Dec-24; (Rs.in Crore)



Source: CEIC, NSDL, RBI, 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