India FI Weekly: RBI liquidity measures may potentially switch system into surplus unless Fx outflows spoil the party

06th Mar 2025

Fig.1: Yield curve maintaining steepening bias; (bps)

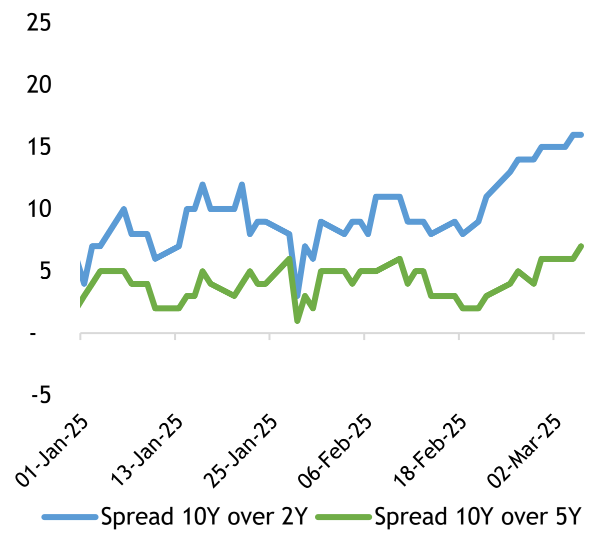
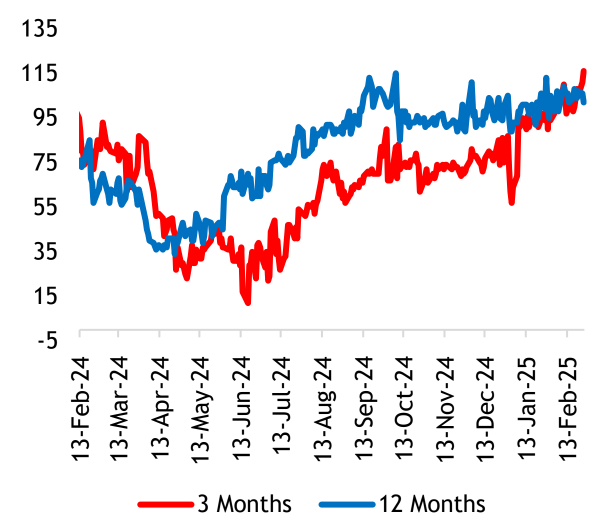


Fig.2: CD-T-Bill spread for 3 months higher vs 12 month; (bps)



Source: CEIC, FBIL, UBI Research

RBI's liquidity announcements worth Rs 1.9 lakh crore on 5th March 2025 were way more than market expectations. While in the near term, overall banking system liquidity may face pressures from seasonal tax outflows (GST, advance tax etc) along with currency leakage, assuming FX related outflows do not play spoilsport, we may potentially see a shift in core liquidity (ex-government balance) towards a strong surplus by end-Mar'25 while system liquidity is also estimated to end the year at neutral to surplus levels. That said, market reaction to the RBI announcements was relatively muted probably on year-end liquidity pressures, rise in SDL supply pressures and given a sharp spike overnight seen in global yields. Nevertheless, recent data suggests growing concerns over slowdown in the US economy on potential impact of trade tariffs which has led 10-year US Treasury yields to slip to 4.31% from 4.80% in mid-Jan when Trump joined office.

RBI liquidity announcements are way more than expectations

- On 5th Mar'25, RBI has announced further liquidity measures for injecting liquidity via OMO purchases worth Rs.1 lakh crore in two equal tranches on 12th & 18th Mar'25. Additionally, USD/INR buy/sell swap auction of $10 billion for a tenure of thirty-six months to be held on March 24, 2025. This shall inject in Rs.1.9 lakh crore of liquidity into the banking system.
- The quantum was way more than market expectations and hence the 10-year bond yield eased by ~3bps to end the session at 6.68%. The reaction was muted probably on overnight jump in global yields and year end profit booking has capped the gains.
- Additionally, the near-term liquidity outlook is likely to stay under pressures on tax outflows (Advance tax, GST etc) along with seasonal CIC (Currency in Circulation) and CRR leakage effects. The funding pressures are visible in 3-month CD-T-Bill spreads which are trading above 12-month CD-T-Bill spread (as of 25th Feb'25 116bps vs 102bps) on financial year end effects and with Rs.1.64 lakh crore of CDs due for maturity during Mar'25.
- Apart from CIC and CRR, the other drains on liquidity are temporary in nature with impact likely to reverse as government backloads spending in the year-end. More importantly, we estimate that the impact of Rs 1.9 lakh crore worth liquidity steps may potentially switch core liquidity into surplus from near neutral levels as of 21st Feb'25 (our detailed calculations in Table 1).
- Interestingly, the outlook for core liquidity may improve further with the RBI likely to provide for a dividend of ~Rs.2.5 lakh crore in May'25. Hence, unless FX outflows spoil the party, we see these measures as adequate in boosting the short-term outlook for "core" liquidity.
- In our view, there is a two-fold intent behind RBI's liquidity surprise: i) to aid transmission of the 25bps rate cut in early Feb'25 which is likely to be repeated in April, in our view with banks still facing credit-deposit growth wedge and not showing any urgency to reduce to deposit rates along with non-repo linked lending rates (MCLR); ii) probably to elongate the maturity profile of the FX forward book (USD 77bn as per latest data for end-Jan'25, with ~60% maturity in less than 3 months) with long-term buy/sell FX swaps.

Ahead of liquidity announcements IGB yields peaked on spike in SDL supply

- The G-Sec supply for FY 2024-25 has ended on 28th Feb'25, it is the ramping up of state bonds supply which dented the sentiments in previous sessions. Market participants were worried of the SDLs supply shooting through the roof likely last year when RBI conducted 2 SDL auctions (including an unscheduled auction) within a week.
- On 04th Mar'25, SDL auction worth Rs.50,500 Crore were conducted whose cut off for 10-year tenor came in at 7.21%-7.34%. The spread between the 10-year benchmark 6.79%, 2034 gilt and the states' 10-year bonds widened to over 50 basis points.
- The 10 year benchmark yield touched 6.75% on 05th Mar'25. Post market hours, RBI announced further measures to inject liquidity via OMOs & Buy/Sell Swap of $10Bn. This led to a gap up opening of government bond prices today, however the overnight rise in global yields (UST & German Bunds) and year end profit booking capped the gains.

Yield curve maintains steepening bias in line with our view

- The Spread of 10 year over 2 year which was around 9bps as on 31st Jan'25, increased to 15bps as on 28th Feb'25. The 2 year G-Sec yield has moved from 6.60% to 6.57% during the month of Feb'25 whereas the 10 year benchmark has moved from 6.69% to 6.72% in the same period, leading to expansion in spreads.
- The lower tenure has softened on the slew of measures taken by RBI during Feb'25 while the demand for higher tenor subsided as we approached closure of G-Sec borrowing calendar and financial year end.

Trump trade tariffs starts to kick in

- US President Donald Trump from 04th Mar'25 has made 25% tariffs effective on goods imported from Canada and Mexico. Trump told that there was "no room left for Mexico or for Canada" to negotiate an alternative to the tariffs, which he has threatened to impose for weeks. He further imposed additional 10% tariffs on Chinese goods.
- A slew of US economic data last week showed some sign of slowdown in US economy thereby softening UST yields on the worries of slow down, falling to 4.15% levels. However, it recovered to 4.25% as fear of trade war kicks in on news of retaliation by Canada, Mexico and China. Further escalation to UST up towards 4.32% in line with European bond yields.

Table 1: Core Liquidity expected to turn around to positive by year end; (Rs. In Lakh Crore)

INR Lakh Crore	Systemic Liquidity Balance	Govt. Balance with RBI	LTRO	Core Liquidity	Spot Fx Intervention	OMOs / Buyback	RBI Dividend	CIC	CRR
FY25 YTD*	-2.09	2.28	-	0.19	-4.59	1.15	2.11	1.40	-0.38
FY 25 Proj.	-0.30 to +0.70	1.20#	-	0.90 to 1.90	-3.00^ to -4.00^	2.15	2.11	2.09	-0.17

**as of 21st Feb'25;*
^adjusted for USD 20bn buy/sell FX swap by RBI;
 # in line with Budget Estimates;
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