India: We see VRRR announcement as a *trend shift*

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BANKING RESEARCH TEAM

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Executive Summary

यूनियन बैंक ऑफ़ इंडिया भारत सरकार का उपक्रम
Union Bank of India A Government of India Undertaking

- *The (surprise) announcement of VRRR* auction by the RBI led to a spike in Tbill cut-off rates by 5-10bps in the auction as compared to previous day. Since 9th June (post 6th Jun MPC decision), 6M & 12M Tbill rates were already up by 15-20bps resulting T-Bill rates to trade above the repo rate (5.50%). Also, funding rates for CDs are also up by a similar quantum, with 1 year CD-Tbill spreads at 75-80bps.*

- *While some market participants expect the impact to be temporary, we see the use of VRRR as a trend shift, with likely use of the liquidity management tool to gradually align WACR** (operating policy target) towards the repo rate even as average systemic liquidity is likely to stay comfortable at ~1% of NDTL*** range in coming months (assuming FX intervention related drag on liquidity, if any, is capped)*

- *WACR has been trending at SDF levels since June MPC, despite the shift in policy stance to neutral. While it is not unusual for the WACR to slip below repo rate in times of surplus of surplus liquidity conditions, the guiding principle of liquidity management framework calls for WACR aligned with repo rate*

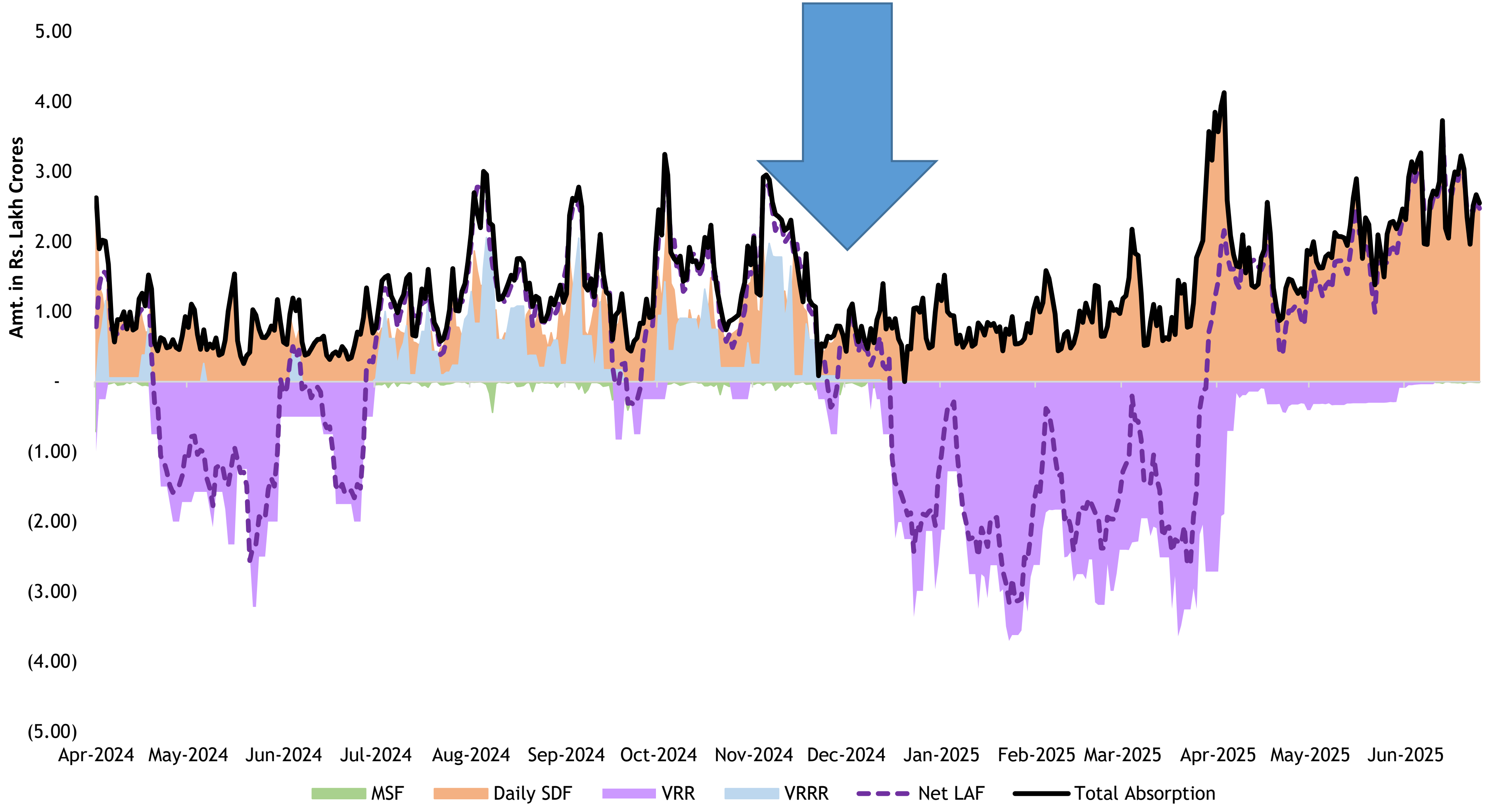
- *We believe that the pace of uptick in WACR is likely to be gradual (given the RBI Governor's views on liquidity & transmission) and contingent of the quantum of VRRR announced & auction cutoffs*

- *In near term, we expect slight flattening of the yield curve primarily led by the shorter end drifting higher. This accounts for our baseline view of no further repo rate changes amid geopolitical & monsoon uncertainty, even as we acknowledge an outside chance of 25-50bps rate cut in H2-FY26 if inflation trends way below the MPC's 3.7% projection for FY26.*

**VRRR: Variable rate reverse repo; **WACR: Weighted avg call rate; ***NDTL: Net Demand & Time Liabilities (o/s of ~Rs 250 lakh cr for banking system)*

VRRR announced after a gap of ~7 months, despite liquidity switching to surplus since April

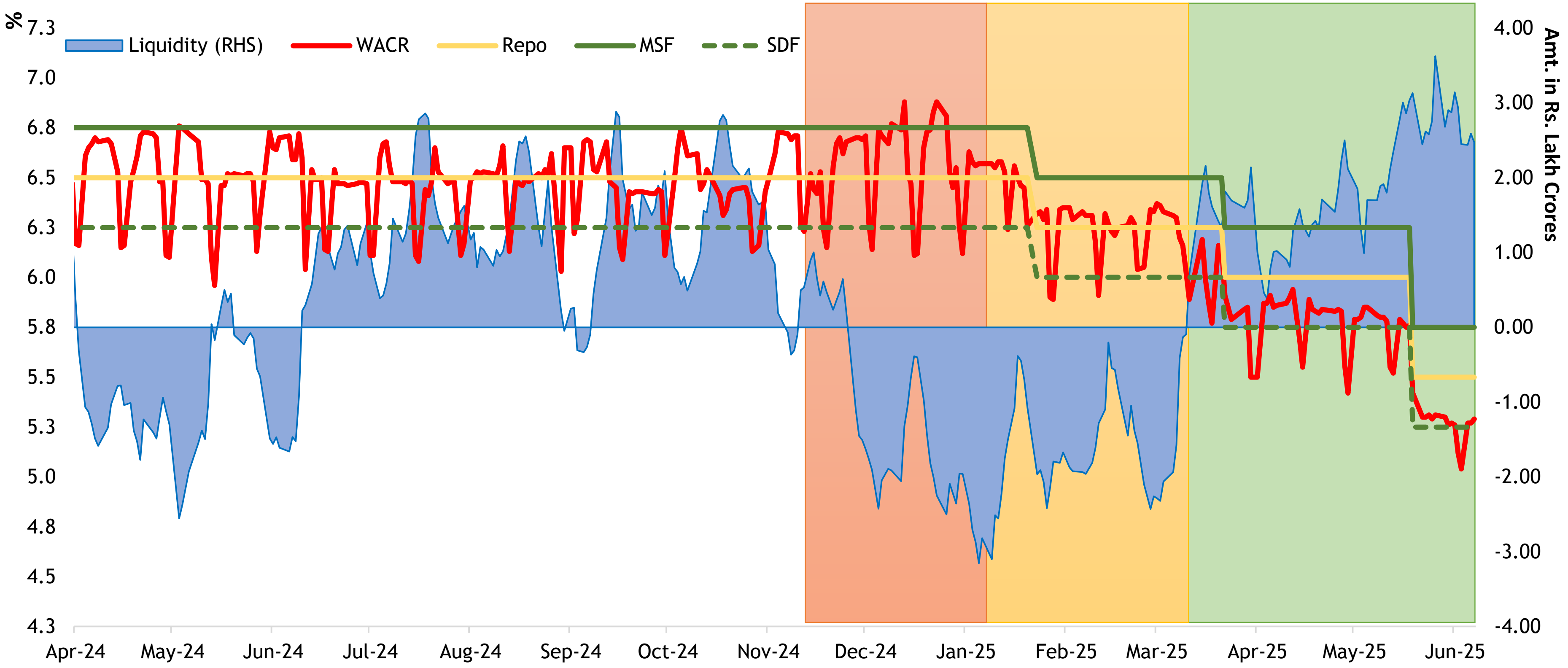
VRRR has been announced for auction on 27th Jun 2025 for the first time since Nov-2024

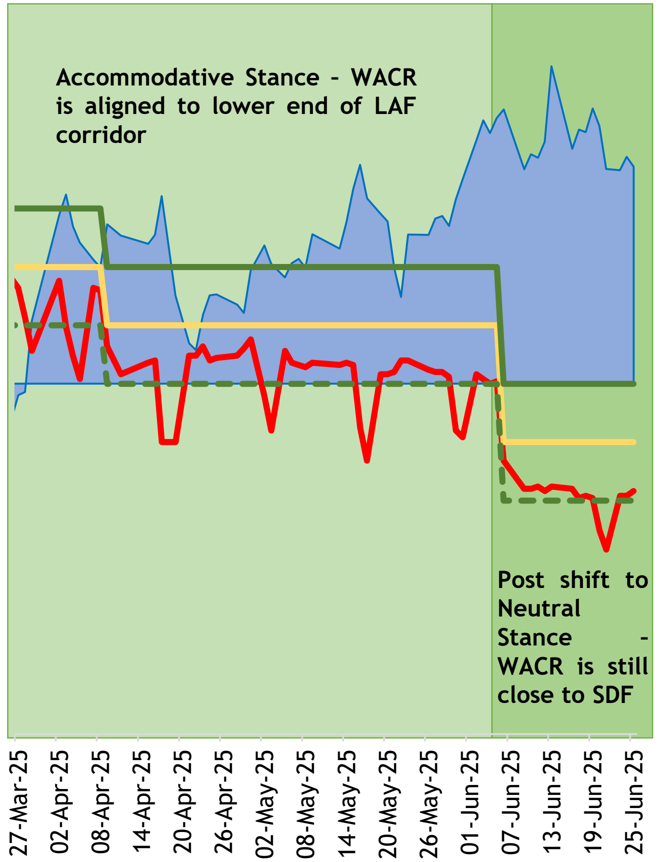


Avg. systemic liquidity in Jun'25 clocked surplus of Rs. 2.76 lakh cr, while banks parked Rs. 2.71 lakh cr in SDF, as VRRRs were not used for liquidity management. This justifies a strong participation in VRRR auction(s) given cut-off are usually closer to repo rate.

Source : RBI & UBI research

Call rate slipped to lower end of the policy corridor due to liquidity flush & VRRR(s) may push for gradual alignment with the repo rate

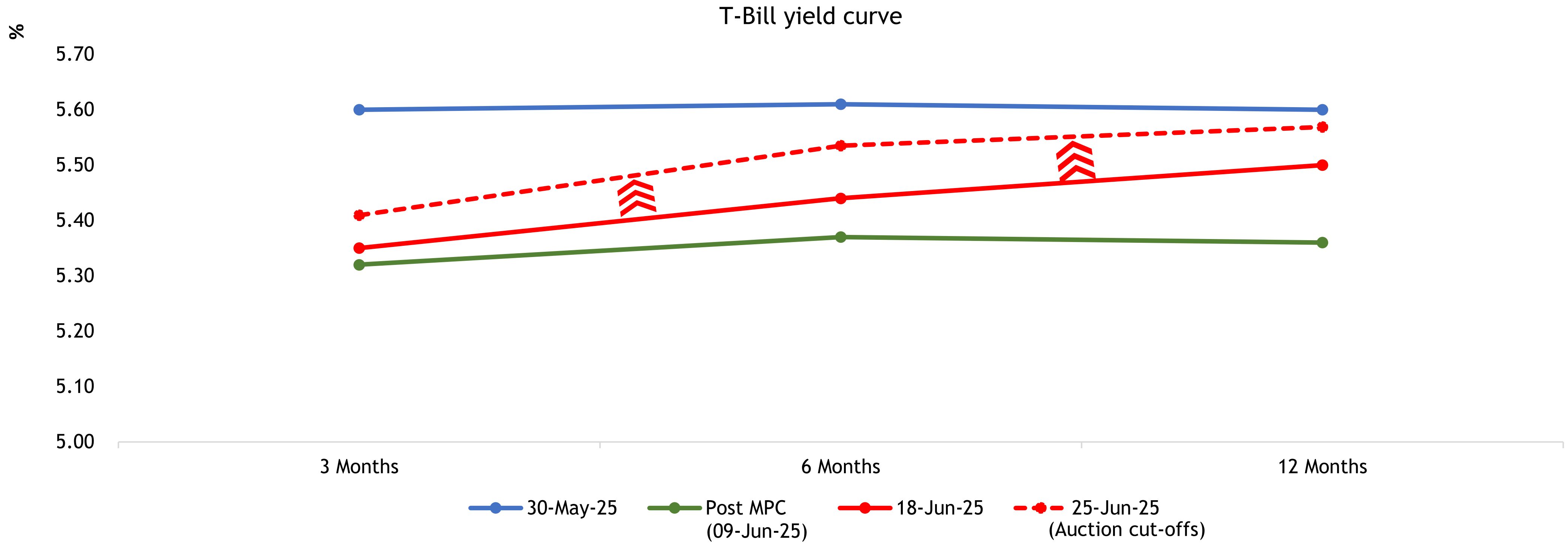




- WACR* was upper bound of LAF corridor in times of liquidity deficit (Dec 2024)
- WACR* was aligned to Repo Rate during Jan to Mar 2025 as Central Bank injected liquidity through various measures
- WACR* was lower bound of LAF corridor in times of liquidity surplus (Apr to Jun 2025)

*WACR: Weighted avg call rate;
Source : RBI & UBI research

Immediate impact of 5-10bps reflected in T-Bill auction cut-offs post VRRR announcement



- T-Bill curve which was on downward drift since the start of CY2025 due to surplus liquidity conditions & downward movement in call rate towards the SDF levels
- However, with the VRRR announcement, threshold shift has been witnessed in the T-bill yield curve yesterday

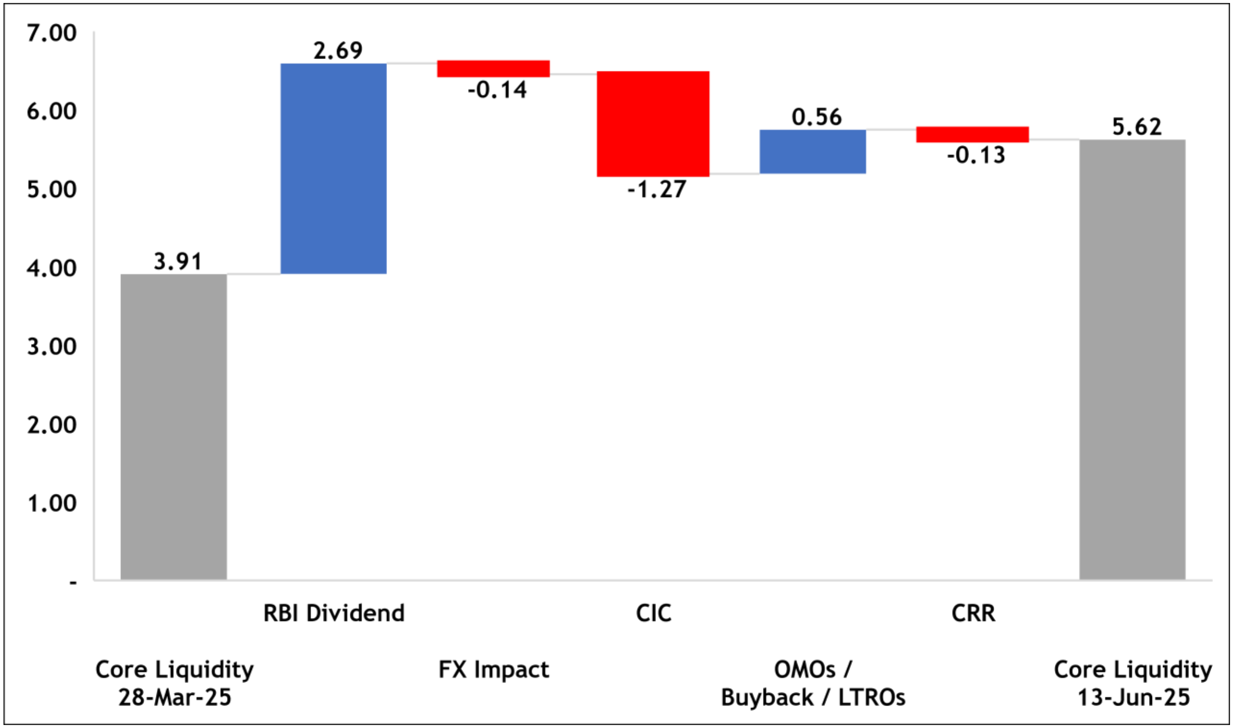
Source : RBI, FBIL & UBI research

Liquidity surplus (system & core) saw a sharp jump since start of FY26 led by OMOs, buybacks & RBI dividend

Annual trends in banking system liquidity (headline & core)

INR Lakh Crore	Systemic Liquidity Balance	Govt. Balance with RBI	LTRO	Core Liquidity	Spot Fx Intervention	LT Swap (USD/INR)	OMOs / Buyback	LTROs	RBI Dividend	CIC	CRR
FY24	0.54	1.72	0.07	2.34	3.40		-0.19	-0.66	0.87	1.33	1.28
FY25	0.11	1.96	1.83	3.91	-5.19	2.18	2.59	1.76	2.11	2.09	-0.21
FY26 YTD *(as of 13th June)*	3.60	2.01	-	5.62	-2.39	2.18	2.39	-1.83	2.69	1.27	0.13

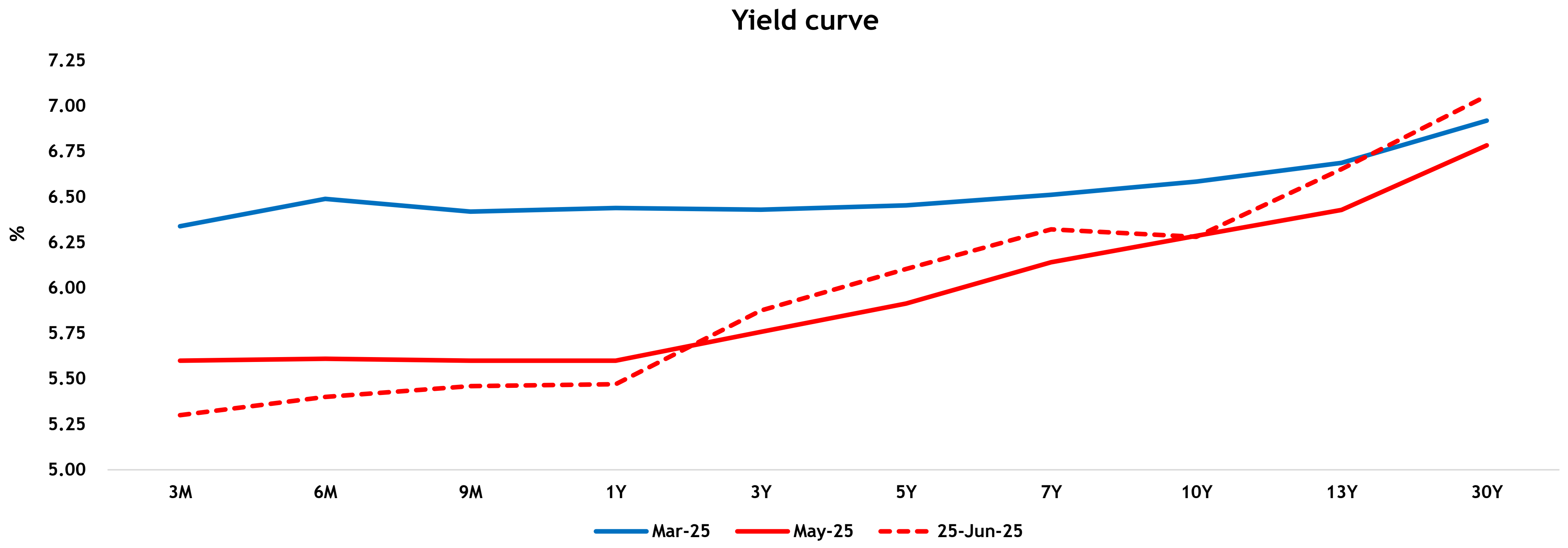
Drivers of Core Liquidity during FY26



- Since the start of Apr'25, banking system liquidity has switched to a strong surplus exceeding 1% of NDTL*
- RBI must be complimented for playing a significant role in boosting liquidity by ~Rs 11 lakh cr via OMOs, FX swaps, CRR cut since Dec'24 with ~Rs 2.5 lakh cr expected since Sep'25 on 100bps CRR cut.
- On balance, we see liquidity dynamics staying in comfortable surplus for the banking system in the coming months. However, we watchful on two counts:
  - *Drags, if any, from FX interventions amid persistent global volatility, forward maturities etc*
  - *Quantum of VRRRs used for liquidity management*

**NDTL: Net Demand & Time Liabilities (o/s of ~Rs 250 lakh cr for banking system); Source: RBI, UBI Research*

Slight flattening likely in the yield curve in the near term

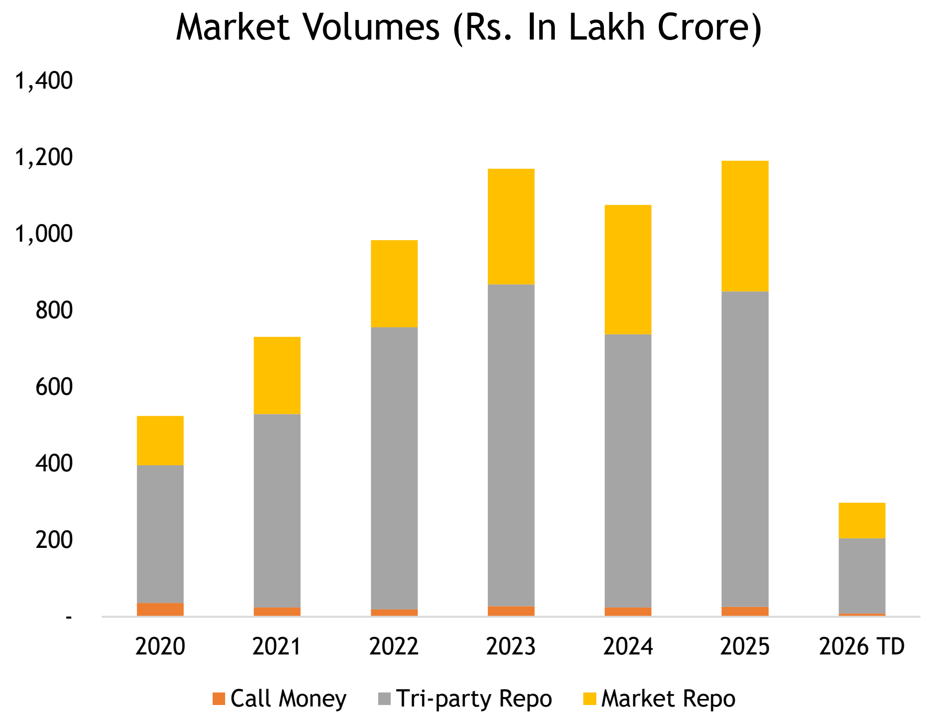


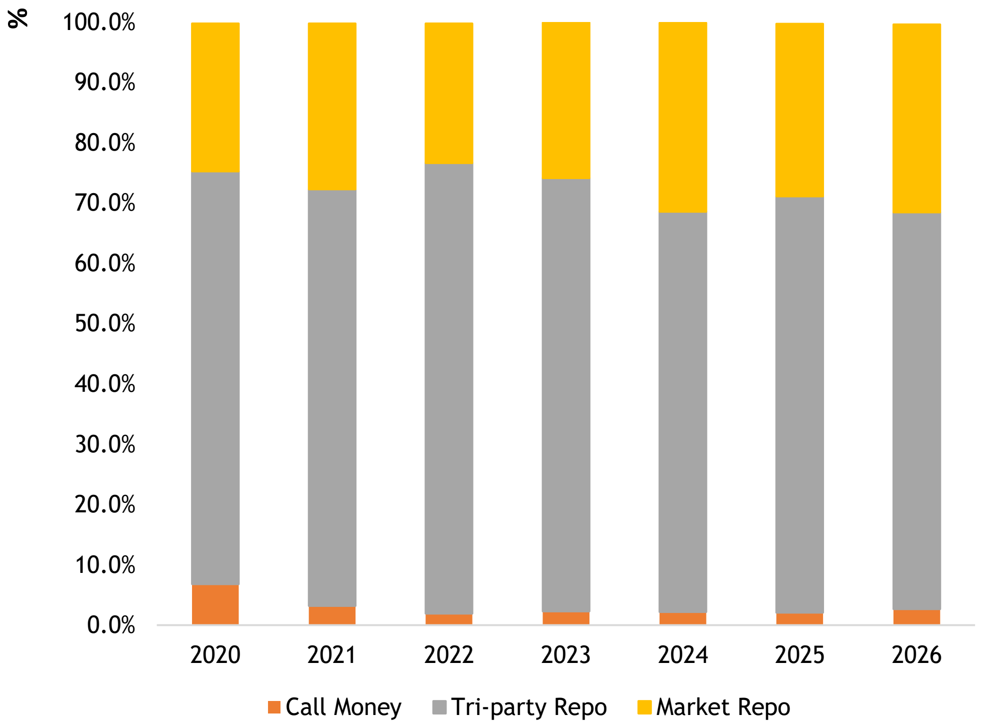
- While the curve usually steepens at the end of the rate easing cycle(s), the recent trends reflect that (adequate) steepening has been clocked in the curve
- However, as the RBI likely implements liquidity management steps to align call rate with repo rate, we expect slight flattening of the yield curve primarily led by the shorter end drifting higher

Source : Bloomberg & UBI research

Elongating Call Money timings may help increase market volumes

The volumes in Tri-party Repo (TREPs) has surpassed the WACR by a wide margin





- **RBI has decided to extend market timings in overnight segment:**
  - ***Call money market shall now operate from 9:00 AM to 7:00 PM (vs 5:00 PM currently) with effect from July 01, 2025***
  - ***Market repo and TREPs shall now operate from 4:00 PM (vs current timing till 2:30 PM & 3:00 PM respectively) with effect from August 01, 2025***

- **Volumes in call money market remain dismal at ~3% of overnight money market, thereby raining questions regarding the utility of WACR as the operating policy target. In this regard, elongating market hours is probably an attempt to improve call money market volumes.**

Source : RBI & UBI research

Thank You !

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