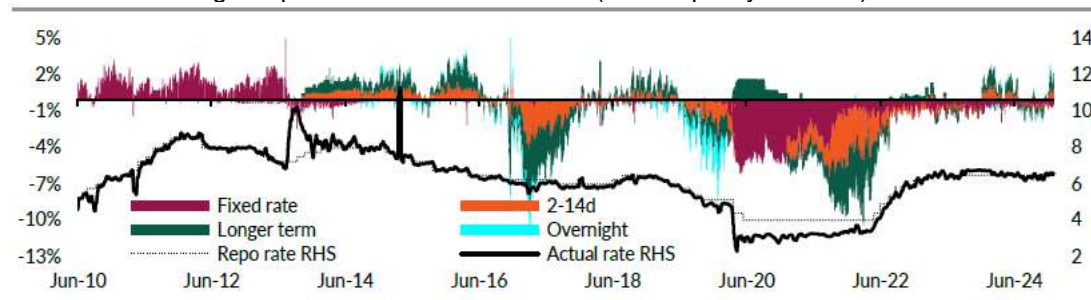


## Liquidity and Banking

### Overnight repo regime does not address durable liquidity

Liquidity conditions have remained stable in the past week, though durable liquidity turned negative for the first time since 2019. Even if global FX markets reverse and allow RBI to intervene on the buy side, the large portfolio of shorts keep a steady drain on liquidity and deposits. We continue to expect a combination of OMO purchases and long-term b/s swaps to boost durable liquidity, with the latter also directly boosting deposits. Return of overnight repo will likely alleviate overnight rate concerns, but keep the rest of the money-market tight – perhaps by design given inflation and INR concerns.

Exhibit 1 - Overnight repos last used before 2014 (LHS: liquidity %NDTL)



Source: Axis Bank Economic Research.

### **Liquidity remains tight ahead of GST payments, durable liquidity negative**

India liquidity conditions remained tight in the current week, ahead of GST collections – with the deficit above Rs. 2 tn for the second consecutive week. The tightening has been driven by durable liquidity having turned negative (for the first time since 2019) in the 10 Jan week, driven largely by FX intervention, that since 4 Oct has drained around Rs. 5 tn and since the Dec MPC meet, has drained around Rs. 1.7 tn from the system. With this, RBI has increasingly turned to VRR as a means to inject liquidity, with total outstanding of Rs. 2.75 tn. This has allowed overnight rates to stabilise around the repo rate for now.

### **Expecting durable liquidity support from OMOs, FX swaps in addition to VRR**

Current market conditions continue to lay stress on the INR, with the USD finding support ahead of the inauguration of US president Trump despite softer US inflation prints and indication of more gradual application of tariffs. Even if some reversal in this is seen, the portfolio of RBI forwards indicates heavy outflows over the next 1 year, draining both liquidity and deposits. Against this, we continue to expect some support from the RBI in terms of long-term buy/sell swaps as well as OMO purchases) – notably, the latter will also directly boost deposits while the former adds to durable liquidity.

### **RBI brings back overnight repo regime, transmission to other MM rates?**

Overnight VRR/VRRR auctions were a staple of RBI liquidity management in 2017 and 2019, given limited take-up in longer-term facilities. These tools helped keep overnight rates around the repo rate, regardless of actual liquidity (which was reflected in other money market rates as the speed of transmission. Daily overnight VRR will likely mimic the pre-2014 period, where the fixed rate repo provided funds overnight, though the rest of the curve evolved with liquidity. With expectations of conditions remaining tight, even with stable overnight rates, transmission to other money markets might be impaired.

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