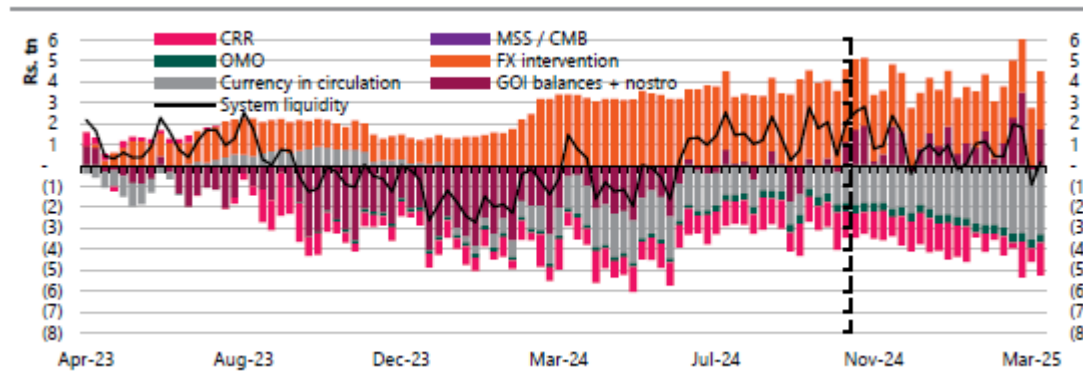


## FX intervention a potential risk to baseline easy liquidity view

India liquidity conditions eased in the past two weeks on heavy pent-up GOI spending as well as maturity of paper, offset partly by mild demand for currency notes and FX intervention. As in the past, RBI's asymmetric FX intervention and drawdown of GOI balances (now the lowest since Apr) have supported deposit growth as well. However, there are practical limits to sterilized RBI FX defence, bringing in risks of supply of the USD over time impinging on both liquidity and deposit growth once again. Our base case remains conditions remaining comfortable for the rest of the year.

### Exhibit: Cumulative liquidity flows starting Apr'23, with projections



Source: Axis Bank Business and Economic Research

### India liquidity conditions ease on pent-up government spending

India liquidity conditions have eased in the current week to a surplus of above Rs. 2.5 tn, in line with heavy pent-up government spending and maturity of G-sec paper – with limited demand for currency notes in the festive period and continued defence of the INR being offsetting factors. Spending and maturities in the period led GOI balances held with the RBI to come to the lowest since April this year, with further declines likely in the coming week.

### FX-related risks emerging to view of comfortable liquidity ahead

As with previous editions of this note, we continue to expect liquidity to remain comfortable through the rest of the year, with pent-up government spending and limited demand for currency notes. However, risks to the projections are beginning to emerge from the FX side, with there being practical limits to the RBI intervening to defend the INR in a fully sterilised way. Maturity of shorts, or unsterilized defence can lead liquidity to dry up – a look at intervention over the past year shows a steady pattern of depreciation though this has been prevented by RBI intervention. While amounts are still smaller than the liquidity surplus, developments are watched ahead.

### Deposit growth supported by official sector amid weakening credit

As in past notes, we see the incremental contribution to M3 growth of the official sector (RBI+GOI) remaining high, with accretion to FX reserves not being sterilised but defence being pushed forward, and with drawdown of government balances. This has led to deposit growth crossing credit growth last month, and has led to easing bank finance conditions seen in CD/OIS spreads. However, FX-related risks could also impinge on these developments negatively, and the state of FX intervention and volatility allowed by the RBI will need to be closely monitored.

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