SBI Research

Dismantling Communication & Signalling Barriers

Premature evaluation of information emanating from MPC by broader markets through myriad pseudo barriers can create structural imbalances in the ecosystem, fuelled by exogenous volatilities… Governor’s Public message clearly demystifies the evolving growth-inflation-stance troika

Issue # 10, FY26 17-June-2025

Executive Summary….

- The aftermath of the recent RBI MPC actions sparked a rally in yields of longer tenor papers, while the shorter ends softened (A Bull Steepening indicating an economic resurgence!!) while misconceptions on liquidity trajectory, coupled with asymmetrical developments within the LAF framework necessitated clearing of air

- The RBI Governor has today taken pains to assuage the frayed nerves of the debt markets by clarifying that the change in stance is a dynamic and evolving process, more attuned to the middle point of immediate present and imminent future in a world besieged with VUCA / BANI (and not a forward guidance for the time being!) which should have a sobering effect on longer tenor yields that had vaulted in an auto pilot mode as the broader markets (sans a minority) had not been bracing for the steep cut from the RBI

- Importantly, Both FDI and FII are expected to embrace revival given the softening interest rate trajectory across DMs (the Fed can front load some of the interest rate cuts in August meet) while progress on trade & tariff talks between important stakeholders means lesser confidence logjams, and lower volatility for asset classes, reinvigorating a risk-on mentality

- The present composition / mix of G-Sec basis evolving trends may necessitate some fine tuning, in our understanding….There is however a dichotomy…For example, issuing more papers at shorter end can frontload redemptions in the medium run for a galloping economy, also this could caste some doubt on Government debt profile

Executive Summary….

- The hardening of yield curve across select tenors, evident through reversion of otherwise southwards oriented yield as pivot became evident in policy rates and inflationary expectations fell substantially, appears more of a short-term knee jerk reaction **as markets arguably failed to anticipate the intent and resolve of the regulator 'to do whatever it takes' to front load growth, with faster transmission of rate cuts expected to be anchored by the surplus liquidity even as the RBI takes a pause for now**

- Frictions within LMF/LAF require to act immediately towards replacing the WACR, long detached from the ground realities and remaining agnostic to the myriad developments, **clearly at odds with the goal of liquidity management. Introducing SORR must be an urgent priority thus….**

- The Governor's emphasis upon maintaining pro-growth levels of durable liquidity, signaling the willingness for embracing long-term, structural changes should clear the air on rumors of liquidity drying up going forward, fanned by select quarters… In particular, the reassurance on durable liquidity should be taken positively by the banking system as the CRR cut and reversal in demand through consumptions revival post a good monsoon augurs well for the sector to come out of the slack.. **CRR cut will free-up lendable resources which should get headroom equivalent to 1.4-1.5% of additional credit growth**

- Compared to evenly dispersed G-sec issuances, SDLs issuances In longer tenors (>10Y) has spiked off late, showcasing states' willingness to front load growth, while pushing back near immediate redemptions

CRR: The Many faces of a monetary policy tool

- The Governor has rightly asserted that the CRR remains a potent tool of monetary policy to manager durable liquidity, while also effortlessly transitioning into a liquidity buffering tool through a multiplier effect expected to unfold before the festivities season kicks in and credit demand revs up from all quarters

- We quote from the SBI Research pre policy report dt Feb 04' 2025 (Prelude to MPC Meeting: February 5-7, 2025)

  "*The RBI could look into using CRR more as a regulatory intervention tool / countercyclical liquidity buffer rather than as a liquidity tool in future. There is an urgent need to revisit the existing liquidity management framework (LMF) by RBI by replacing the WACR as a policy rate as it does not serve the intended purpose….* "

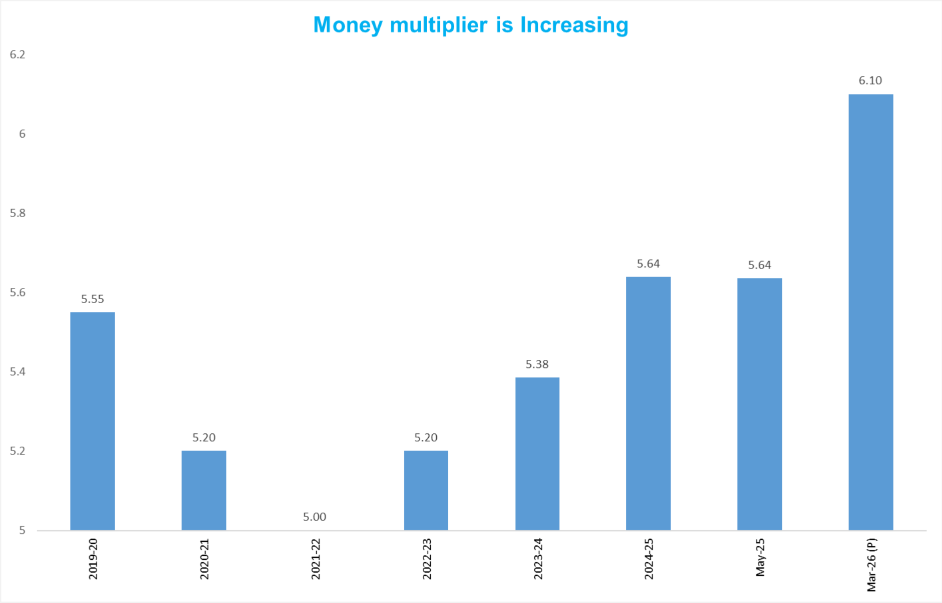
- **Reading in sync with SBI Research report dt January 20' 2025 wherein sweeping changes in LMF were suggested** *(In principle, liquidity management per se still has some operational challenges like improving the market microstructure, a proper indicator of liquidity tightness in the system and most importantly maintaining a delicate balance between effective mix of durable and transient liquidity injection / withdrawal….Amend Liquidity Management Framework to replace Weighted Average Call Rate /WACR with Secured Overnight Rupee Rate/SORR… Considering inclusion of a certain portion of CRR /countercyclical Liquidity Buffer towards HQLA as a countercyclical measure to help improve liquidity… and, need to continuously develop the term money market to provide sufficient liquidity beyond the overnight time slot***)**

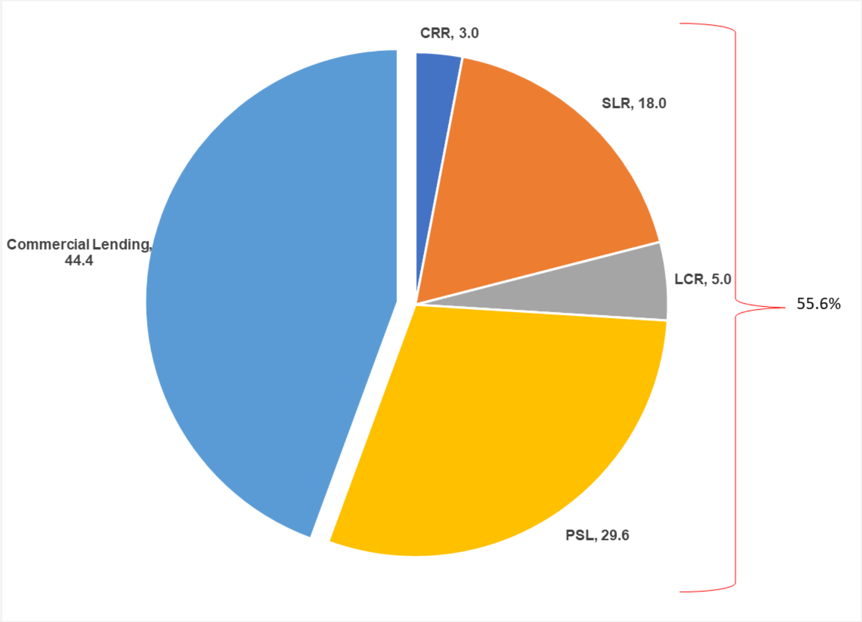
- While the fresh cut in CRR augurs well on liquidity front, and gives a quick respite to banking sector through additional deployable resources, **we reiterate that CRR no longer remains a liquidity management tool primarily, but is truly evolving into a regulatory intervention tool / countercyclical liquidity buffer tool that increasingly acts as the enabling guardrail of banks' optimizing returns on resources, as also assets as they endeavor to protect the NIM**…also, RBI's series of Fx swaps to stabilize the rupee amidst global upheavals in off late could meet the maturity profile smoothly without disturbing the liquidity conditions

- **The move to cut CRR thus signals a pivot to the better synchronization of overnight as also term money market rates with policy rates given WACR has increasingly been detached from the realities of broader markets (TREPS, CBLO), paving the immediate need to move towards the SORR based regime**

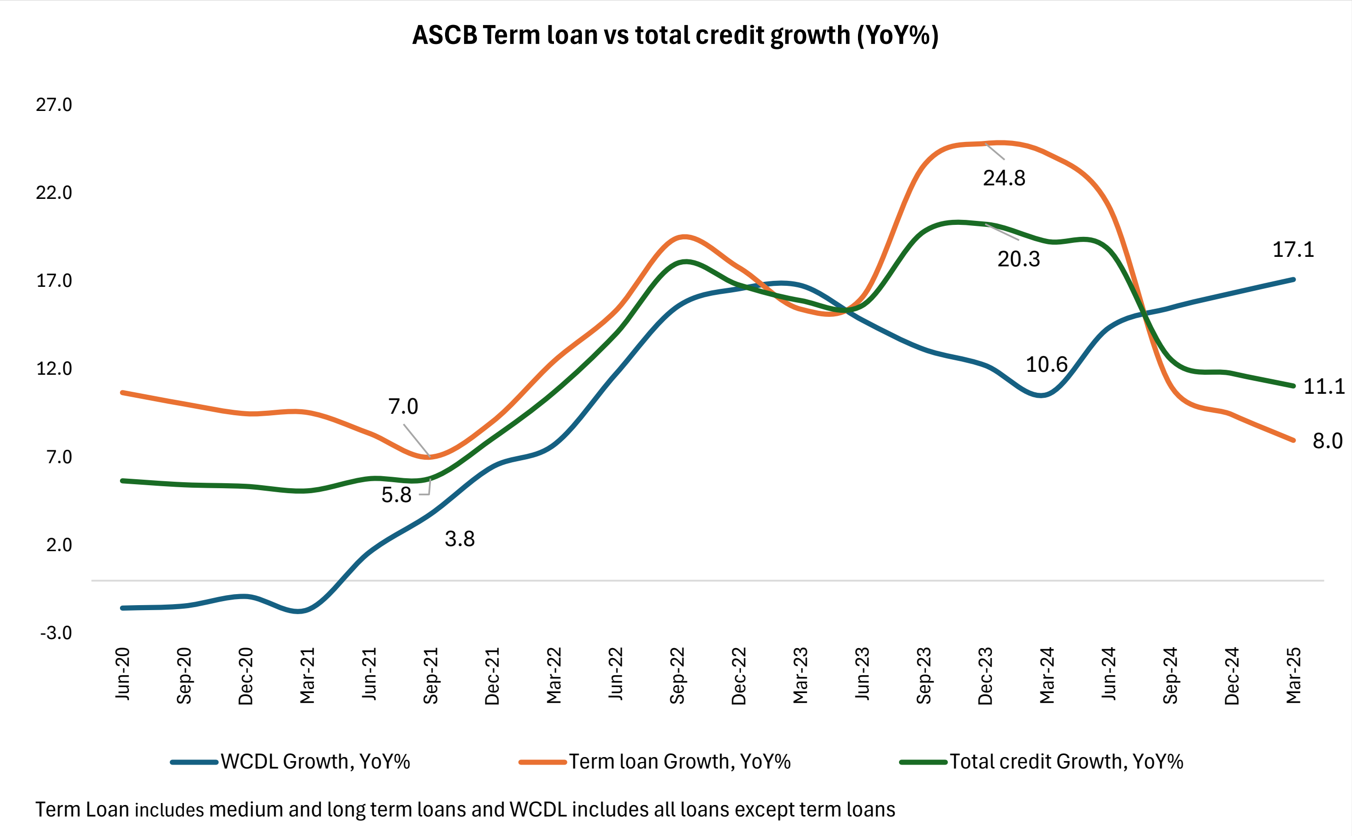
Impact of CRR on Credit Growth

- The cut in CRR would release primary liquidity of about ₹2.5 lakh crore to the banking system by December 2025. Besides providing durable liquidity, it will reduce the cost of funding of the banks, thereby helping in monetary policy transmission to the credit market.
- The reduction in CRR may not mathematically translate to any change in deposits and lending rates, however, it may have positive impact on margins (3-5 bps on NIM) of the banks
- The CRR cut will reduce the M0, so, the money multiplier may cross ~6% by March 2026
- **CRR cut will free-up lendable resources which will get headroom equivalent to 1.4-1.5% of additional credit growth**





The focus on growth in RBI policy was justified…Working capital growth has cushioned credit growth fall to single digit



- Investment announcements increased to more than Rs 50 trillion in FY25 (from Rs 38 trillion in FY24) supported by both Government as well as Private participation. However, execution appears to be timid as reflected in single digit growth of ~9% in term loans as compared to ~ 11.1% growth in overall ASCB credit at the end of March’25 vis-à-vis ~25% and ~20% growth respectively a year ago

- Present growth is mainly on account of growth in working capital loans which grew by around 17.1% in March’25 vis a vis around 10% a year ago

Monetary Policy Tools and Liquidity Management Framework

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- The asymmetrical nature of the LAF, within a rate easing cycle, and surplus liquidity has meant the operating target of the monetary policy sliding to the lower end of the corridor.

- The situation, while not being totally unusual, warrants immediate corrective measures lest the situation is exploited by a few wherein borrowing costs have an implicit arbitrage for some, inciting parking gains

- The first, and foremost goal should be to replace the WACR at the earliest, long detached from the ground realities and remaining agnostic to the developments, **clearly at odds with the goal of liquidity management**

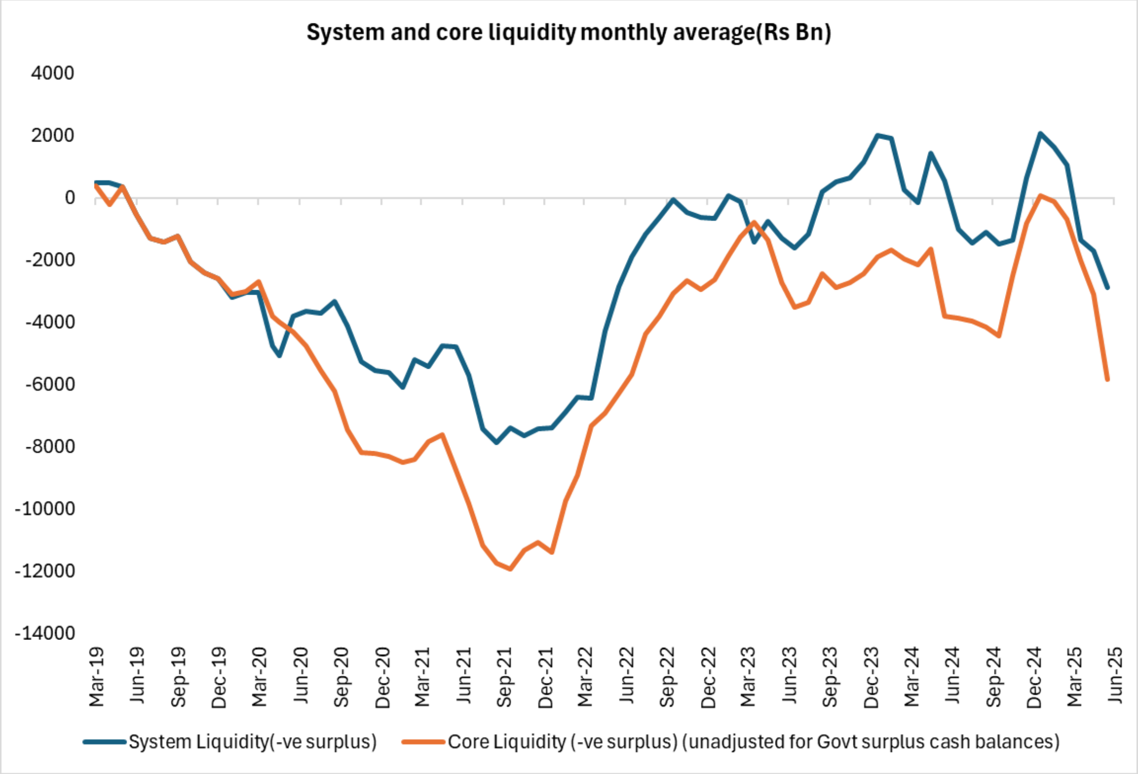
- **SORR therefore is a true indicator of the overnight market rate and the liquidity situation. We believe, once SORR is introduced, RBI will frontload the LMF to replace WACR with SORR as the operating target and many structural frictions in the ecosystem should dissipate soon**

- Introducing tools like VRRR (stopped since Dec'24), even as SDF parking has been quite high would need a glide path and term structure, keeping in mind variables like INR volatility management (maturing SWAPs), growth momentum (credit demand) and OMOs trajectory

VRRR and SDF position (Rs lakh cr)				
Month	VRRR auctions (Monthly Sum)		SDF (monthly average)	Net LAF (Monthly Average,-ve surplus))
	Regular including overnight	14 days		
Jan-24	-	-	0.4	2.0
Feb-24	1.6	-	0.7	1.9
Mar-24	2.6	0.3	1.0	0.2
Apr-24	2.2	0.1	1.0	-0.2
May-24	0.3	-	0.8	1.4
Jun-24	0.4	-	0.6	0.6
Jul-24	4.4	0.1	0.7	-1.0
Aug-24	4.7	0.4	0.8	-1.5
Sep-24	3.5	0.2	1.1	-1.1
Oct-24	4.6	0.9	1.0	-1.5
Nov-24	5.7	0.1	0.9	-1.4
Dec-24	NIL		0.9	0.6
Jan-25			0.8	2.1
Feb-25			1.0	1.6
Mar-25			1.7	1.1
Apr-25			2.0	-1.4
May-25			2.1	-1.7
Jun-25			3.0	-2.9

Liquidity Conundrum reimagined: Optimal liquidity is envisaged in foreseeable time

- The Governor's emphasis upon maintaining pro-growth levels of durable liquidity, signaling the willingness for embracing long-term, structural changes should clear the air on rumors of liquidity drying up going forward, fanned by select quarters… In particular, the reassurance on durable liquidity should be taken positively by the banking system as the CRR cut and reversal in demand through consumptions revival post a good monsoon augurs well for the sector to come out of the slack



G sec borrowing trend…. Keeping the borrowings in check

- The market borrowing program of the GoI has shown an orderly evolution off late with net borrowings not showing any spike

- Further, there are genuine efforts to curtail the overall Debt level under the overarching guidelines of the FRBM act (The debt-to-GDP ratio for the government is estimated to be 57.1% in 2024-25, projected to further decline to 56.1% in 2025-26)

- Both FDI and FII are expected to embrace revival given the softening interest rate trajectory across DMs (the Fed can front load some of the interest rate cuts given the cooling off labor markets and inflation control in sight, August onwards, bridging the wedge with ECB that can otherwise tweak the capital flows / investments between US-EU)

- Progress on trade & tariff talks between important stakeholders means lesser confidence logjams, and lower volatility for asset classes that should reinvigorate a risk-on mentality

Government Borrowing in Rs Lakh Cr

	G sec				Switch		
Year	Gross Borrowing	Redemption	Net Borrowing	Outstanding	Gross Borrowing	Redemption	Buyback/ Others
FY 15	5.9	1.5	4.4	41.6	0.4	0.4	0.1
FY 16	5.9	1.8	4.0	45.7	0.4	0.4	0.4
FY 17	5.8	2.3	3.5	49.1	0.4	0.4	0.6
FY 18	5.9	1.8	4.1	53.2	0.6	0.6	0.4
FY 19	5.7	1.5	4.2	57.5	0.3	0.3	-
FY 20	7.1	2.4	4.7	62.2	1.6	1.6	-
FY 21	13.7	2.3	11.4	73.6	1.6	1.5	-
FY 22	11.3	2.8	8.5	82.1	2.0	1.7	-
FY 23	14.2	3.4	10.9	92.9	1.0	1.1	-
FY 24	15.4	4.7	10.7	103.6	1.0	1.0	-
FY 25	14.0	3.3	10.7	112.6	1.5	1.5	0.9
FY 26(BE)	14.8	3.3	11.5	-	2.5	2.5	-
FY26 till date*	3.2	0.8	2.4	114.5	0.4	-	0.5

Source: RBI,SBI Research;*as on 13.06.2025

Paper wise O/S Gsec (as on Jun13,2025)

Tenure	Amount in Rs Lakh cr	% share
1-5	2	1.5
5-10	13	11.8
10-20	54	47.3
Above 20	45	39.4

G sec borrowing issuance trend

- The pre-pandemic data by the RBI places the GoI debt paper issuances in five buckets, with nearly two-third of the borrowings in 10 years and below segment (factoring in a miniscule share of 14 years paper)

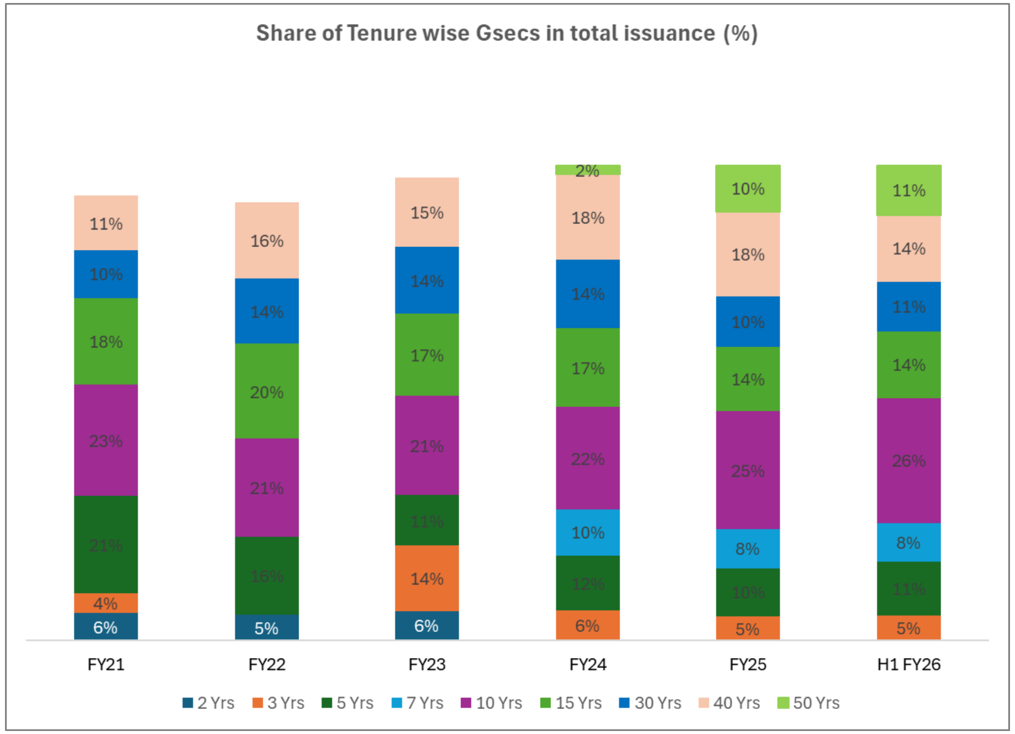
- The benchmark and below tenor papers now constitute ~50% of the debt stock being issued, with the share of benchmark papers hovering around 25%.... Mint street has desisted from issuance of 2 years paper in recent years while the 5-9 years duration too has shown a generic shift away

- Longer duration papers (15 & above in general- 30 & above in particular) have clearly been a favorite, signaling a shift in deft management of Public finances even when the yields had hardened post inflationary run-up even as twin Black Swan events striked

- Opening up of Bond markets for overseas investors in 2023 was counter-intuitive to whims and fancies of diverse segments of domestic players, with non-bank participants increasingly siding with longer tenors finding worthy competitors from long-only strategic portfolio investors

- The present composition / mix of G-Sec basis evolving trends may necessitate some fine tuning, in our understanding….There is however a dichotomy…For example, issuing more papers at shorter end can frontload redemptions in the medium run for a galloping economy but this could caste some doubt Government debt profile

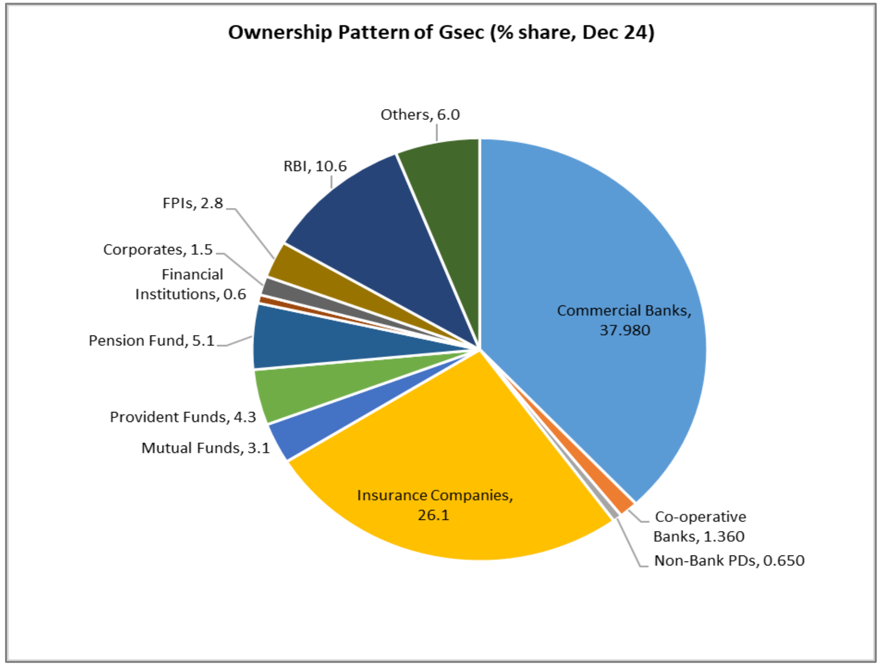
Bucket wise Gross borrowing share of papers(% share)						
Tenures	FY15	FY16	FY17	FY18	FY19	FY20
1-4 Yrs	-	-	-	-	9%	8%
5-9 Yrs	25%	16%	19%	21%	21%	21%
10-14 Yrs	40%	45%	52%	52%	31%	36%
15-19 Yrs	16%	19%	14%	13%	15%	11%
20 Yrs & above	19%	19%	15%	15%	24%	24%
Total	100%	100%	100%	100%	100%	100%

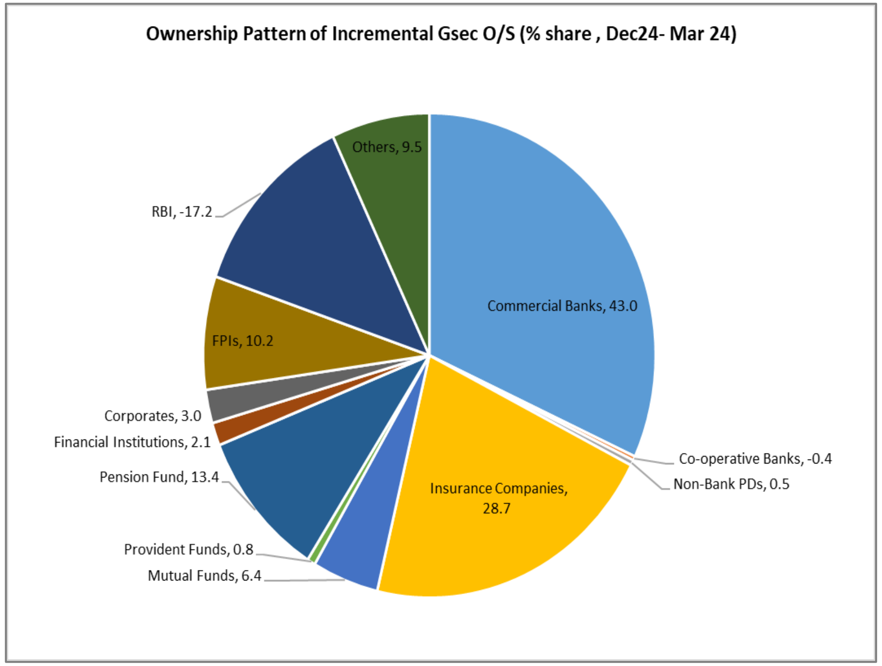


Ownership pattern of G-Sec: Banks had cornered Lion's share of incremental issuances in 9M FY25

- The relative slowdown in credit growth, post regulatory crackdown on unsecured and unsafe lending practices, ensured a renewed interest from Commercial Banks to renege on mopping up papers during the 9M (FY25)…. A protracted rate easing cycle expectations drove the rally further, with staggered, secular rate cuts woven in participants' investment intent & outlook….

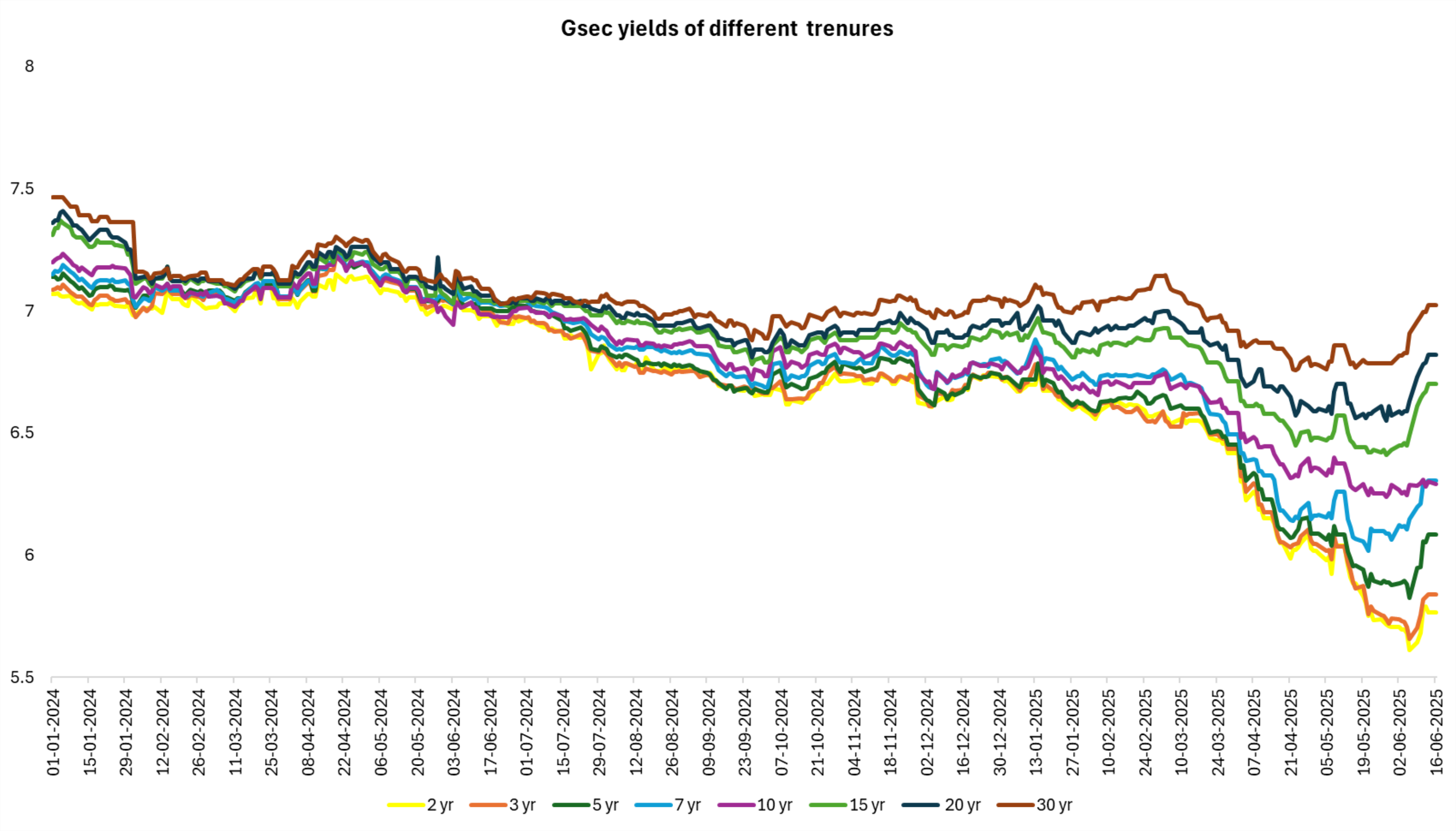
- The large cut caught most market participants little prepared and ill equipped perhaps but blame was somewhat squarely put on liquidity trajectory (wrongly) and alignment of WACR within the LAF corridor (rather rightly)





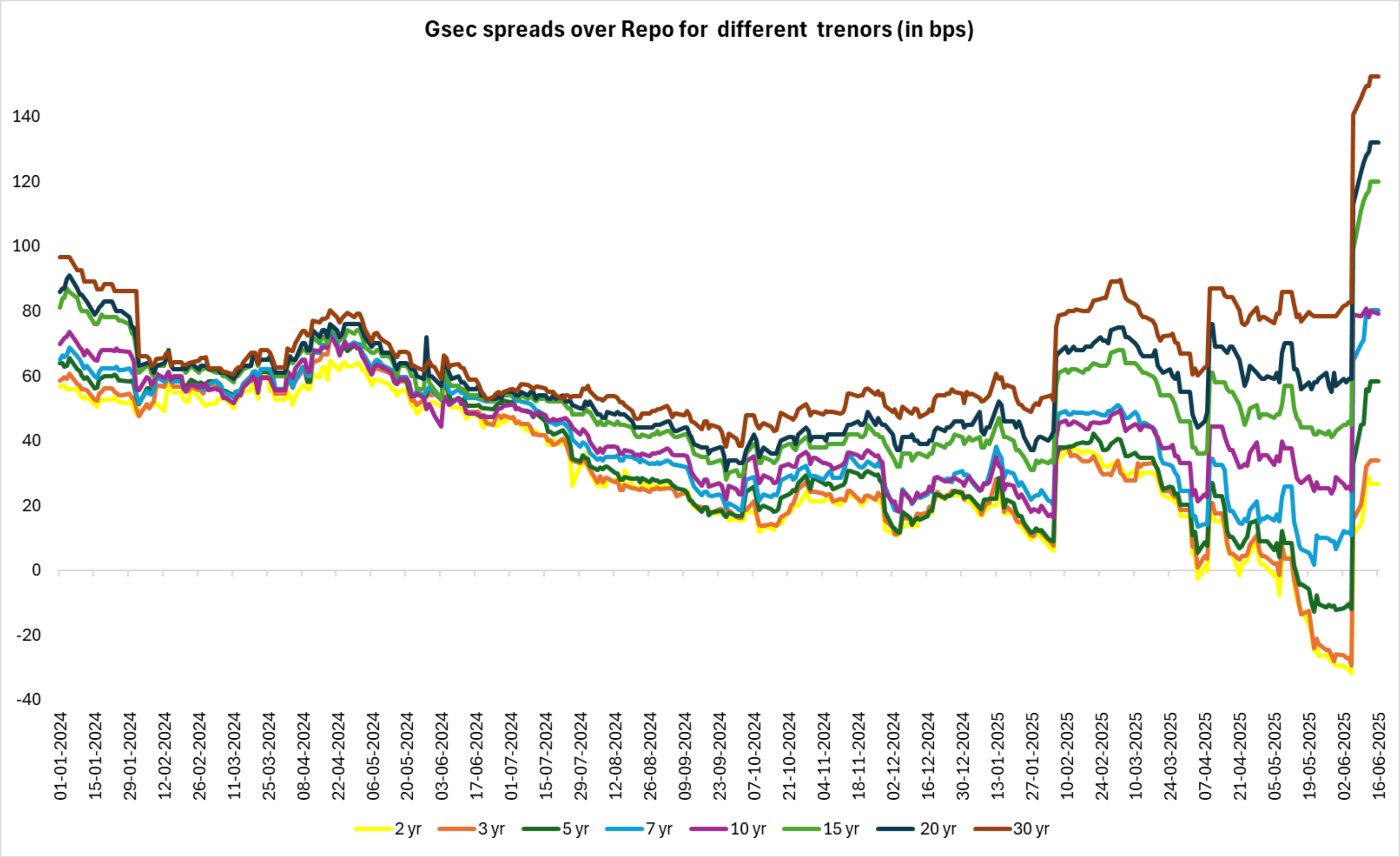
G sec yields should auto adjust, post a recalibration by participants

- The hardening of yield curve across select tenors, evident through reversion of otherwise southwards oriented yield as pivot became evident in policy rates and inflationary expectations fell substantially, appears more of a short-term knee jerk reaction as markets arguably failed to anticipate the intent and resolve of the regulator ‘to do whatever it takes’ to front load growth, with faster transmission of rate cuts expected to be anchored by the surplus liquidity even as the RBI takes a pause for now



Steepening of Yield Curves: A Simple Bull Steepening or mispricing of information?

- The RBI Governor has taken pains to assuage the frayed nerves of the debt markets by clarifying that the change in stance is a dynamic and evolving process, more attuned to the middle point of immediate present and imminent future in a world besieged with VUCA (and not a forward guidance for the time being!) which should have a sobering effect on longer tenor yields that had vaulted in an auto pilot mode as the broader markets (sans a minority) had not been bracing for the steep cut from the RBI



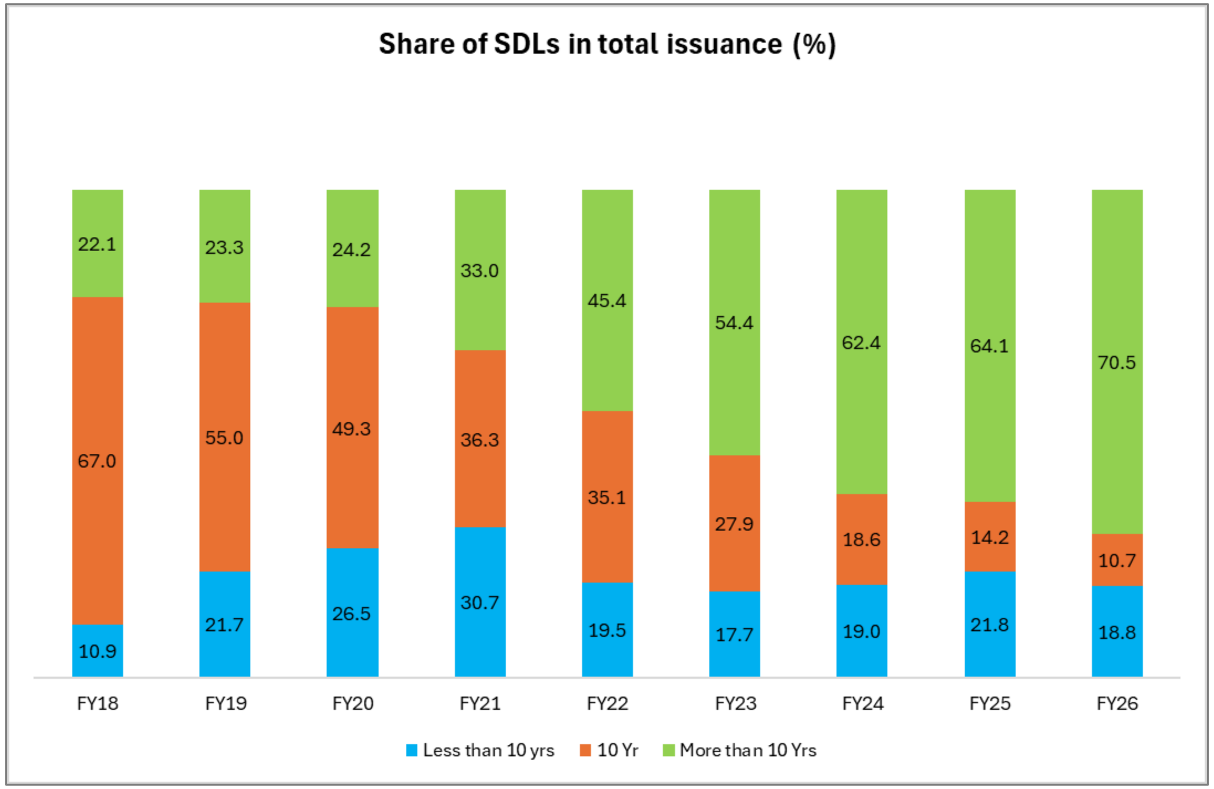
SDL borrowing trend

- The net borrowing by States, increasingly siding with the "Net Borrowing Ceiling (NBC)“ of 3%, expressed as a percentage of their projected Gross State Domestic Product (GSDP) that puts a tab on the total amount states can borrow, however warrants increased switch and buyback mechanisms even as risk premium of different states needs a revisit for a dispassionate spread over comparable G-sec

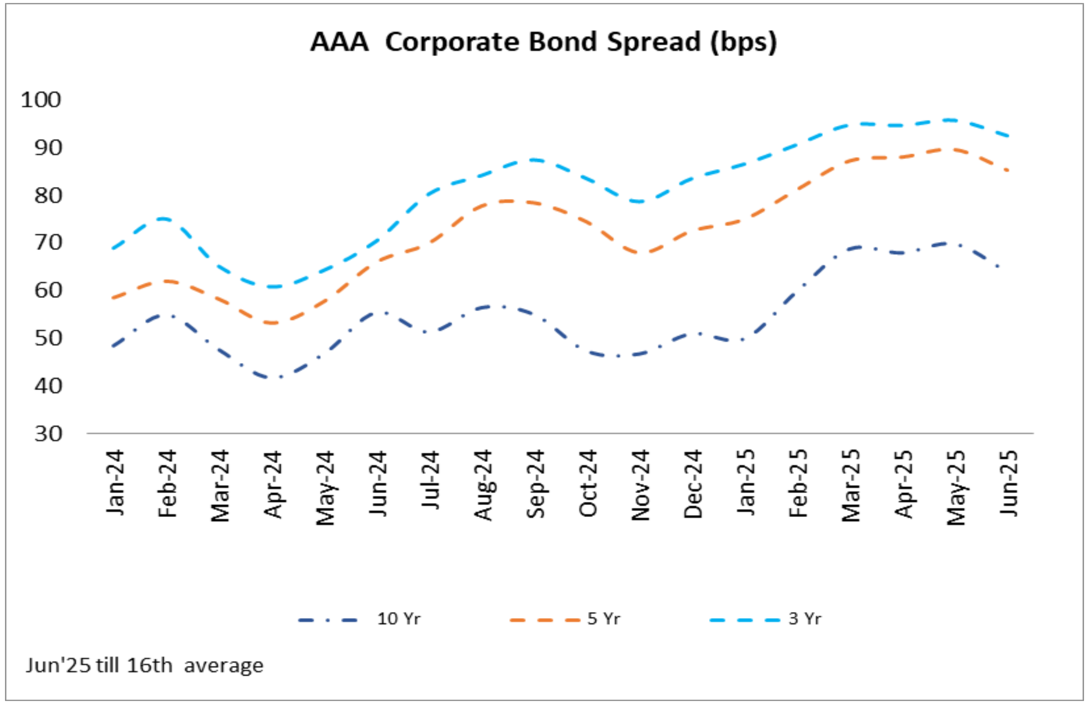
SDL Borrowing in Rs Lakh Cr				
Year	Gross Borrowing	Redemption	Net Borrowing	Outstanding
FY 15	2.5	0.3	2.2	12.7
FY 16	4.0	0.4	3.7	16.4
FY 17	4.9	0.4	4.5	20.9
FY 18	4.2	0.8	3.4	24.3
FY 19	4.8	1.3	3.5	27.8
FY 20	6.3	1.5	4.9	30.7
FY 21	8.0	1.5	6.5	39.2
FY 22	7.0	2.1	4.9	44.1
FY 23	7.6	2.4	5.2	49.3
FY 24	10.1	2.9	7.2	56.5
FY 25	10.7	3.2	7.5	62.2
FY 26(BE)	10.9	3.7	7.2	-
FY26 till date*	1.65	0.53	1.12	64.0
Source: RBI,SBI Research;*as on 13.06.2025				

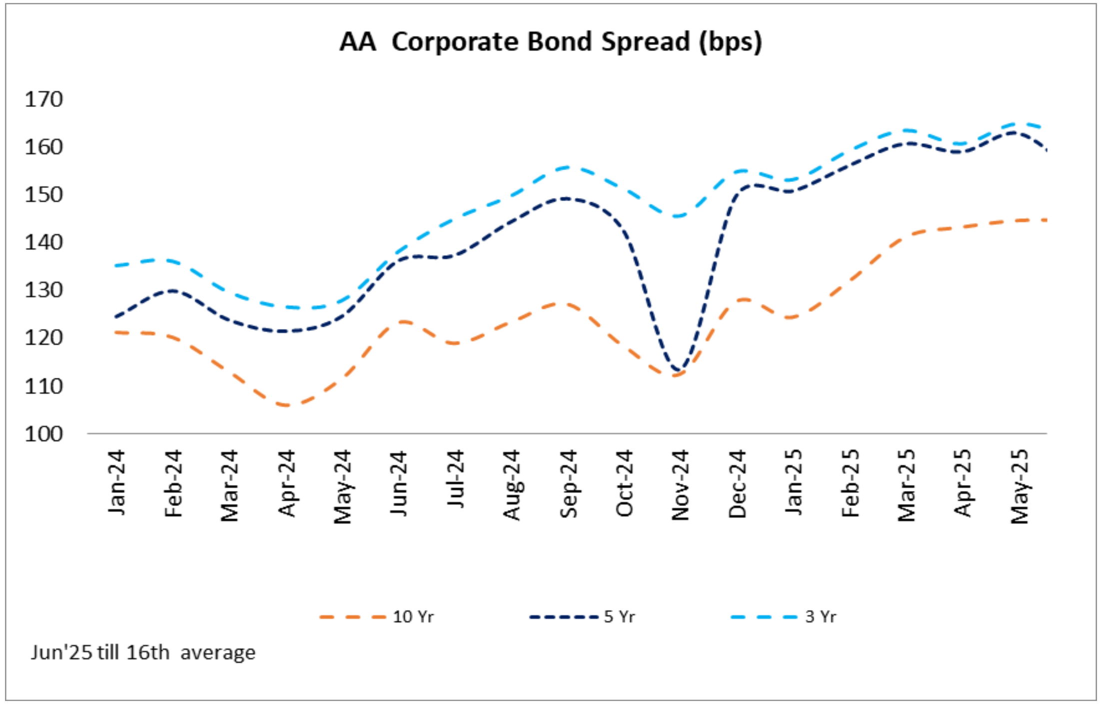
Share of longer dated SDLs in total issuance increased sharply to 71% in FY2026 from 22% in FY2018

- Compared to evenly dispersed G-sec issuances, SDLs issuances In longer tenors (>10Y) has spiked off late, show casing states' willingness to front load growth, while pushing back near immediate redemptions



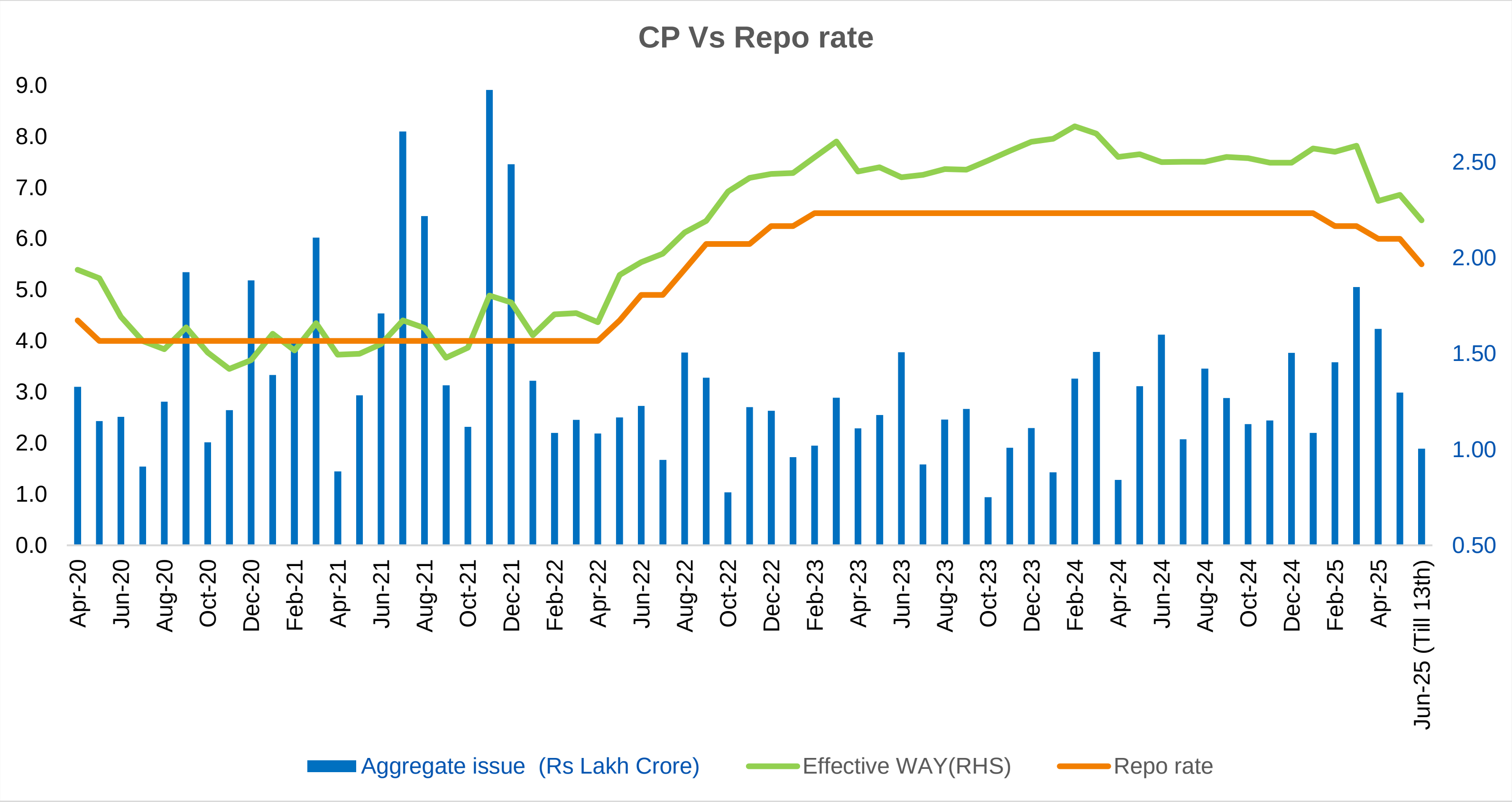
Corporate bond spread declined, marginally





- The Average Spread of AAA corporate bond, across tenor, over G-Sec, declined by 4-6 bps in June’2025 as compared to May’25
- However, average spread for a AAA 10 year bond, in Q1FY26, increased by around 15 bps to 67 bps from 52 bps in FY25
- Spread for a ten year AA corporate bond, over G-Sec, remains at almost same level of 145 bps in June’25 as compared to May’25
- However, for a medium tenor note of 5 year, the same declined by 8bps in June’25 to 155 bps from 163 bps in May’25

Commercial paper WAY declined by 146 bp, spread with repo too decrease by ~ 60 bps



- Commercial Paper (CP) issuances increased by 14.4% to Rs 15.69 lakh crore in FY25 as compared to 13.72 lakh crore in FY24 suggest reliance on short term paper as it gives more pricing power and flexibility to corporates
- CP Weighted Average Yield (WAY), in June'2025, **declined by 146 bps at 6.42% as compared to 7.82% in March'2025** due to policy rate cut and improved system liquidity
- The average spread between CP WAY and repo rate, which was around 143 bps in Q4FY25, now reduced to 82bps in Q1FY26

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