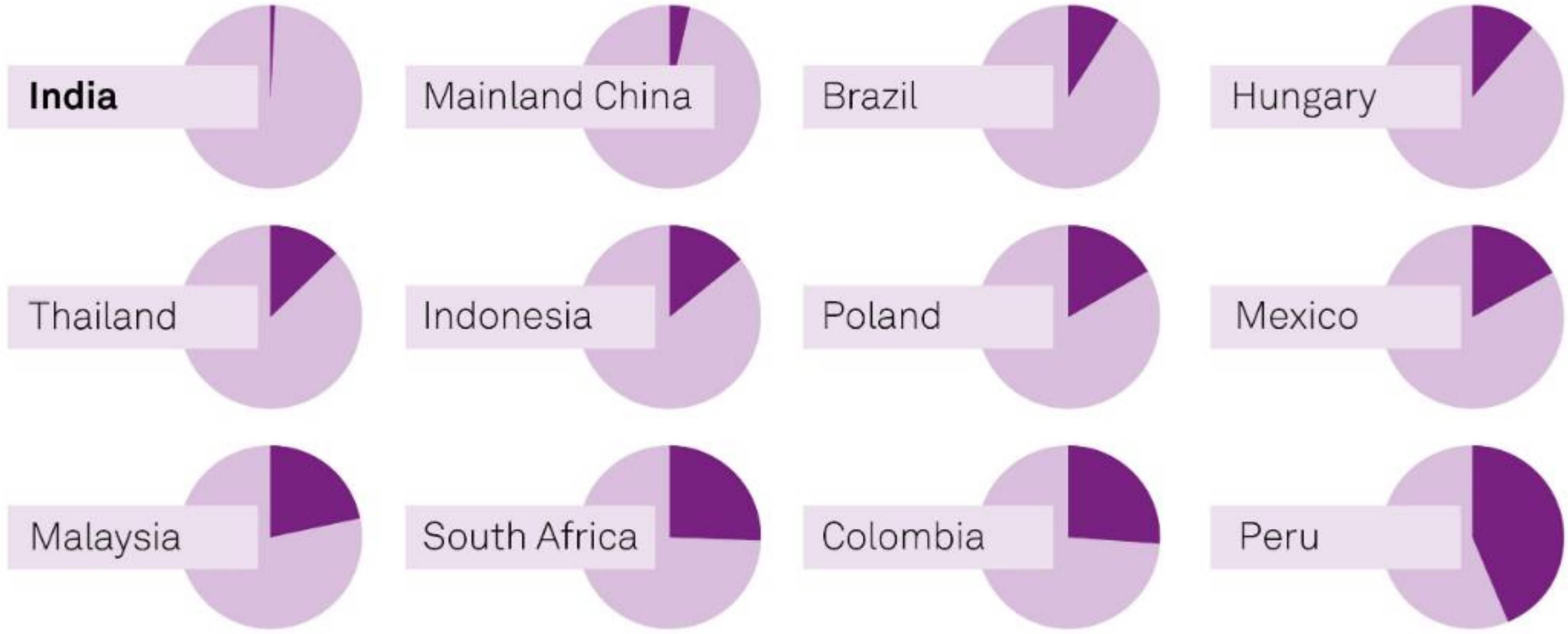
SBI Research

India's inclusion in JP Morgan Bond Index a moment to cherish: Contours of Liquidity management in the wake of 24x7x365 banking & capital flows opening up new vistas in macro management….MPC meeting could opt for status-quo

25-September-2023

JP Morgan Global Bonds Index Inclusion: A harbinger of Hope

Foreign Ownership of Indian Government Bonds has been abysmally lower related to EM peers…about to change….



Source: S&P Global (status as on end 2022)

JPMorgan to include India in emerging market bond index.. Pivoting Investment & Credit markets…

- JP Morgan Chase, largest commercial bank in the USA, reported on September 21 (US timings) that it will add Indian Government Bonds (IGBs) to its benchmark Emerging-market Index Global Diversified (GBI-EM GD)
- The index provider will add the securities starting June 28, 2024. India will have a maximum weight of 10% on the index. JPMorgan said 23 IGBs with a combined notional value of $330 billion are eligible for inclusion. All fall under the category of "fully accessible" for non-residents. **As on August 31, GBI-EM GD had benchmarked AUM of $236 Billion**
- India's weight, post inclusion, is expected to reach the maximum weight threshold of 10% in the GBI-EM Global Diversified, and approximately 8.7% in the GBI-EM Global index (**thus, ensuring likely passive flows of ~$24 Bn at current AUM/holdings by March'25**)
- Meanwhile, another major index provider, **FTSE Russell also has Indian bonds on *index watch* for inclusion in its emerging market gauge.** Incidentally, the FTSE Emerging Markets Government Bond Index - Capped **(EMGBI-Capped) oversaw total funds (AUM) of $1477 Billion as on end August, making it 6-times plus larger than JPM GBI-EM GD!! If the inclusion process at JPM GBI-GM materially stabilizes, we can see another BIGGER inclusion by mid-2025!!**
- We believe choosing the JPM GBI-EM could be a deliberate move on part of GoI/RBI to ensure future developments have a natural progression, evolving & maturing organically to mitigate possible points of friction.. Add to this the third index, the Bloomberg Barclays EM bond index and the funds flow numbers significantly go up!

…JPMorgan to include India in emerging market debt index.. Pivoting Investment & Credit markets

- Funds flows between DMs and EMs should have another hitherto invisible connotation; ***the changing demographics***. With DMs increasingly facing an aging profile (significant increase in longevity enhancing life expectancy), decline in fertility inducing negative rates of population growth going forward and retirement of the baby-boom generations increasing the old dependency ratio (60 years-plus population as a percentage of total population) leading to a **demographic transition** further accentuating the shifting contours of economic forces and flight of capital to younger regions gaining traction
- **The recessionary fears in the USA could have another ramification; reset of sizeable amount of loans taken to finance house purchases through the pandemic**. As the 5 years reset clause becomes due during 2025-26, the rollover of fixed rate loans taken at cheaper rates in 2020-21 at likely higher rates (considering Fed's penchant for Higher for Longer regime to leave no stone unturned in its quest to quell the prices satisfactorily) could materially upend borrowers' EMI outgo. Coupled with Education and Auto loans, this poses a very lasting challenge to average American…..
- **Spiraling oil prices should take a breather at these levels as vocal members of OPEC+ may not like to destabilize the markets** further in the long run beyond $90/bbl, having reached the optimal level where their production cost is generously being compensated while also successfully having signaled to the world the pervasive power they wield over prices trajectory
- Existing literature shows benchmark driven investments (BDI) growing correlation with portfolio flows to emerging markets, as **investment benchmarks are increasingly shaping portfolio allocation dynamics in EM countries…** The growing role of benchmark-driven investments appears to reflect the confluence of several factors and may be contributing to more synchronized portfolio flows. Thus, India could be the recipient of sustained incremental portfolio flows in the future…. For example, portfolio flows to EM local bond markets have traditionally been much more synchronized for countries in a benchmark index (viz. the J.P Morgan GBI-EM Global) than those that were not in the index (IMF Working Paper WP/20/192).

Country weight projections for JPM GBI-EM series post India inclusion

	GBI-EM Global Diversified			GBI-EM Global			GBI-EM Global Div IG 15% Cap			JESG GBI-EM Global Diversified		
Country	Current Wgt (%)	Est. Wgt (%)	Delta (%)	Current Wgt (%)	Est. Wgt (%)	Delta (%)	Current Wgt (%)	Est. Wgt (%)	Delta (%)	Current Wgt (%)	Est. Wgt (%)	Delta (%)
India	-	10	10	-	8.74	8.74	-	14.59	14.59	-	6.73	6.73
China	10	10	-	54.56	49.83	-4.73	15	15	-	6.43	6.73	0.31
Indonesia	10	10	-	6.70	6.12	-0.58	15	13.13	-1.87	9.64	10	0.36
Mexico	10	9.99	-0.01	6.59	6.02	-0.57	14.83	12.90	-1.93	9.64	10	0.36
Malaysia	10	9.49	-0.51	5.07	4.63	-0.44	12.34	9.94	-2.40	9.64	9.59	-0.05
Brazil	10	9.00	-1.00	4.84	4.40	-0.45	-	-	-	9.64	9.09	-0.55
Thailand	9.79	8.14	-1.65	4.35	3.98	-0.38	10.58	8.53	-2.06	9.44	8.23	-1.21
South Africa	8.11	6.75	-1.36	3.61	3.29	-0.31	-	-	-	7.82	6.82	-1.01
Poland	7.57	6.29	-1.27	3.36	3.07	-0.29	8.18	6.59	-1.59	9.73	8.48	-1.25
Czech Republic	6.18	5.14	-1.04	2.75	2.51	-0.24	6.68	5.38	-1.30	7.94	6.92	-1.02
Colombia	4.50	3.72	-0.78	2.00	1.82	-0.19	4.87	3.89	-0.97	4.34	3.76	-0.58
Romania	3.84	3.20	-0.65	1.71	1.56	-0.15	4.15	3.35	-0.81	4.94	4.30	-0.64
Hungary	3.09	2.57	-0.52	1.37	1.25	-0.12	3.34	2.69	-0.65	3.97	3.46	-0.51
Peru	2.39	1.98	-0.40	1.06	0.97	-0.09	2.58	2.08	-0.50	2.30	2.00	-0.30
Chile	2.01	1.67	-0.34	0.89	0.81	-0.08	2.17	1.75	-0.42	2.58	2.25	-0.33
Egypt	1.04	0.87	-0.18	0.46	0.42	-0.04	-	-	-	0.67	0.58	-0.09
Turkey	0.74	0.62	-0.12	0.33	0.30	-0.03	-	-	-	0.48	0.42	-0.06
Serbia	0.29	0.24	-0.05	0.13	0.12	-0.01	-	-	-	0.28	0.25	-0.04
Uruguay Global	0.22	0.18	-0.04	0.10	0.09	-0.01	0.24	0.19	-0.05	0.28	0.25	-0.04
Dominican Republic Global	0.17	0.14	-0.03	0.08	0.07	-0.01	-	-	-	0.16	0.14	-0.02
Philippines Global	0.06	-	-0.06	0.03	-	-0.03	0.07	-	-0.07	0.06	-	-0.06

FTSE Emerging Markets Government Bond Index - Capped (EMGBI-Capped): INDEX PROFILE (next likely inclusion)

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Description	# of Issues	Par Amount*	Market Value*	Market Weight (%)	Average Coupon (%)	Average Life (Years)	Yield to Maturity (%)
EMGBI-Capped	**405**	**1,535.81**	**1,477.03**	**100.00**	**5.58**	**8.16**	**6.61**
Brazil	5	81.91	81.27	5.50	10.00	4.39	10.46
Chile	12	36.13	35.45	2.40	4.61	9.27	5.80
China	72	142.06	147.70	10.00	2.86	6.88	2.37
Colombia	13	72.17	64.49	4.37	7.47	9.62	10.06
Hungary	19	53.84	45.42	3.08	3.26	5.99	7.52
Indonesia	44	137.46	147.70	10.00	7.28	9.26	6.43
Mexico	18	157.19	147.70	10.00	7.46	8.53	9.77
Malaysia	30	111.01	114.25	7.74	4.09	10.09	3.82
Peru	11	37.97	37.65	2.55	6.49	10.07	6.45
Philippines	40	95.31	94.49	6.40	5.71	7.22	6.49
Poland	15	119.89	110.48	7.48	2.82	4.44	5.31
Romania	24	56.16	54.71	3.70	5.12	5.84	6.49
Saudi Arabia	46	110.89	101.92	6.90	3.19	9.58	4.54
South Africa	12	149.15	123.75	8.38	8.58	12.54	11.11
Thailand	28	142.35	143.07	9.69	2.60	7.51	2.60
Turkey	16	32.31	26.96	1.83	13.04	5.28	19.93

Source: FTSE Russell, Amount in US$ Bn, as on Aug 31, 2023

23 securities under FAR is eligible for inclusion in JP Morgan Index….out of Rs 28 trillion ($340 bn), only 2.5% utilized… significant headroom available even after accounting for current FPI holdings…

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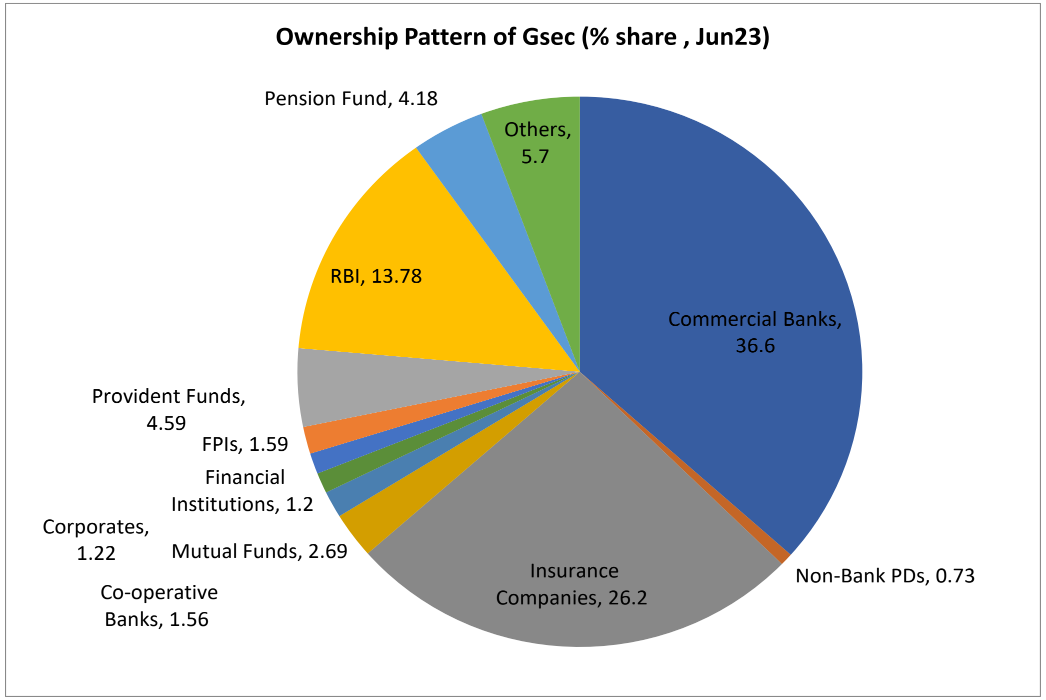
Debt Utilization status of eligible securities under the FAR (21 Sep'23)				
ISIN	Security Description	Indicative Value Of Aggregate Holding Of FPIS (INR CR)	Outstanding Position Of Govt Securities (INR CR)	Sec Holdings (%)
IN0020190362	06.45% GS 2029	3773	114840	3.29
IN0020180454	07.26% GS 2029	6254	130709	4.78
IN0020190032	07.72% GS 2049	126	84000	0.15
IN0020200054	07.16% GS 2050	461	99798	0.46
IN0020200070	05.79% GS 2030	2403	111619	2.15
IN0020200153	05.77% GS 2030	3520	123000	2.86
IN0020200252	06.67% GS 2050	2685	149162	1.8
IN0020200294	05.85% GS 2030	1312	120832	1.09
IN0020210095	06.10% GS 2031	4837	148086	3.27
IN0020210194	06.99% GS 2051	1002	146835	0.68
IN0020210244	06.54% GS 2032	2883	156000	1.85
IN0020220037	07.38% GS 2027	6426	142000	4.53
IN0020220011	07.10% GS 2029	8493	158598	5.36
IN0020220029	07.54% GS 2036	1486	149000	1.0
IN0020220060	07.26% GS 2032	7894	148000	5.33
IN0020220086	07.36% GS 2052	1999	161000	1.24
IN0020220102	07.41% GS 2036	1942	150000	1.29
IN0020220151	07.26% GS 2033	6907	150000	4.6
IN0020230010	07.06% GS 2028	2987	96000	3.11
IN0020230036	07.17% GS 2030	1886	84000	2.25
IN0020230051	07.30% GS 2053	226	77000	0.29
IN0020230077	07.18% GS 2037	399	60000	0.66
IN0020230085	07.18% GS 2033	675	42000	1.61
Total		**70576**	**2802479**	2.5%
Source: NSDL, SBI Research				

Current investment through Debt & Debt-VRR route

A back of the envelope estimates from current ownership Pattern of Government of India Securities suggest $24 billion gap..same as postulated fund flow post index inclusion…. Sub 7% yield?.....



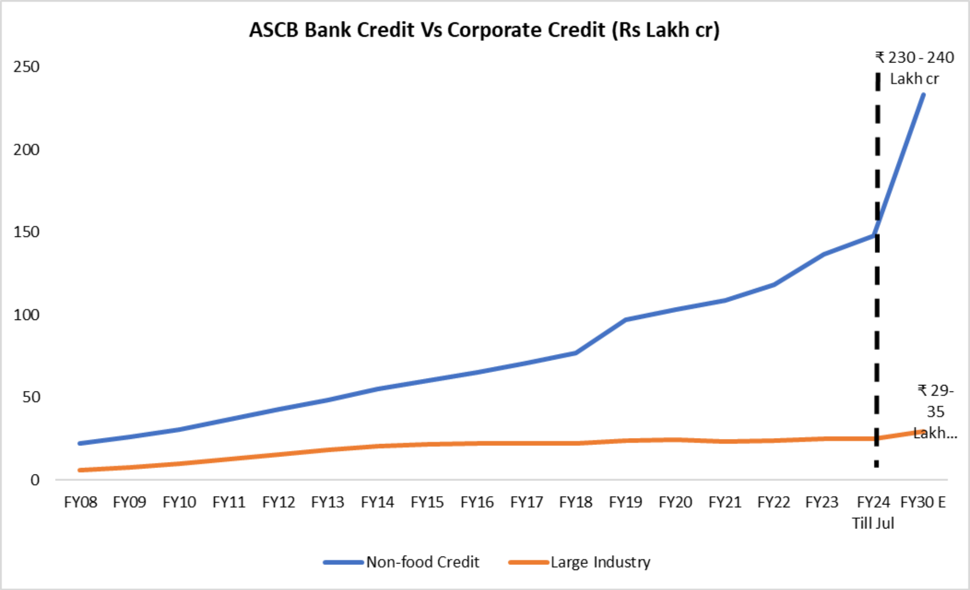
Market Borrowings (Rs lakh crore)					
	FY22	FY23 RE	FY24 BE	FY24 till date	FY24 Till date as % of Budgeted
Centre					
Gross Borrowing	11.3	14.2	15.4	8.5	55.02
Repayments	2.8	3.1	3.6	1.6	43.65
Net Borrowing	8.5	11.1	11.8	6.9	58.51
State					
Gross Borrowing	7.0	7.6	8.2	3.2	38.78
Repayments	2.1	2.4	2.9	1.1	38.25
Net Borrowing	4.9	5.2	5.4	2.1	39.07
Total					
Gross Borrowing	18.3	21.8	23.6	11.7	49.39
Repayments	4.9	5.5	6.5	2.7	41.27
Net Borrowing	13.4	16.3	17.2	9.0	52.45
Source: RBI,CCIL					

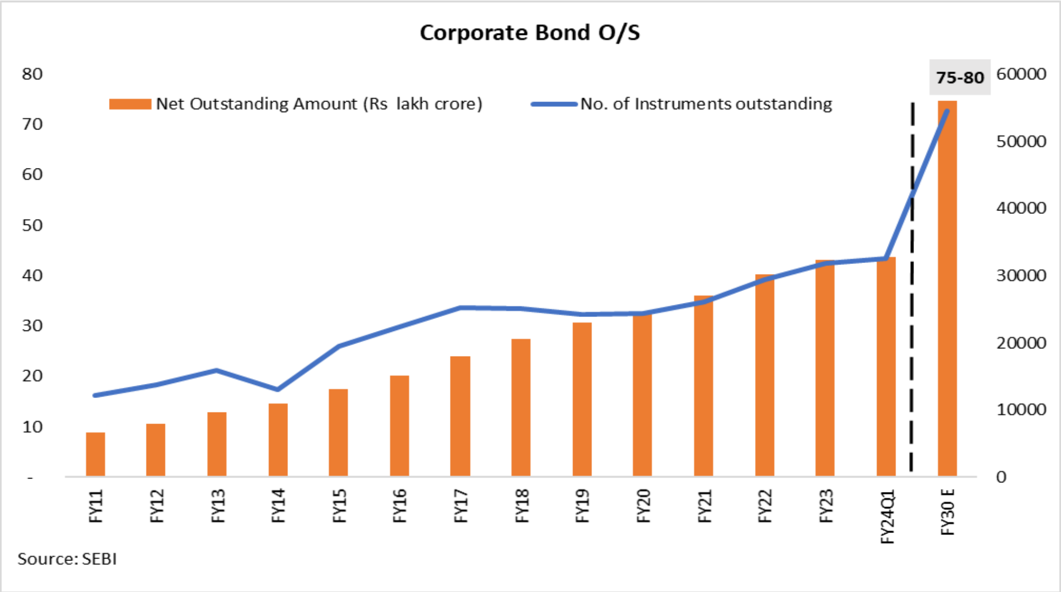
- Outstanding Dated Government Securities (as on 20 Sep'23), aggregating Rs 98 trillion and due for redemption till 2064, have a handful of formidable players like Banks and Insurance companies who together account for ~62% ownership among themselves though overall share of Banks has dwindled by ~10% in the last decade (from 47.25% in March'2010). Interestingly, Banks lean more towards shorter tenor, preferably for 10 year or below offerings, leaving the longer tenors for insurance/pension companies and others with analogous appetite…the passive funds flow could tilt more towards Longs tenor from a suite of investors

- The total net G-Sec supply is expected at Rs 12.3 lakh crore in FY25, along with SDL demand of around Rs 6.0 lakh crore and T-bill of Rs 50,000 crore. After considering the demand of securities by various players, the gap is expected to be around Rs 2 trillion / ~$ 24 billion. This matches with the likely India weightage in the JPM Bond Index by March'25 but a lot should depend on ironing out the potential areas of conflict resolution along taxation in settlement for willing investors. The additional demand of G-sec owing to inclusion in the JPM Bond Index will likely shift the domestic demand towards the SDL & T-bills, thereby affecting the yield

- **We believe yields could touch 7% even before March of current fiscal and should affirmatively breach 7% in FY25……Demand for G-sec could now outstrip Supply of G-sec…This could be a new turning point in G-sec market in India where supply has traditionally outstripped demand for G-sec….**

Credit Deployment to Industry could witness an Inflexion Point…Same for Corporate Bond Offerings





- Along with optimally priced and adequately underwritten bank credit (through various conventional as also non-conventional mechanisms including trade receivables discounting, packing/post-shipment credit, factoring etc.), a liquid and deep Corporate bonds market is a *sine qua non* towards meeting the massive capex and new investments requirements, particularly in the wake of urgent energy and mobility transition needs (also subsidizing likely impairment of conventional assets), anchoring monetization of assets (NIP) and recalibration of manufacturing capabilities …the breather through bonds inflows should handhold the channeling of 'surplus' resources to meet the credit gap across sectors as also incremental ESG commitments of Corporates…a Corporate bonds index should be the next thing

Liquidity management in the wake of 24x7x365 banking

Drivers of Liquidity in India need to be understood…demand for liquidity is turning more on-tap given a 24/7 payment system while supply of liquidity is a constellation of several autonomous factors…

- Various factors determine liquidity in India. The autonomous factors include forex intervention by RBI, Government surplus cash balances and excess reserves maintained by banks with RBI, while the discretionary factors or policy driven factors affecting liquidity include OMOs by RBI, CRR requirements and net LAF operations of RBI

- System liquidity depends on the repo operations, Marginal Standing Facility, Standing Liquidity Facility adjusted for amount parked in SDF and as excess reserves. System liquidity adjusted for government surplus cash balances determines the durable liquidity

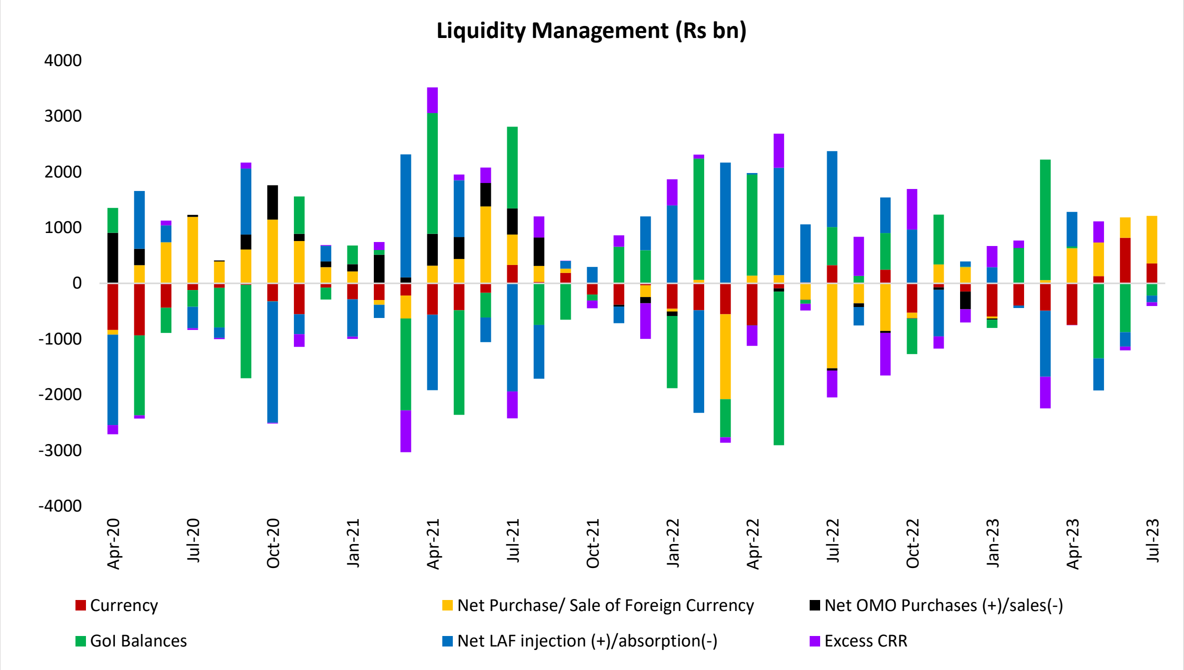
- **Demand for liquidity is on-tap and supply of liquidity is adhoc**

- Government cash balances and foreign flows are ‘noisy’, forcing RBI to manage liquidity carefully

Drivers of Liquidity in India

Variable(1)	Change in (1)	Impact on Banking System Liquidity
Autonomous factors		
GoI Cash Balances	Build-up	↓
	Drawdown	↑
Forex intervention by RBI	Purchase	↑
	Sales	↓
Excess Reserves maintained by banks with RBI	Build-up	↓
	Drawdown	↑
Policy driven (Discretionary) factors		
Open Market Operations by RBI	Purchase	↑
	Sales	↓
Cash Reserve Requirements (CRR)	Increase	↓
	Reduction	↑
Net LAF position	Injection*	↑
	Absorption#	↓

*: (Repos + MSF – Reverse Repos) > 0; #: (Repos + MSF – Reverse Repos) < 0; Increase (↑); Decrease (↓)



Current Liquidity Update shows ~Rs 1.5 trillion deficit….but….

- FY24 started with a liquidity surplus as given by net durable liquidity around Rs 1.2 lakh crore which declined gradually to around Rs 90,000 crore by mid- May

- However, it started increasing after the announcement of withdrawal of Rs 2000 notes by RBI. The increase in deposit of Rs 2000 notes led to increase in liquidity with average durable liquidity of Rs 3.7 lakh crore by 10 Aug'23. Accordingly, the RBI in its Aug'23 monetary policy decided to impound on additional liquidity of around Rs 1 lakh crore through incremental CRR (ICRR) of 10%, which in turn led to moderate reduction in durable liquidity to Rs 2.4 lakh crore

- Since the liquidity has now reduced, RBI decided to gradually remove the ICRR and free up capital for banks. **However, system liquidity deficit has again increased in recent days**

Liquidity Position (Rs lakh crore)			
	1-Apr-23	Average in FYTD24	21-Sep-23
Repo Outstanding	0.54	0.11	0.09
Reverse Repo Total	0.00	0.49	0.19
SDF statrted on 08.04.2022	2.88	1.05	0.47
MSF	0.01	0.18	1.99
Standing Liquidity Facility Availed from RBI	0.20	0.06	0.03
SLTRO for Small Finance Banks	0.03	0.03	0.03
Net LAF (-absorption)	-2.10	-1.09	1.48
Excess Reserve	0.06	0.02	-0.12
System Liquidity (-absorption)	-2.17	-1.11	1.61
Government Cash Balance	-0.96	1.30	4.04
Core Liquidity (-Surplus)	-1.21	-2.41	-2.43
Source: RBI, SBI Research			

…But….. IS such liquidity deficit typically a reflection of Unusable Liquidity held up within the banking system because of a 24/7 payment culture?.....

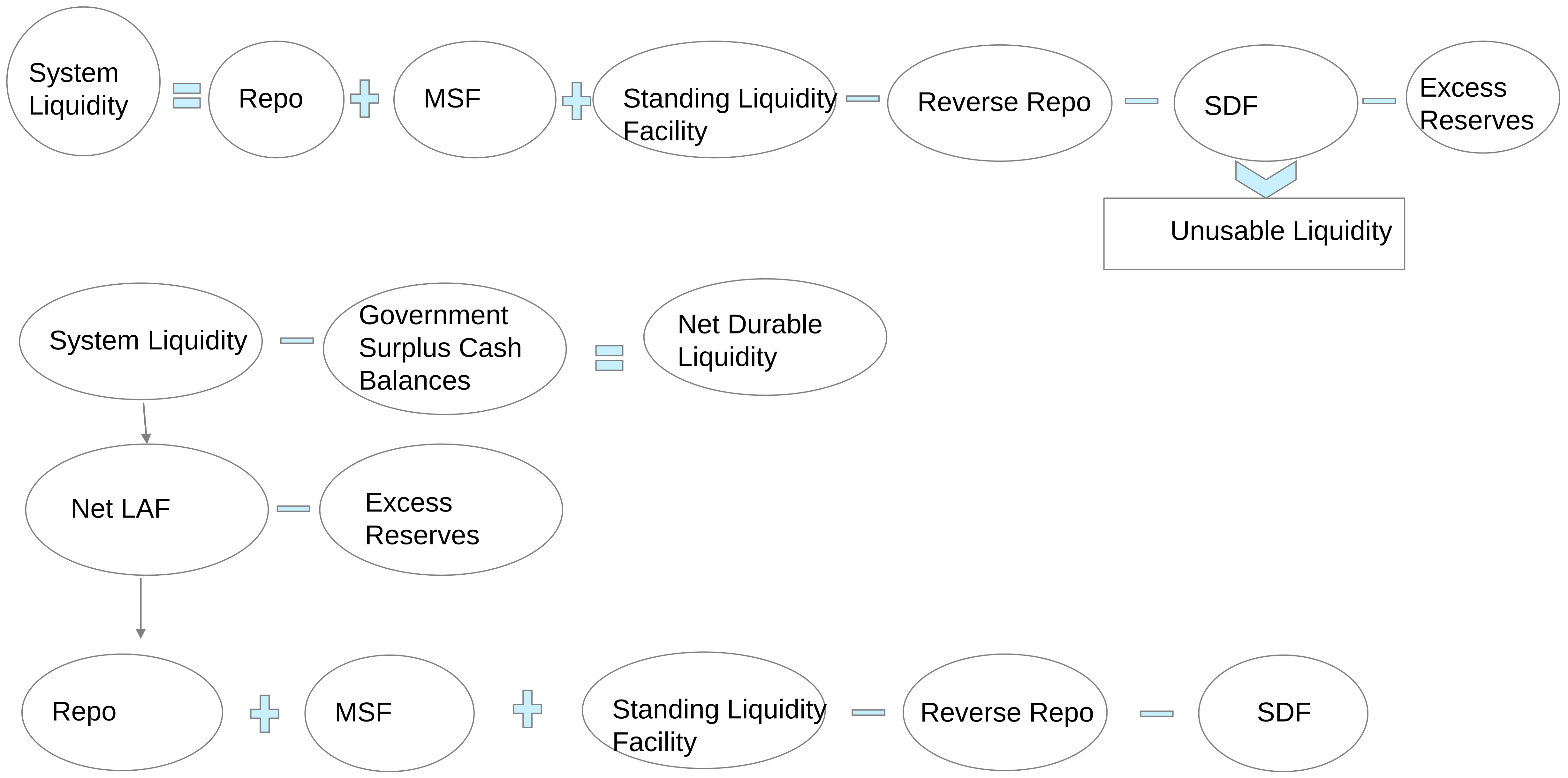
- Unusable liquidity is difficult to define

- We may define unusable liquidity is that part of SDF balance that is sticky in the sense it does not come down even when system liquidity, otherwise, tightens substantially

- We have this unusable liquidity largely because of:
  - 24x7x365 banking led cash-flow issues that force banks to carry surplus balances,
  - Very short-term surpluses that banks find difficult to deploy in a better way, for e.g., surplus amount coming due to withdrawal of Rs 2000 denomination note

- **The paradox of unusable liquidity is thus:** ***something that can be used to stem panic is actually partially frozen to prevent that panic from ever occurring…a catch-22 situation***

Liquidity flowchart



Estimate of Unusable Liquidity

- The 24*7 payment systems is posing an issue for banks, leading them to park some money in SDF even in situations of deficit liquidity. This can be termed as liquidity for precautionary motive. Thus, the whole analysis of liquidity should be seen in the light of this precautionary motive of liquidity

- When we look at the liquidity data since 8th April 2022 (when SDF started), there have been 55 days (of 358 working days) when system liquidity was in deficit mode and banks on an average parked around Rs 76,000 crore in SDF during those days which can thus be considered as the unusable liquidity

Average values since 8 Apr'22 (Rs bn)					
	MSF	SDF	Net LAF	Excess Reserves	System Liquidity
Since 8 Apr'22	89	1,302	-1,311	24	-1,335
On deficit liquidity days	247	757	390	-21	411
On surplus liquidity days	-158	546	-1,701	45	-1,746
SDF on the days of deficit liqudity represents unusable liquidity, which banks maintain for precautionary motive					

Liquidity facilities under revised Liquidity Management Framework of RBI

Sl. No.	Instrument	Quantum	Periodicity/Timing
	A. Instruments under LAF framework to manage short-term/transient liquidity		
1	14-day variable-rate repo auction (Main operation)	Auction amount will be decided by the Reserve Bank and a single auction (either repo or reverse repo) will be conducted based on the assessment of liquidity conditions by the Reserve Bank.	Every Friday between 10:00 AM and 03:00 PM as notified by RBI in the auction notification.
2	Variable Rate Term Repo auction (Tenor: overnight and up to 13 days) (Fine-tuning operations)	The auction amount will be decided by the Reserve Bank, based on an assessment of the liquidity conditions.	Discretionary
3	Fixed Rate Reverse Repo	No restriction on amount	Daily (Including Saturdays, Sundays and holidays) between 5.30 PM and 11.59 PM
4	Marginal Standing Facility (MSF)	Individual banks can draw funds up to Excess SLR + 2 per cent below SLR.	
5	FX Swaps	The amount will be decided by the Reserve Bank, based on the assessment of the liquidity conditions	Discretionary
6	Standing Deposit Facility (SDF)	Placement of surplus funds with RBI through manual or ASISO mode	**1.Manual**: Between 5:30 PM and 11:59 PM on all days and reversed on the following working day 2.**Automatic**: All days from 09:00 AM and 11:30 PM
	B. Instruments to manage durable liquidity		
7	Long Term Variable Rate Repo (LTR) Tenor: Beyond 14 Days	The auction amount will be decided by the Reserve Bank, based on an assessment of the liquidity conditions.	Discretionary
8	Long Term Variable Rate Reverse Repo (LTRR) Tenor: Beyond 14 Days		
9	FX Swap Auctions	The auction amount will be decided by the Reserve Bank, based on an assessment of the liquidity conditions.	Discretionary
10	Open Market Operations (OMOs)		

Efficient Market Hypothesis is lost in Translation of Perceived Liquidity…..

- The securities market evolvement and deepening seems to have hit a roadblock; CCIL timings not consistent with transitory glide path to Efficient Market Hypothesis where market participants (individually, as also diverse yet complementary sets) should be able to freely transact and meet their specific needs FIRST within the ecosystem, with recourse to central bank happening in true sense of lender of last resort cliché

- Currently, analysis of market activities point to asymmetric behaviour of one set of banks parking the surplus funds under SDF (whose dynamic funds transfer under ASISO mechanism ensures all surplus funds can effortlessly be placed overnight with the central bank at 'okayish/ not too bad' yield) while a distinct set of banks borrows from the central bank under MSF. The corridor should have been 'yield agnostic' for both sets ideally, and it's difficult to decipher the behavior of a bank parking funds in the SDF instead of actively exploring the means to deploy it through market channels

- **Against the backdrop of liquidity hangover, in the light of 24*7 movement/ transfer of funds by corporates at increased frequency, enhancing the timing of CCIL clearing till 5:00 pm (from the present 2:30 pm) could catalyze the participants to incrementally engage with counter parties in mutually beneficial ways**

- Large outflows from the system, even with a near predictable pattern (GST and advance tax every quarter, EPFO every month) affect the liquidity management adversely though the system recovers from such bouts of stresses with the active support by the central bank

Does 24x7x365 Payment & Settlement System pose risk for Liquidity Management?

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- With the availability of NEFT and RTGS system round the clock throughout the year on all days, i.e., on 24x7x365 basis, the amount of transactions in NEFT + RTGS (customers only) has increased from Rs 92 lakh crore in Nov’19 to Rs 151 lakh crore in Jun’23
- Banks cash management could be tested with the extension of payment facilities to a 24X7x365 basis
- This is testifying when we decompose monthly NEFT + RTGS (customers only) payments in cyclical and trend part: The cyclical variation (total minus trend) is positive for quarter-end with higher magnitude every fiscal
- For rest of the year the cyclical variation is negative which is also increasing with each fiscal
- The average increase in cyclical portion over two fiscals (FY23 over FY21) is a whopping 45% and is increasing
- **This indicates that the efficiency gains in payment & settlement systems are creating new risks in liquidity management for banks**

Cyclical Variations in NEFT+RTGS (Rs lakh crore)

Month	FY21	FY22	FY23	FY24	% Change (FY23/21)
Apr	-8.1	-11.2	-14.3	-15.4	77.5
May	-10.0	-11.7	-16.1	-18.8	60.9
Jun	0.3	0.4	0.5	0.6	42.0
Jul	-0.6	-0.7	-0.8	-	37.9
Aug	-6.4	-8.6	-10.0		55.3
Sep	6.1	7.3	9.0		47.8
Oct	-5.2	-6.2	-6.9		34.7
Nov	-5.1	-6.8	-7.7		48.8
Dec	12.4	15.1	16.2		30.5
Jan	-3.3	-3.8	-4.5		38.1
Feb	-5.6	-6.7	-7.6		36.2
Mar	33.6	38.4	42.2		25.5

Source: SBI Research

Funds movement patterns in different times and on different days are incoherent

- The I-CRR requirement is being gradually reversed for banks; ensuring systemic liquidity remains in comfortable mode at the onset of festival period. Banks ensure adequate CRR requirement is met by them on a dynamic basis, preferably acting within a set corridor of 90-110% of requirements, ensuring the regulatory obligation is met judiciously based on average of reporting fortnight
- Since, a bank is conscious, as also cautious to meet the CRR requirement (unremunerative for them) while ensuring sufficient liquidity is available to them to meet the funds transfer demands of corporates, the shifting synergy of these twin objectives interplay with their appetite for transacting in securities market, within the overarching liquidity latitude
- On a net basis (net of inflows/outflows through online modes), banks have, at best, an indeterminate pattern, clouding approximation of resultant surplus/deficit at end of day which further limits their manoeuvrability to navigate through the liquidity management, while attempting to profit through the arbitrage opportunities indulging in shorter tenor operations
- The issue aggravates on weekends and holidays, with funds flows on select Saturdays in particular inching towards the normal trading days as corporates resort to deft funds management, in sync with their own cashflows. **Banks, unsure of momentum and funds flows on such periods, tend to be risk agnostic, piling on buffer of extra liquidity that remains unusable in essence**

FX operations are intensive and have a linear relationship with liquidity management

- FX operations by RBI to provide stability to the rupee against a defiant dollar and resurging crude trajectory affect the systemic liquidity greatly (apart from OMO operations)
- Despite huge turmoil in economies globally, and currency markets imbibing the enhanced volatility proactively, INR has shown resilience with a mostly orderly movement, helped in part by robust foreign funds flows in CY24 as also deft moves by the central bank to cushion the rupee from excessive volatility
- Both spot and forwards/NDF markets are utilized for nudging rupee towards a particular level though it's the Fx swap that is emerging as the optimal and most preferred tool to engage in Buy/Sell of the currency, with a future dated contra contract ensuring there is no immediate impact on the other leg of transaction immediately
- The challenge to keep a robust forex reserves level that imparts confidence in meeting the import commitments as also servicing of debts, at the same time choosing a diverse investment mix through judicious allocation to yielding, as also non yielding assets (Gold purchase by RBI totalled 99.3 tonnes through 2002&2023 augmenting its reserves close to 800 tonnes while RBI's total holding of US treasury securities swelled to US$236 Bn in June'23 up from US$199 Bn in April'22) has a significant drag/bearing on liquidity management
- **One must give full credit to the Mint Street in steering through this perplexing path, with subtlety and speed mixed judiciously**

Final Thought

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- So, what will be the RBI's policy look like:

Indicator	Our View
Repo rate	❑ We expect the RBI to pause in October policy ❑ The recessionary fears in the USA could have another ramification; reset of sizeable amount of loans taken to finance house purchases through the pandemic. As the 5 years reset clause becomes due during 2025-26, the rollover of fixed rate loans taken at cheaper rates in 2020-21 at likely higher rates (considering Fed's penchant for Higher for Longer to leave no stone unturned in its quest to quell the prices satisfactorily) could materially upend borrowers' EMI outgo…Coupled with Education and Auto loans, this poses a lasting challenge to average American….but will there be soft landing / **slowdown frontloaded?.....** ❑ Domestically, we believe at 6.50%, we are in for a prolonged pause as seasonality of inflation is tapering first…..
Stance	❑ We believe the stance should continue to be withdrawal of accommodation as inflation is unlikely to tread below 5% in rest of FY24……
Risks for growth/inflation	❑ Growth outlook continues to be strong…. Spiraling oil prices should take a breather at these levels as vocal members of OPEC+ may not like to destabilize the markets further in the long run beyond$90/bbl having reached the optimal level where their production cost is adequately being compensated while also successfully having signaled to the world the power they wield over prices trajectory
Forward Guidance	❑ It is not advisable to give a forward guidance yet…..

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