ICRA

Liquidity and Monetary Policy

Impending release of RBI dividend, lower currency leakages to ease liquidity pressures from May 2025, reducing need for OMOs, forex swaps

MARCH 2025

Highlights

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Owing to tight liquidity conditions, the RBI has injected durable liquidity of Rs. 3.2 trillion so far since January 30, 2025, and is set to inject another ~Rs. 1.3 trillion over the rest of March 2025

This, along with seasonal factors, the RBI dividend pay-out, and elongated maturity profile of the RBI's net short forward book would aid in easing liquidity in early-FY2026

ICRA expects a 25 bps rate cut in April 2025, followed by another one in either June or August 2025

- After remaining in surplus during Q2-Q3 FY2025, systemic liquidity has turned to a large deficit of Rs. 1.7 trillion (-0.8% of NDTL) in Q4 FY2025 so far (till March 17), amid sustained dollar outflows and seasonal increase in currency with the public (CWP). Owing to the tight liquidity conditions, the Weighted Average Call Rate (WACR) exceeded the repo rate during most of this quarter.
- This, along with seasonal tightness due to quarter-end tax outflows prompted the Reserve Bank of India (RBI) to conduct open market operations (OMOs) of Rs. 1.0 trillion and $/INR buy/sell swap of $10 billion in March 2025, after the liquidity injection via these avenues in February.
- Overall, the RBI has injected durable liquidity to the tune of Rs. 3.2 trillion so far via OMOs and swaps since January 30, 2025, which has prevented a further compression in durable liquidity amid continued pressure from dollar outflows and currency leakage. The impending swap and OMO will further augment durable liquidity by ~Rs. 1.3 trillion over the remainder of March 2025.
- The sizeable durable liquidity injection during Q4 FY2025 along with the seasonally lower pressure on account of currency leakage is expected to augur well for liquidity conditions in early-FY2026, although dollar outflows will remain a key monitorable. Additionally, the expectations of a large RBI dividend pay-out in May 2025 would augment systemic liquidity, while tempering the need to conduct OMOs and forex swaps in the immediate term.
- The RBI's net short forward position surged to a record high of $77.5 billion by end-January 2025. The unwinding of the same would drain rupee liquidity, although the elongation of maturity profile at end-January 2025 vis-à-vis end-November 2024, implies that the impact would be spread over a relatively longer period and not just concentrated in the immediate term.
- The sub-4% February 2025 CPI inflation print has cemented the expectation of a 25 bps rate cut in April 2025. This may be followed by another 25 bps cut either in June 2025 or August 2025, depending on the Q4 FY2025 GDP growth print that will be available at end-May 2025. However, tight liquidity conditions may delay transmission of rate cuts to bank deposit and lending rates.

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