Macro Strategy

Liquidity Matters...Redux

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Economic Update ▸ **Monetary Policy** ▸ **December 01, 2025**

Banking system liquidity has moderated notably since Sep-25, thanks to a sizable unsterilized FX intervention. Our liquidity model indicates that the impending moderation in liquidity ahead could be as low as 0.2% of NDTL by end-Mar-26 in the absence of new primary infusion by the RBI. We estimate that additional primary injections—mainly via OMOs—of about Rs2trn over remainder FY26 will be required to keep liquidity near 1% of NDTL. While markets debate the need and timing of another rate cut, this much-needed liquidity boost would be far more efficacious. It would not only ensure smoother and better monetary transmission but also help alleviate the current excessively steep and unhealthy yield curve.

System liquidity swings from bumper surplus to sub-0.5% of NDTL

After a comfortable run since June—when average liquidity surplus stayed over 1% of NDTL—system liquidity has seen a marked tightening since mid-Sep-25, with surplus levels slipping below 0.5% of NDTL through mid-Sep to Nov-25. The squeeze reflects a combination of seasonal and frictional factors: festive-driven currency in circulation (CIC) leakage, advance income tax and GST outflows, and a likely cash build-up amid muted/delayed government spending through mid-Sep/Oct-25. More structurally, however, RBI's sizable unsterilized FX intervention in recent months has drained liquidity on a durable basis, pulling durable liquidity (banking liquidity + government cash balances) down sharply—from above Rs5trn at its peak to ~Rs3.3trn now. However, a steady stream of VRRs by the RBI ensured that overnight rates stayed aligned with the repo rate.

Unsterilized FX intervention — A key liquidity spoiler

Despite sizable liquidity injections (Rs2.4trn) via OMOs in 1QFY26, estimated secondary OMOs worth ~Rs300bn in Nov-25, and 1% CRR cut, system liquidity has tightened. Recent easing from lower CIC and higher government spending has only partly offset the drag from RBI's aggressive spot FX intervention (USD22-25bn estimated since Sep-25) – the primary cause of liquidity drain. With persistent INR pressure and tight liquidity, the RBI has shifted from taking partial forward deliveries earlier in FY26 to rolling over upcoming maturities and rebuilding its short USD forward position since Sep-25. CIC growth has also run ahead of last year's (Rs1,475bn YTD vs Rs310bn FYTD25), reflecting rural recovery/stronger consumption. Still, we expect FY26E CIC/GDP at 11.1%, broadly unchanged from FY25.

Tighter liquidity ahead requires more primary infusion

Our liquidity model points to further tightening ahead, driven by additional CIC drain in 4Q (~Rs770bn expected vs ~Rs800bn in 3Q), though FX intervention will remain the dominant liquidity drag, with patchy FPI flows, a wider trade deficit, and US–India trade-deal uncertainty likely keeping USD-INR volatile and prompting active RBI actions. Liquidity pressures are compounded by the heavy bunching of RBI's FX buy–sell forward maturities—about ~USD37bn over the next 3 months. Even if the RBI takes delivery of only 30% of these, the resulting liquidity drain could be roughly Rs1trn. Undoubtedly, the recent liquidity squeeze has coincided with increased RBI forward intervention, with the net short forward book rising by ~USD10bn, from ~USD53bn in Aug-25 to ~USD64bn in Oct-25.

Additional primary injection of Rs2tn needed for ~1% NDTL liquidity surplus

Absent further OMOs and with only modest FX intervention, we estimate banking system liquidity could end FY26 near the lows of 0.2-0.3% of NDTL. To lift the surplus back to ~0.9–1.0% of NDTL, the system would require over Rs2trn of additional primary infusion, assuming BoP deficit of ~USD20bn and CIC leakage of ~Rs1.6trn in 2H. Despite bumper primary infusion in 1HCY25, we had argued in May-25 that the RBI's job was still half done. RBI's guidance of 1% NDTL worth of liquidity surplus would still require the RBI to inject primary liquidity of >Rs4.5trn through FY26 (of which Rs2.4trn of OMOs were done till May-25; refer to *Liquidity matters!*). We expect the next leg of primary injections to begin around Dec/Jan-26, mainly via direct OMOs, though FX swaps cannot be ruled out.

OMOs to be a effective transmission tool + natural GSec a demand balancing factor

Historically, past easing cycles have ended with liquidity surplus well above 2% of NDTL. Yet reserve money growth has slowed sharply—from 18% at the Covid peak to only 2% YoY—and the RBI's balance-sheet growing only 4.4% FYTD26 (till Nov-25), with FX intervention offsetting gains since Jan-25. Against this backdrop, policy support is needed to manage rising C–D ratios and sustain ~12% credit growth against sub-10% deposit growth, while also easing the ultra-steep yield curve, accommodating higher SDL supply in 4QFY26, and acting as a balancing factor in the demand-supply mismatch in the sovereign market.

Key highlights:

- System liquidity to reduce to ~0.2-2.3% of NDTL by Mar-25 in the absence of new OMOs
- We estimate primary RBI infusion of Rs2trn in RoFY for adequate banking liquidity
- OMOs to be a more effective tool of transmission, as the rate cut cycle nears its end

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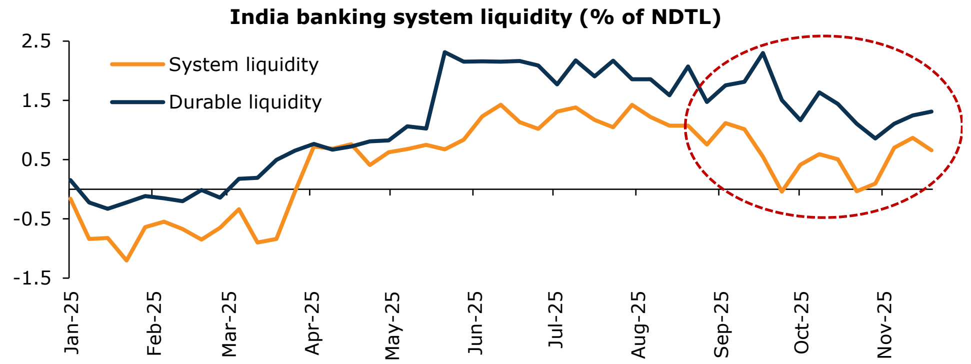
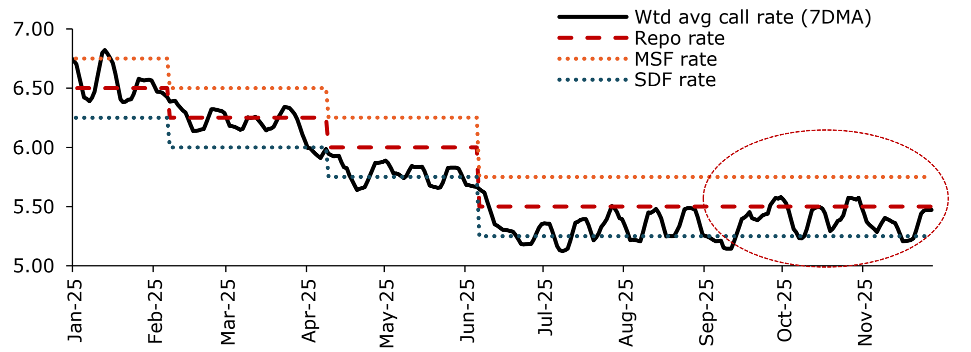
Exhibit 1: System liquidity has tightened substantially since mid-Sep



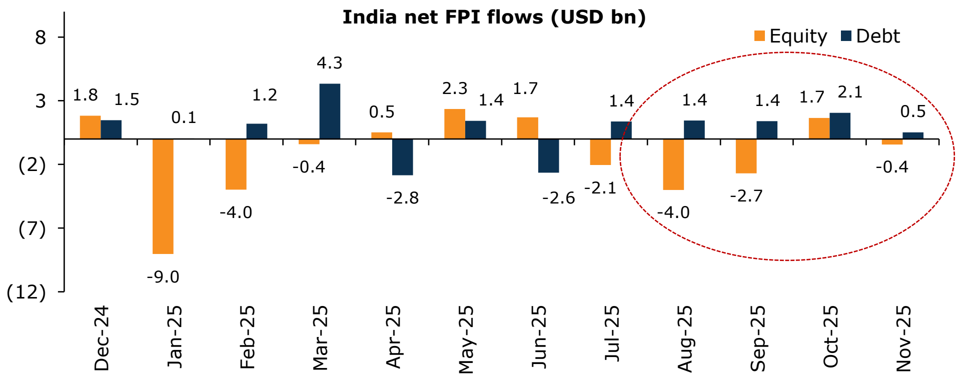
Source: RBI, Emkay Research; Positive values indicate surplus liquidity, and negative values indicate deficit liquidity; Durable liquidity = System Liquidity + Govt. surplus

Exhibit 2: However, frequent RBI VRRs have kept the call rate range-bound between the repo and SDF rates



Source: RBI, Emkay Research

Exhibit 3: Persistent FPI outflows (especially equity) since Aug have been a drag on liquidity



Source: RBI, Emkay Research estimates; Note: Data for 3QFY26 is till 28-Nov

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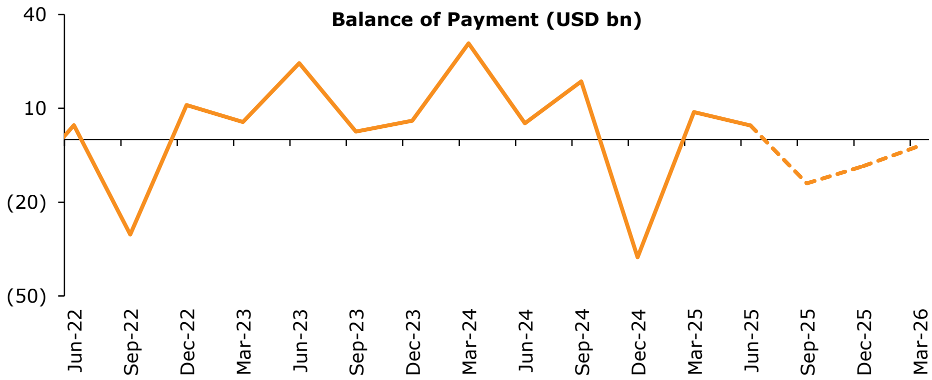
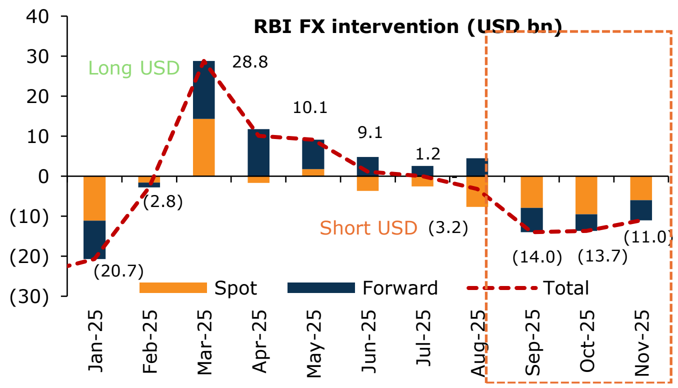
Exhibit 4: BoP likely turned to a steep deficit in 2QFY26, and is likely to remain stretched in FY26 at a ~USD20bn deficit



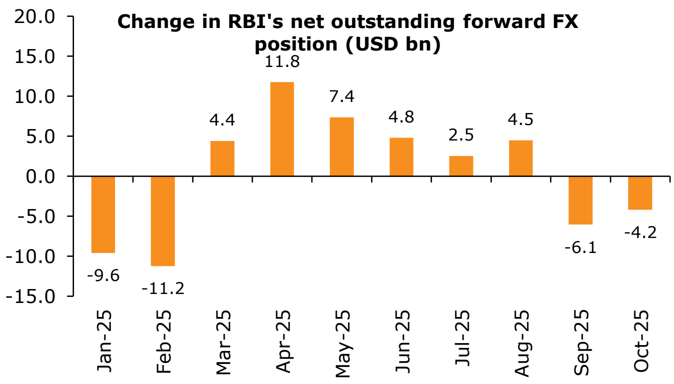
Source: RBI, Emkay Research estimates

Exhibit 5: RBI has been intervening heavily via both, spot and forwards, to support the INR since Sep-25



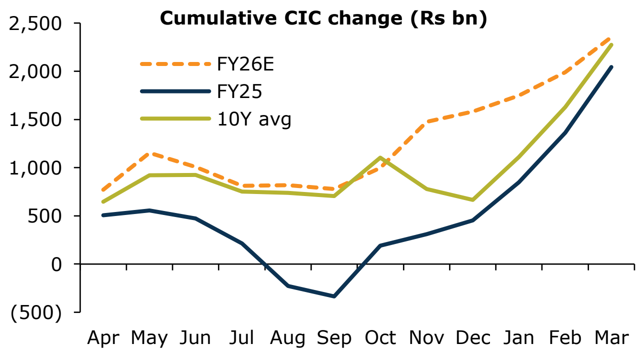
Source: RBI, Emkay Research estimates; Note: Spot intervention data for Oct and Nov as well as forward intervention data for Nov are Emkay estimates

Exhibit 6: After four months of reducing its short USD forward position, RBI has been building its forward book since Sep



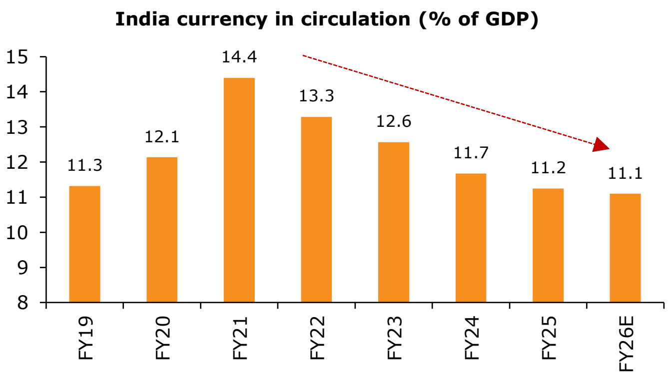
Source: RBI, Emkay Research

Exhibit 7: FY26TD CIC leakage has been far higher than last year and in line with the high 10Y average



Source: RBI, Emkay Research estimates

Exhibit 8: However, outstanding CIC is still expected to decline to ~11.1% of GDP in FY26E



Source: RBI, Emkay Research estimates

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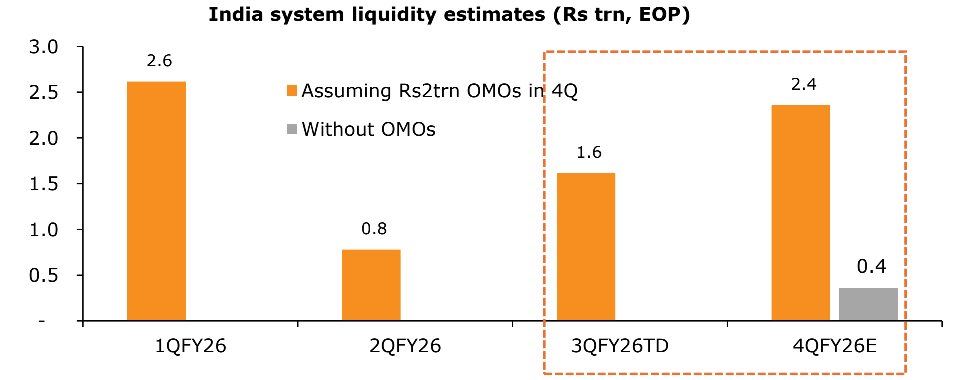
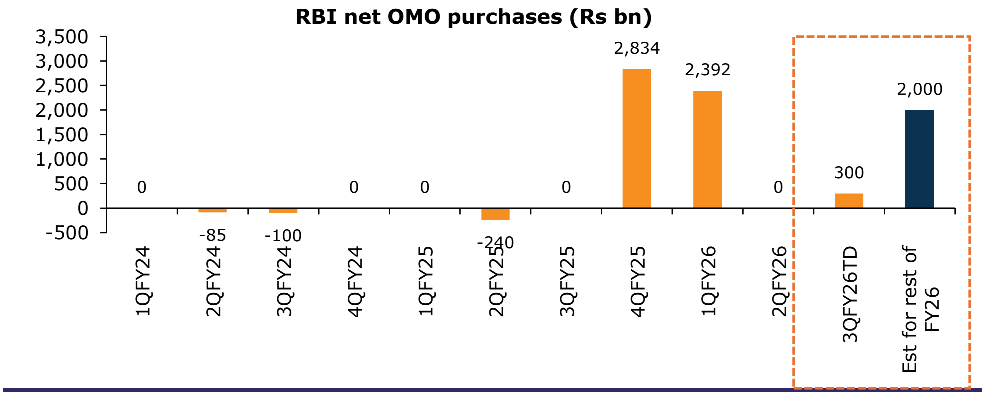
Exhibit 9: System liquidity surplus is likely to fall dramatically sans OMOs ahead



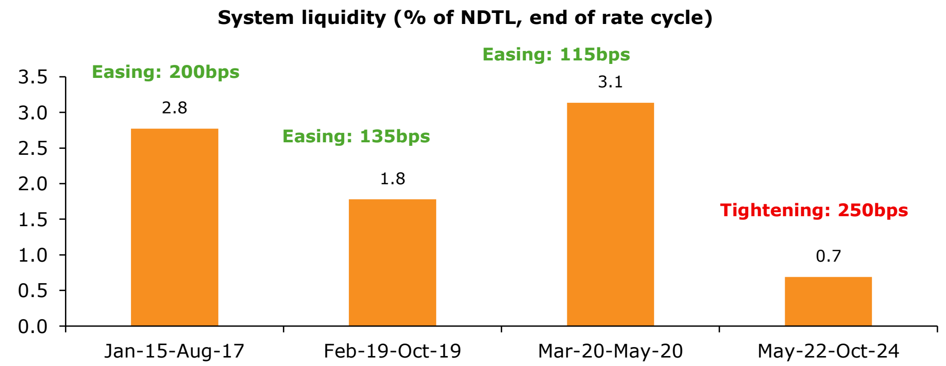
Source: RBI, Emkay Research estimates

Exhibit 10: RBI may need to infuse nearly Rs2trn after conducting secondary market purchases of ~Rs300bn in Nov-25 and bumper primary OMOs in 1QFY26



Source: RBI, Emkay Research estimates

Exhibit 11: Past easing cycles have all seen system liquidity at much higher than 1% of NDTL at the end of the cycle



Source: Bloomberg, Emkay Research

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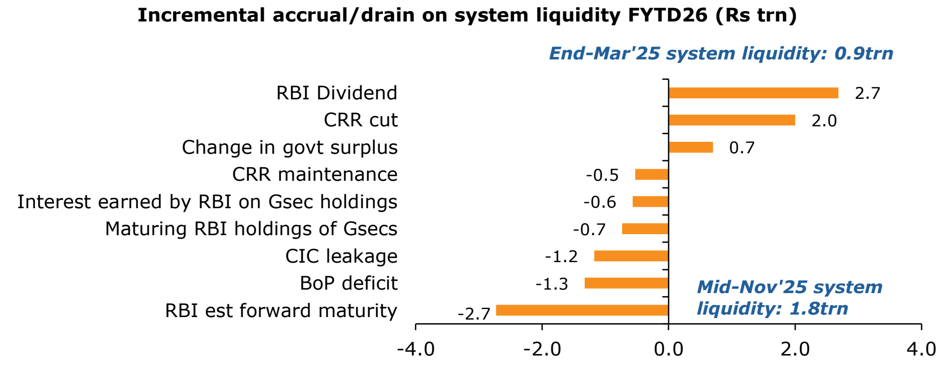
Exhibit 12: Despite the heavy OMOs and CRR cut, system liquidity has moved lower since Sep-25, largely due to RBI's FX intervention and higher CIC leakage



Source: RBI, Emkay Research estimates

Exhibit 13: OMOs/primary injection of ~Rs2trn would be needed to take system liquidity to ~1% of NDTL by end-FY26

Mid-Nov 2025	Rs bn
System Liquidity (Mid-Nov-25) 3DMA	1,832
Estimated Govt surplus	1,000
Estimated Core Liquidity (Mid-Nov-25)	2,837
Incremental est liquidity drivers till end-FY26	**Rs bn**
Currency in circulation leakage	-1,100
CRR maintenance (adj for CRR cut)	310
Maturing RBI holdings of Gsecs	396
Interest earned by RBI on Gsec holdings	-224
RBI FX spot intervention	-858
RBI OMOs + other primary liquidity infusion	2,000
Estimated System Liquidity (End-March'26)	**2,356**
Estimated Govt surplus	800
Estimated Core Liquidity (End-March'26)	**3,156**

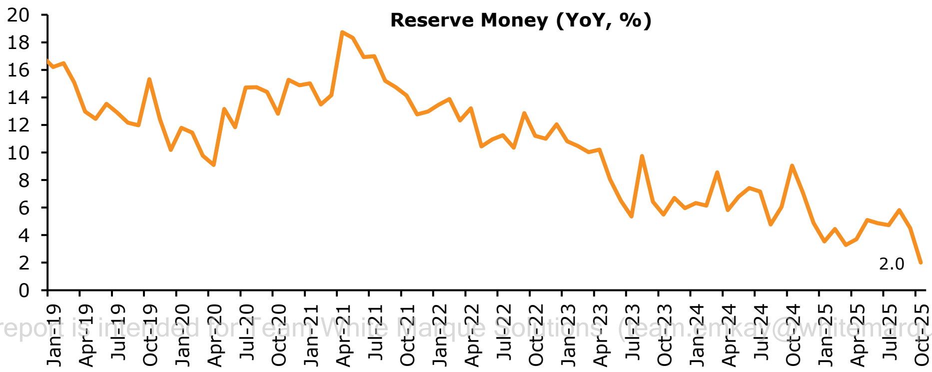
Source: RBI, Emkay Research estimates

Exhibit 14: Both, reserve money and RBI balance sheet growth, have been slower than that in FY25 and 3Y CAGR so far in FY26

YoY growth	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26TD*	3Y CAGR
RBI total assets	13.4	30.0	7.0	8.5	2.5	11.1	8.2	4.4	10.3
Reserve Money (M0)	15.1	9.8	14.2	12.3	10.0	8.5	3.3	-0.6	5.1

*Source: RBI, Emkay Research; Note: *FY26TD is incremental growth from end-Mar-25*

Exhibit 15: Reserve money growth has been consistently falling since the Covid peak



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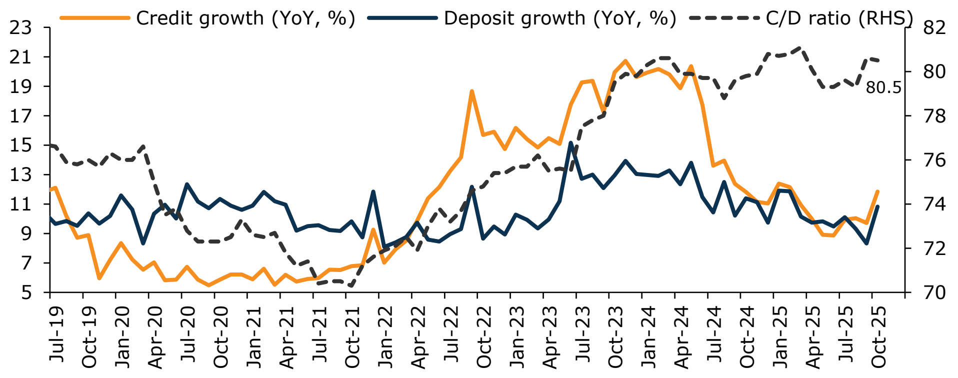
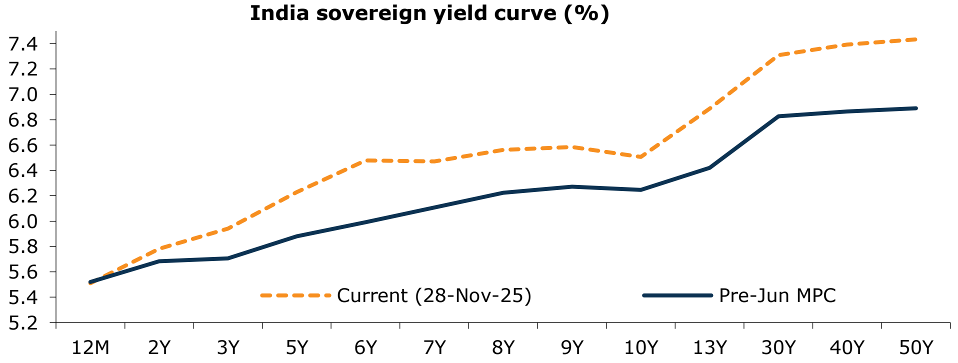
Source: RBI, Emkay Research

Exhibit 16: Banks' C-D ratio has crossed 80% recently, amid CRR cut and deposit mobilization challenges



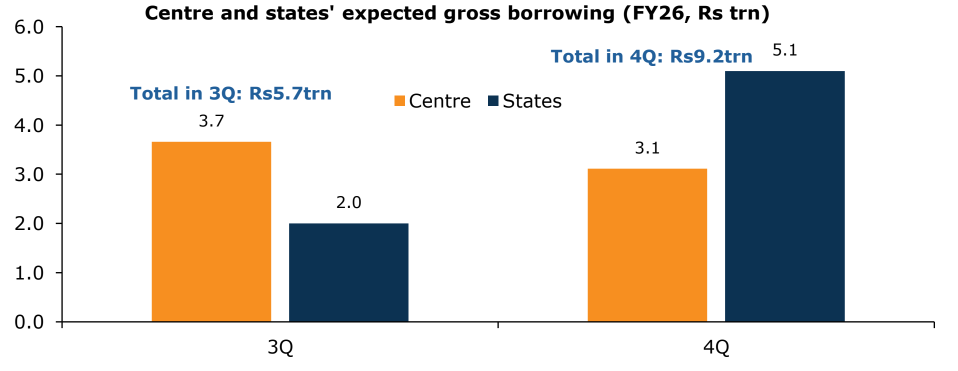
Source: RBI, Emkay Research

Exhibit 17: The sovereign yield curve remains considerably steeper vs pre-Jun MPC



Source: Bloomberg, Emkay Research

Exhibit 18: States' borrowing is expected to cross Rs5trn in 4QFY26 and keep supply high



Source: RBI, Emkay Research estimates

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ADD	5-15% upside
REDUCE	5% upside to 15% downside
SELL	>15% downside

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