

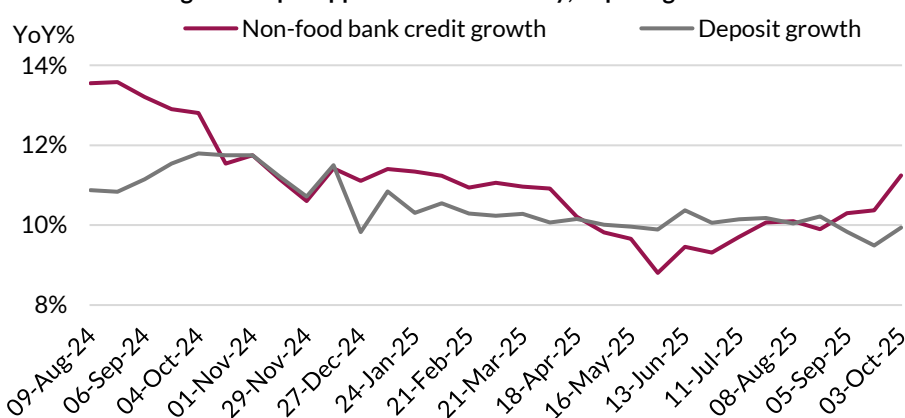
The Rupee's Release: RBI's shift in the face of the Impossible Trinity

Liquidity stress has re-emerged: deposit growth has stagnated despite a rebound in credit. Wholesale funding costs are rising, and CD-OIS spreads have widened. RBI share of money creation has (again) fallen sharply due to aggressive FX sales, driven by maturing forward shorts. These have offset CRR cuts, tightening durable liquidity – the Impossible Trinity at work. Deposits are also destroyed by growing currency demand (CIC) as the economy recovers and rising retained earnings in banks. With more forwards set to mature, and CIC likely to rise further, the RBI may need to inject more base money via OMOs. To sustain growth momentum, they may need to pre-empt the seasonal tightening of liquidity in 4Q.

October 28, 2025

Economic growth

Exhibit 1 - Credit growth up 2.4pp from lows end-May; deposit growth still the same



Source: RBI, Axis Bank Research

Stress on deposits is back: CD-OIS widens again as RBI share of money falls

Despite a substantial (2.4pp) recovery in YoY credit growth from the bottom in May-2025, deposit growth has been unchanged (Fig 1). This has again started to push up the cost of liquidity (Fig 10: 12M CD-OIS has rebounded to 110bps) and wholesale deposit rates. This is because RBI's share of money-supply has shrunk by 1.2pp in the last four months, with its share of incremental money creation falling from ~23% to just ~11% (Fig 2-3).

Impossible trinity at work: effect of RBI FX interventions contrary to stance

As it decided to let an estimated US\$24bn of FX forward sales mature, the RBI has had to sell about US\$33bn over the 18 weeks from 23-Jun to 17-Oct (Fig 4). This led to liquidity destruction of ~₹2.8tn, more than offsetting the ₹1.3tn released by 50bps of CRR cuts, bringing outstanding durable liquidity down to 1.5% of NDTL, and net liquidity to neutral (Fig 12). Another USD15 bn of FX sales could offset the impact of CRR cuts scheduled in Nov.

Deposit 'destruction' is adding to the pressure on wholesale funding rates

With the cyclical headwinds emerging from a higher-than-reported fiscal consolidation in FY25 and the policy-engineered sharp slowdown in credit growth now receding, economic momentum is improving. This has increased demand for currency in circulation (CIC, Fig 8-9). Further, higher bank profits (Fig 6) also destroy deposits: on the combined banking system balance sheet, liabilities effectively shift from deposits to equity.

While RBI letting the INR move helps, base money injections still need to rise

With the RBI allowing the INR to move again in the last two days, liquidity drain from FX sales should slow, but US\$30bn of forward shorts are estimated to mature by Mar-2026. With CIC expected to grow by another Rs1tn, it would be prudent to inject base-money via Open Market Operations even before liquidity conditions tighten seasonally in 4Q; Rs2tn-plus may be needed. Given the high equity base, the system should also be comfortable with high LDRs.

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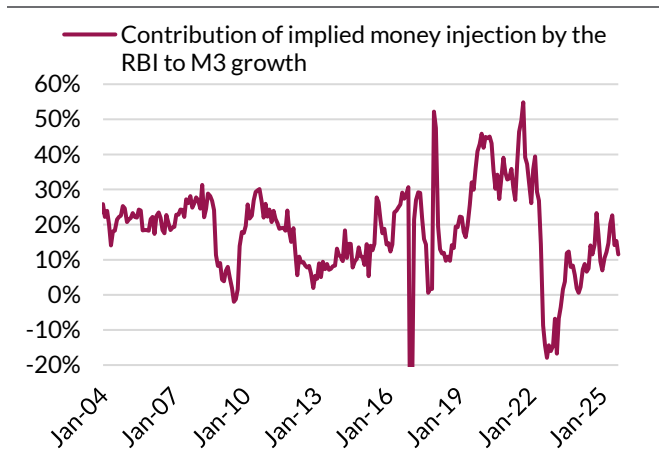
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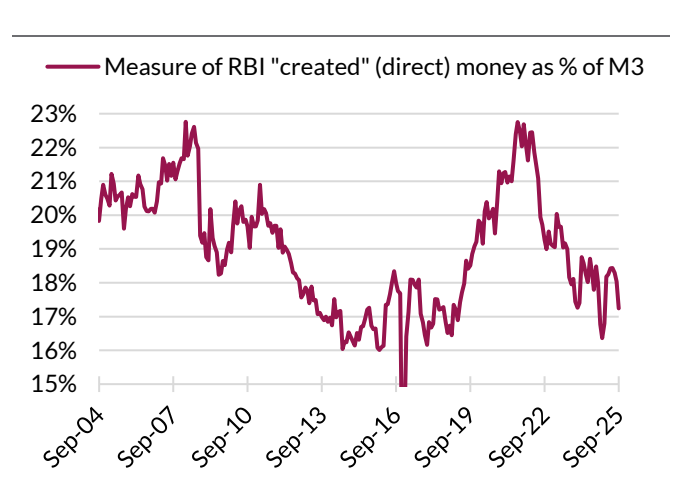
Story in Charts

Exhibit 2 - RBI's share of incremental M3 (rolling 12M) fell to 11% in Sep-25 vs. 23% in Jun-25



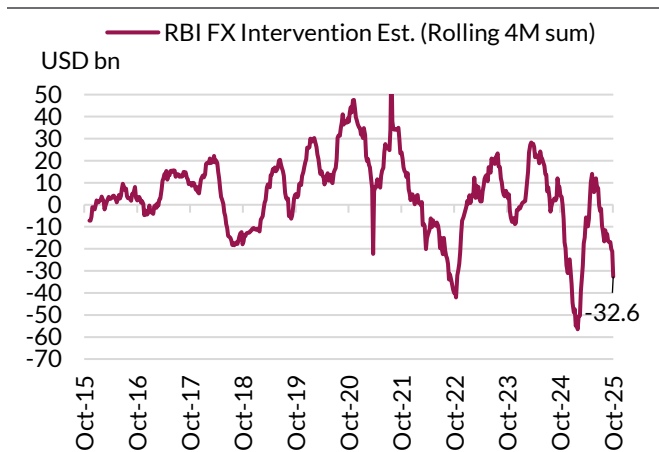
Source: RBI, Axis Bank Research

Exhibit 3 - Thus, RBI's share of M3 fell 1.2pp in four months



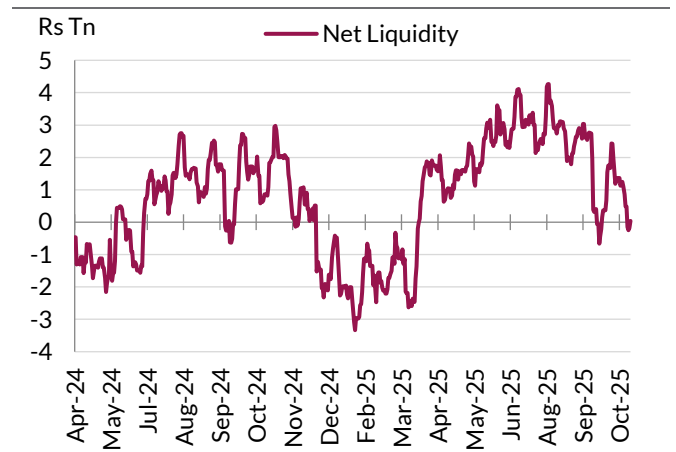
Source: RBI publication, Axis Bank Research

Exhibit 4 - RBI's heavy FX intervention the primary reason



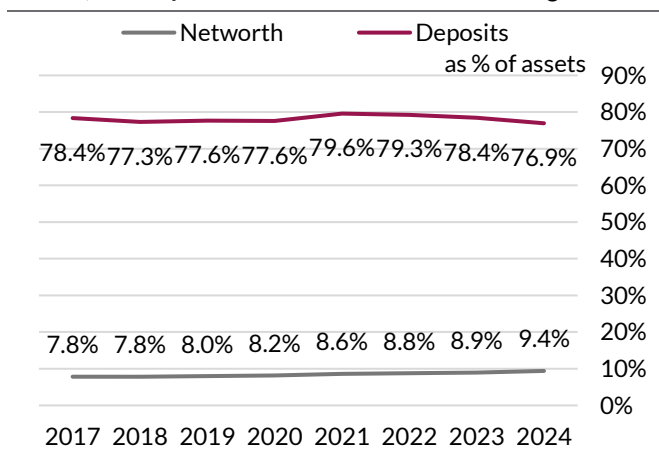
Source: Bloomberg, Axis Bank Research; data till 17th Nov only

Exhibit 5 - FX actions destroyed net/durable liquidity by ~3tn



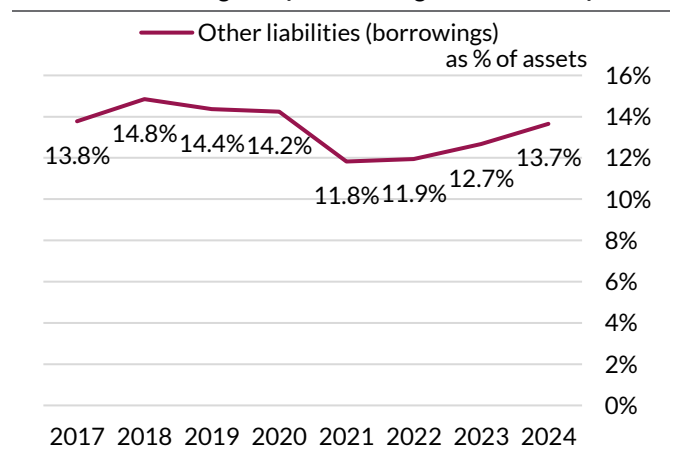
Source: Bloomberg, Axis Bank Research

Exhibit 6 - Regime shift: deposits to assets to be lower vs. pre-COVID; this requires RBI to be comfortable with higher LDR



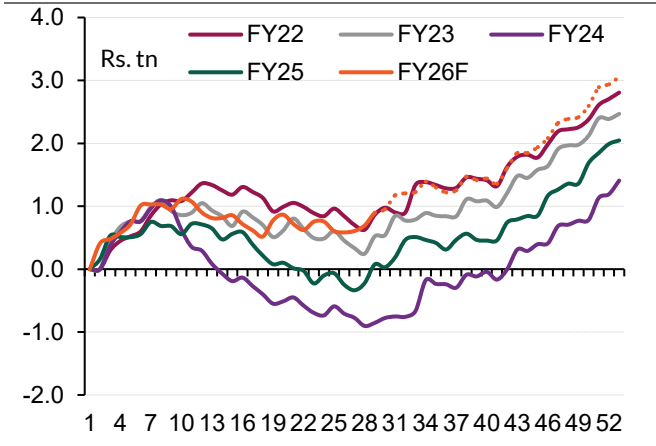
Source: RBI, Axis Bank Research

Exhibit 7 - Lower bank borrowings have aided deposit creation in 1H though they were a drag in the last few years



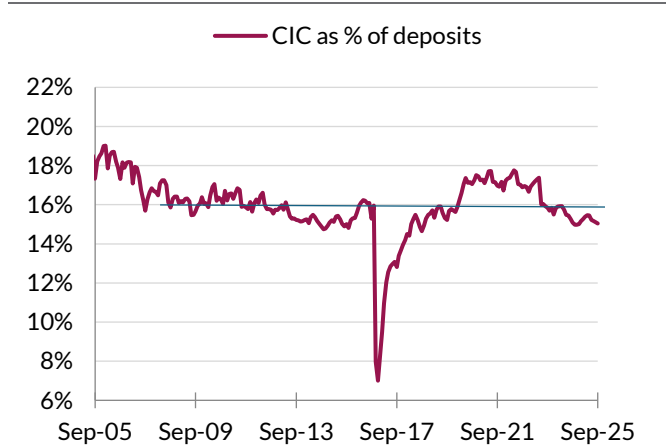
Source: RBI, Axis Bank Research

Exhibit 8 - Increased currency in circulation (CIC) another factor that lowers deposits but this is not unusual....



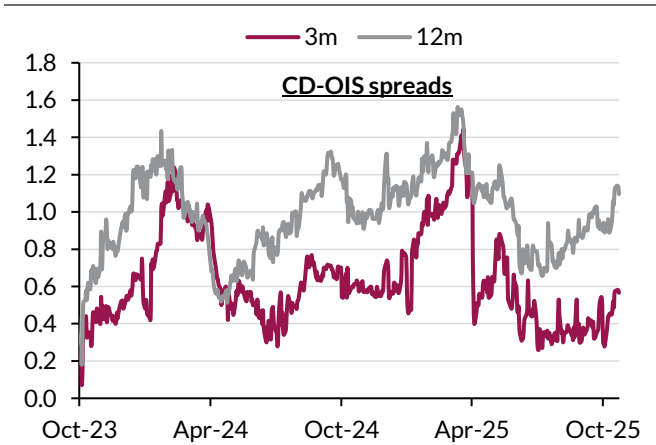
Source: RBI, Axis Bank Research

Exhibit 9 - CIC as % of total deposits exhibits normal trend, largely in line with 20Y median



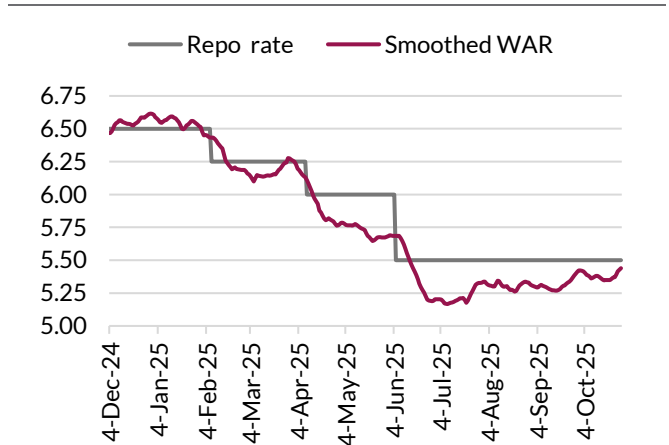
Source: RBI, Axis Bank Research

Exhibit 10 - Deposit 'destruction' putting pressure on wholesale funding rates



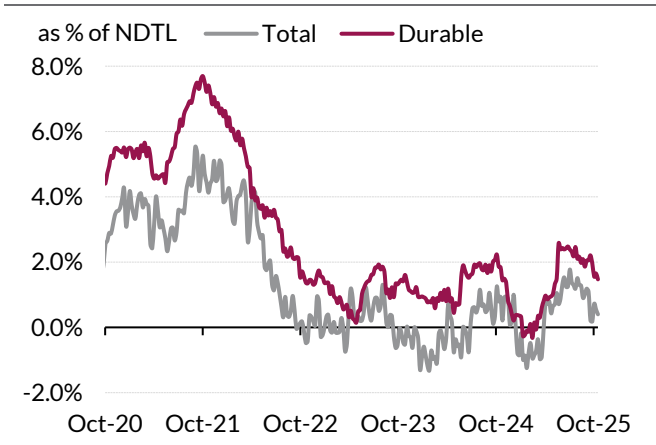
Source: RBI, Axis Bank Research

Exhibit 11 - O/N rates have moved closer to repo rate consistent with 'neutral' stance but represents 25bps rate hike



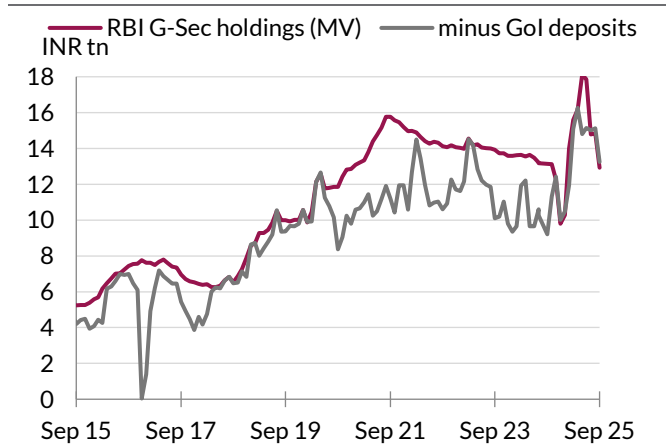
Source: RBI, Axis Bank Research

Exhibit 12 - Durable liquidity at 1.5% of NDTL, despite CRR cuts; two further cuts to restore it to 2%



Source: RBI, Axis Bank Research

Exhibit 13 - OMOs needed to inject durable liquidity (the decline below is a combination of valuation losses and expiry)



Source: RBI, Axis Bank Research

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