Worst of liquidity deficit may be over

VRR auctions, govt spending likely to help ease situation

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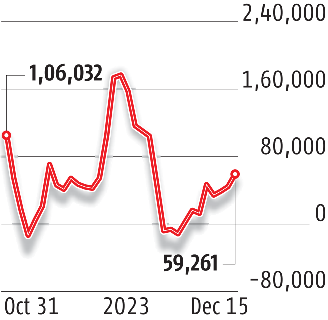
The worst of the liquidity deficit may be over, despite the heavy outflows scheduled over the next few days. The Reserve Bank of India (RBI), according to market participants, has signalled its support for banks with variable rate repo (VRR) auctions.

Bond market participants anticipate a mitigation of liquidity strain through factors, such as the reversal of variable rate reverse repo (VRRR), and government spending.

Approximately ₹4 trillion worth of outflows are expected because of advanced tax and GST payments in December. Additionally, a redemption of ₹59,533 crore bonds is scheduled in January.

INTO THE SYSTEM

Net liquidity injected by RBI (₹ cr)



Source : RBI, Bloomberg
Compiled by BS Research Bureau

"The market feels that the RBI has given its first signal towards liquidity by conducting a VRR (auction) to reduce the impending tightness in liquidity. I think the worst of the liquidity deficit is over and from here on, we will see a slight easing of liquidity. This may also mean that the rate hike era is truly over," said Vijay Sharma, senior executive vice-president at PNB Gilts.

Liquidity has remained largely in deficit mode in the current quarter.

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But the RBI infused ₹59,260 crore and ₹1.5 trillion on Friday and Sunday, respectively. The banking system liquidity deficit widened to a near five-year high on November 21 on the back of monthly goods and services tax payments; the central bank had infused ₹1.74 trillion on that day.

"Given that it is just a seven-day instrument that they have given, this necessarily means that they are also expecting that liquidity will improve once the government spending comes in," said Indranil Pan, chief economist at YES Bank. Against the notified amount of ₹ 1 trillion, the RBI received bids worth ₹ 2.7 trillion at the 7-day VRR auction – the first in six months. Banks borrowed the amount at a weighted average rate of 6.63 per cent. Significant demand was also fuelled by elevated call rates and tri-party repo rates in the market, dealers said. Earlier, the RBI conducted a VRR auction on June 19. The market expects that the RBI will abstain from conducting open market operations of bond sales in the near term. However, if and when foreign inflows into bonds materialise, the central bank can utilize OMOs as a tool to manage liquidity, absorbing excess funds in the system.