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DUAL REMORSE

With yields hardening while economy showing signs of an uptick, markets need to move out of the uncertainty frame of mind as structural reforms and consumption boost could be enduring and lift sentiments…. Liquidity and communication need constant fine tuning though

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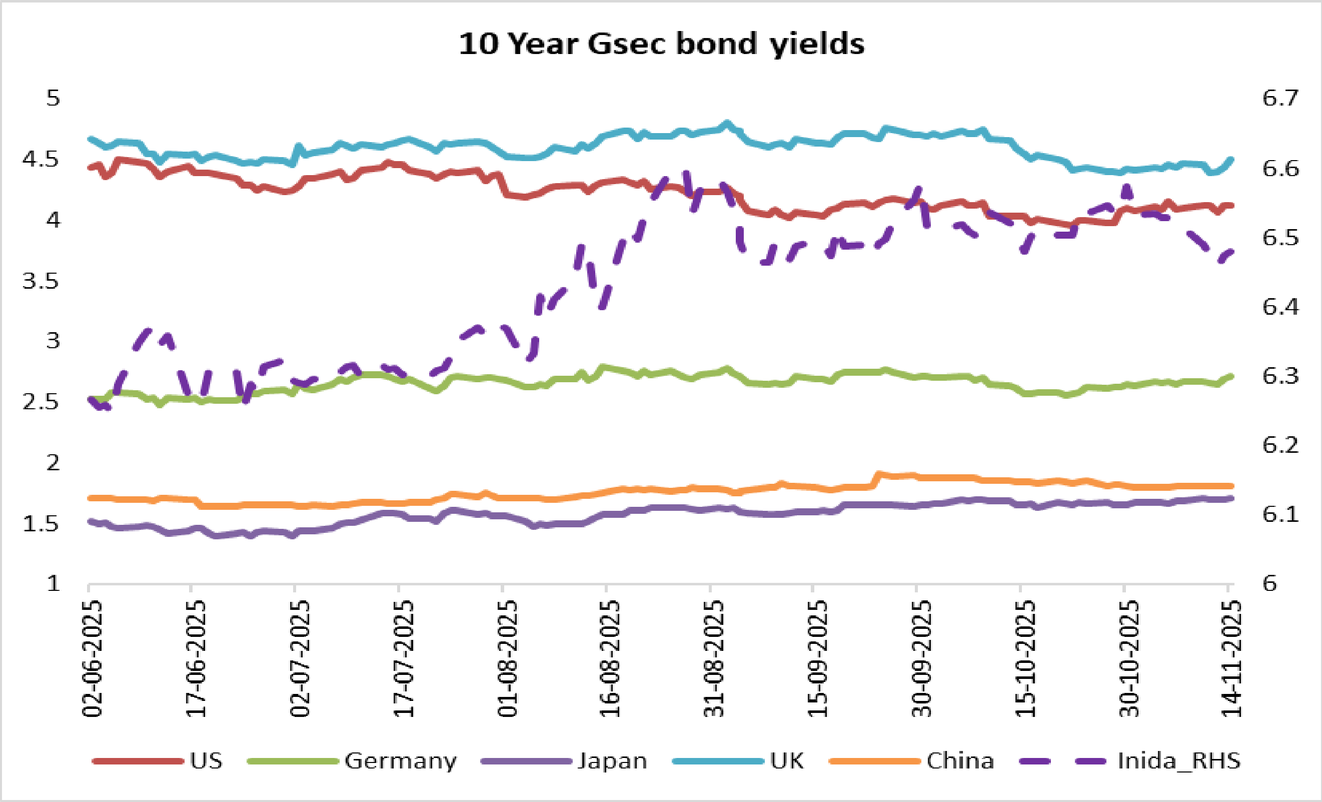
Ascent of different asset classes indicates exuberance…. Yields harden in response to uncertainty

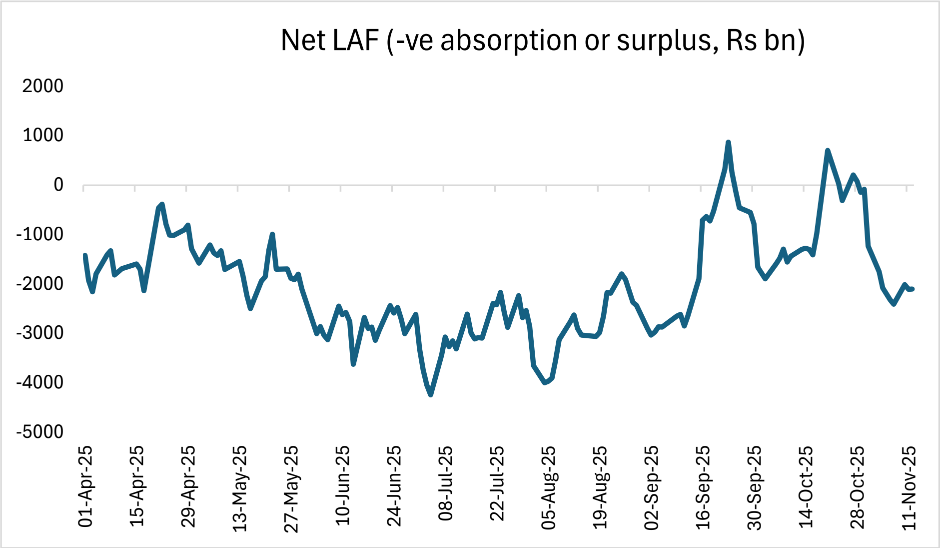
- After a phase of rate cuts celebrating benign inflationary regimes, benchmark yields globally show signs of nervous movement with rapidly evolving contours of uncertainty hanging like a Damocles sword
- **With debt issuances likely to spiral as policy makers endeavor to meet myriad challenges, Central Banks have often struggled to use communication as a confidence building measure for broader market forces, aligning rates with expectations in a declining rate environment**
- Interestingly, the correlation between different asset classes looks a little disjointed with stock markets galloping though concentrated in select Tech stocks), PE/VC deals taking off with renewed enthusiasm and yields hardening across most tenors even as the rise of divergent assets like Gold/Silver as also Virtual Digital Assets point to new buffers in the era of risk-on

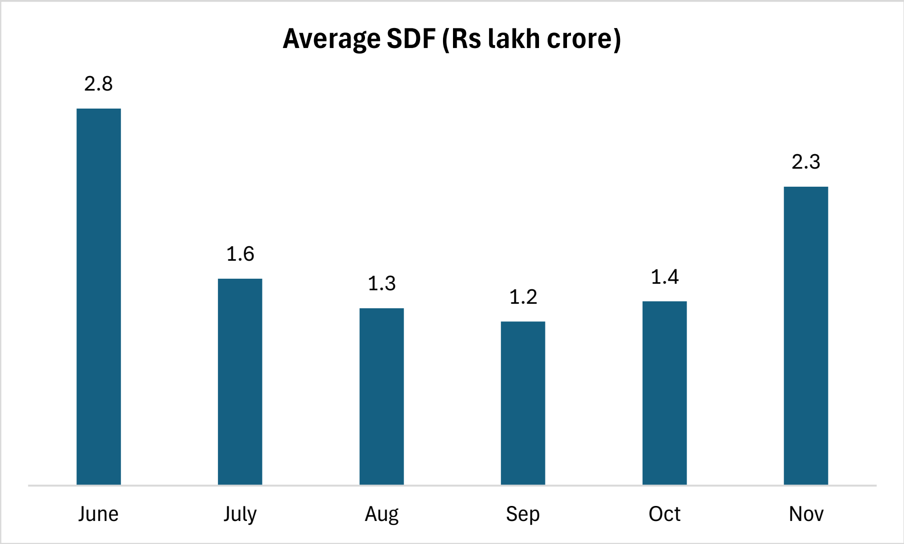


Source: Bloomberg, SBI Research

Liquidity turned volatile since mid-Sep…. Comfortable yet watchful

- Back home, banking system liquidity has turned volatile with surplus reducing significantly in mid-Sep, turning into deficit mode for some days in the third week of Sep-25. Average surplus liquidity which was Rs 2.7 lakh crore in the first half of Sep reduced to mere Rs 0.28 lakh crore in the second half of the month with advance tax and GST led outflows
- October'25 again saw huge swings in liquidity, with first half having a surplus of Rs 1.5 lakh crore followed by Rs 0.31 lakh crore surplus in the second half. Liquidity turned to deficit on 4 days between 16-31st October. It is now in a surplus of Rs 2.4 lakh crore as on 13 Nov'25… Central Bank came with a term VRRR on 14th November morning intending for a mop of surplus liquidity of Rs 1,00,000 crore, however, there was soft demand to the tune of around Rs 57,000 crore
- Meanwhile, the amount parked in SDF remained high in Aug-Oct'25 averaging Rs 1.3 lakh crore. In November, it has increased again to Rs 2.3 lakh crore, denoting excess funds parked with RBI. **Interestingly, In times of deficit also, large amount has been parked in SDF which typically represents *unusable* liquidity/ liquidity used for precautionary motive to care for unforeseen outflows in times of 24/7 payments**… CRR measures could add to liquidity

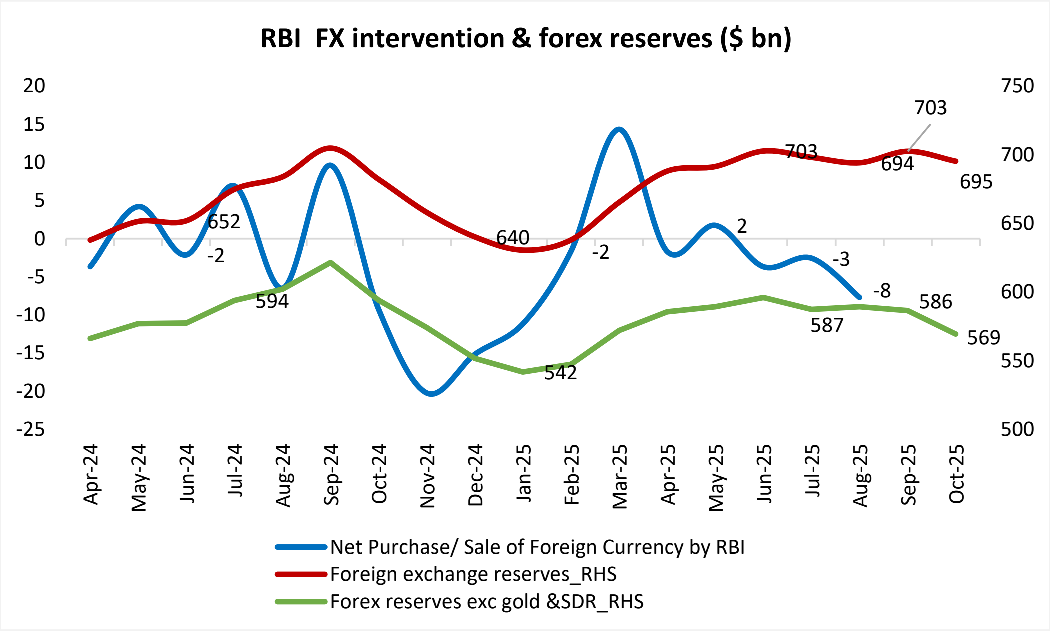




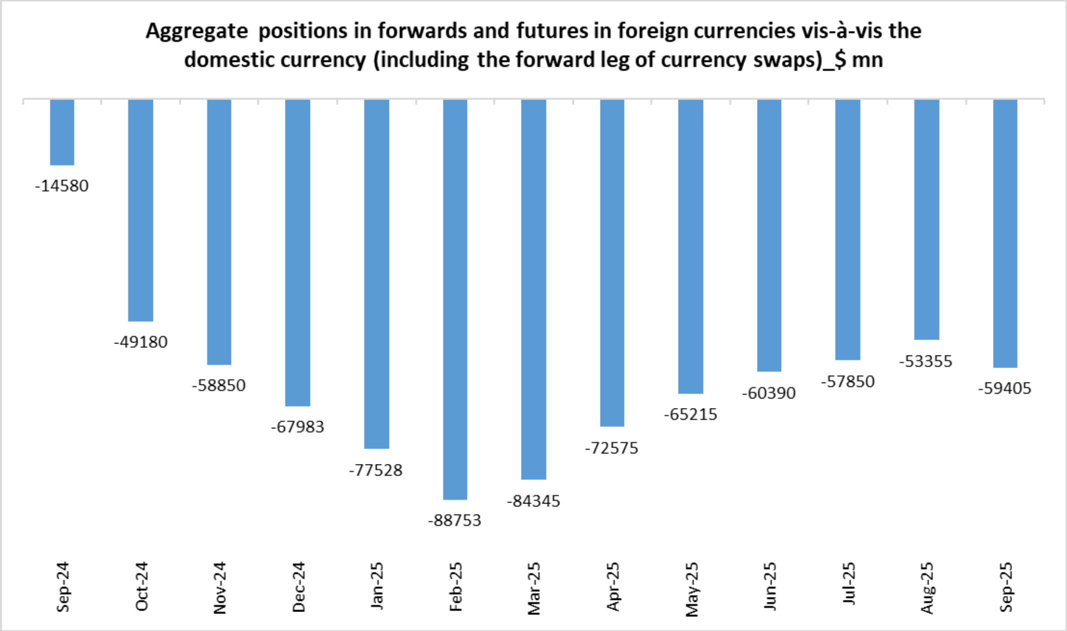
Source: RBI press release on daily money market operations, SBI Research

…Meanwhile, RBI intervened in the Exchange Market to defend the Rupee, thereby putting liquidity under strain…..

- RBI intervened against the comfortable forex reserves to defend the rupee exchange rate from excessive speculation. The net sale of foreign currency amounted to ~$14 bn during Jun-Aug'25, equivalent to Rs 1.2 lakh crore withdrawal of permanent liquidity from the system
- Foreign exchange reserves which were $703 bn in June'25 have come down to $690 bn in end October. Excluding gold and SDR, reserves have come down by $30 bn to $569 bn from $599 bn during the same period. With rupee continuing to exhibit depreciating bias, RBI intervention to support the rupee would have continued post August'25 and could have comfortably surpassed these numbers today.. **The spate of recent RBI OMO in secondary market could be thus a tactical ploy to inject permanent liquidity to negate the permanent liquidity withdrawal because of RBI intervention in forex market…**
- **RBI has recently changed its intervention strategy by relying more on the NDF markets rather than the spot intervention to manage volatility in the rupee which has the benefit of not impacting banking liquidity**



Source: RBI Monthly Bulletin, SBI Research



Sep'25 is estimated on the assumption that more than one year bucket will continue with same amount

….However, such was balanced by secondary market activity showing increased buying of Govt securities by ‘OTHERS’

- While Banks and Mutual Funds have been selling the G-sec in the recent months, ‘OTHERS’ category has mostly been the buyers of the G-sec
- Is the Central Bank stealthily anchoring G-Sec, while the broader markets are guesstimating?

Net Market Activity in the Trading of Gsec in Rs Bn						
Months	Public sector Banks	Foreign Banks	MF	Private Banks	Others	P Dealers
Jan-25	-281	279	-148	-24	550	-376
Feb-25	33	141	-73	7	154	-263
Mar-25	-86	363	-160	-23	63	-158
Apr-25	213	-283	74	259	274	-536
May-25	606	-488	40	112	384	-654
Jun-25	110	53	-249	127	300	-342
Jul-25	-85	118	15	-27	278	-298
Aug-25	269	-37	42	-228	275	-321
Sep-25	112	-5	-101	71	158	-235
Oct-25	-65	-79	-6	35	166	-50
Nov-25	-174	40	-101	-133	374	-6
Source: CCIL, Bloomberg						

…This is also visible in increase in share of RBI in Outstanding Government Securities

- RBIs share in outstanding Government securities has increased to 14.2% in Jun-25 from 11.9% in Jun-24, and 10.6% in Dec'25 while the share of Banks has declined and Insurance companies has remained largely the same

- Given the borrowing of Central Government is around ~ Rs 1.00 lakh crore each month for the months till February'26 (feeble amount only in March), and comparatively large SDL issuances would be jostling with short term government borrowings, we believe the yields could be rangebound and moving sideways in days to come…

Percent Share of Outstanding Dated Securities

	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Commercial Banks	37.52	37.550	37.980	36.18	35.28
Co-operative Banks	1.42	1.350	1.360	1.29	1.29
Non-Bank PDs	0.7	0.770	0.650	0.76	0.59
Insurance Companies	26.1	26.0	26.1	25.81	25.95
Mutual Funds	2.9	3.1	3.1	2.68	2.46
Provident Funds	4.4	4.3	4.3	4.24	4.35
Pension Fund	4.7	4.9	5.1	4.91	4.96
Financial Institutions	0.6	0.6	0.6	0.71	0.74
Corporates	1.4	1.6	1.5	1.49	1.26
FPIs	2.3	2.8	2.8	3.12	2.80
RBI	11.9	11.2	10.6	12.78	14.21
Others	6.0	5.9	6.0	6.01	6.13

Source: RBI Monthly bulletin, SBI Research

Market Borrowings (Rs in Lakh Crore)

Category	FY26 BE*		H1 FY26 actual		H2 FY26 as per calendar**
	Gross	Net	Gross	Net	Gross
Dated Securities	14.8	11.5	8.0	5.0	6.77
SDLs	11.5	7.8	4.1	2.9	6.6
91-Day T-Bills	6.06	0	4.3	0.1	2.07
182-Day T-Bills	4.84	0	1.8	-0.4	1.98
364-Day T-Bills	3.61	0	1.6	0.0	1.56

Source: RBI, Union Budget Document, SBI Research, *SDL as per SBI estimate, **SDL and T bills Q4 is estimated

OMO had helped quell market fears early this year while infusing liquidity, though VRRR has now become a new toolkit

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- RBI did OMO purchase of Rs 5.2 trillion between Jan-May'25, apart from ensuring sufficient liquidity in the system. This helped in moving the call rate down from an average of 6.6% in Jan'25 to 5.8% in May'25. **This was in consonance with a rate easing cycle that had started in February 2025..Such OMO purchases results in permanent liquidity infusion pushing the call rate towards the lower end of the policy corridor**
- However, post June'25 RBI rate cut of 50 bps, call rate has moved towards the upper end of the policy corridor with sporadic VRRR auctions pushing up the call rate towards/ beyond the upper end of policy corridor. **The recent announcement by RBI regarding a VRRR auction / temporary liquidity withdrawal comes against a backdrop of secondary RBI open market operations of permanent liquidity injection.. The last auction has pushed the call rate beyond 5.5% and also the TREPS rate**
- **RBI engaging in OMOs (purchases) as also VRRR during the same time zone opens the trifecta of liquidity maneuvering in both directions coupled with a low inflation and targeting of policy rate….in a situation of inflation consistently surprising on the downside and the calls for rate cut the questions remains about timing of pushing the call rate / operating rate beyond the current repo rate at 5.5% (call rates have already moved past 5.5% post the latest VRRR)**

OMO purchase in Rs cr

Tenure of Securities	Jan- Mar'25		FY26	
	Amount accepted	% share	Amount accepted	% share
upto Years	25754	10.5	20202	8.4
> 5 to < 10 yrs	86364	35.3	115279	48.2
10 yrs	43893	17.9	32929	13.8
> 10 yrs, < 15 yrs	88550	36.2	70793	29.6
Total	**244561**	**100.0**	**239203**	**100.0**
OMO (Outright)	38825		12490	
Total OMO purchase	283386		251693	

OMO and Call Rate

Date	Call Rate (%)	OMO (Rs bn)	
		Sale	Purchase
Nov-25	5.40	0.0	124.7
Oct-25	5.49	0.0	0.0
Sep-25	5.46	0.0	0.0
Aug-25	5.44	0.0	0.0
Jul-25	5.38	0.0	0.0
Jun-25	5.38	0.0	0.1
May-25	5.83	0.0	1192.0
Apr-25	5.95	0.0	1200.0
Mar-25	6.33	0.0	1445.5
Feb-25	6.36	0.0	800.0
Jan-25	6.61	0.0	588.4
Dec-24	6.65	0.0	0.2
Nov-24	6.53	0.0	0.0
Oct-24	6.50	0.2	0.0
Sep-24	6.55	58.2	0.0
Aug-24	6.52	76.9	0.0
Jul-24	6.52	105.6	0.2
Jun-24	6.60	0.1	0.1
May-24	6.61	0.0	0.0
Apr-24	6.56	0.0	0.0
Mar-24	6.61	0.1	0.1
Feb-24	6.63	0.0	0.0
Jan-24	6.76	0.0	0.0

Source: RBI WSS, Bloomberg, SBI Research

RBI has continued with VRRR since end-June

- RBI started Variable Reverse Repo Rate (VRRR) auctions since 27 June and continued to absorb excess liquidity till mid-Oct

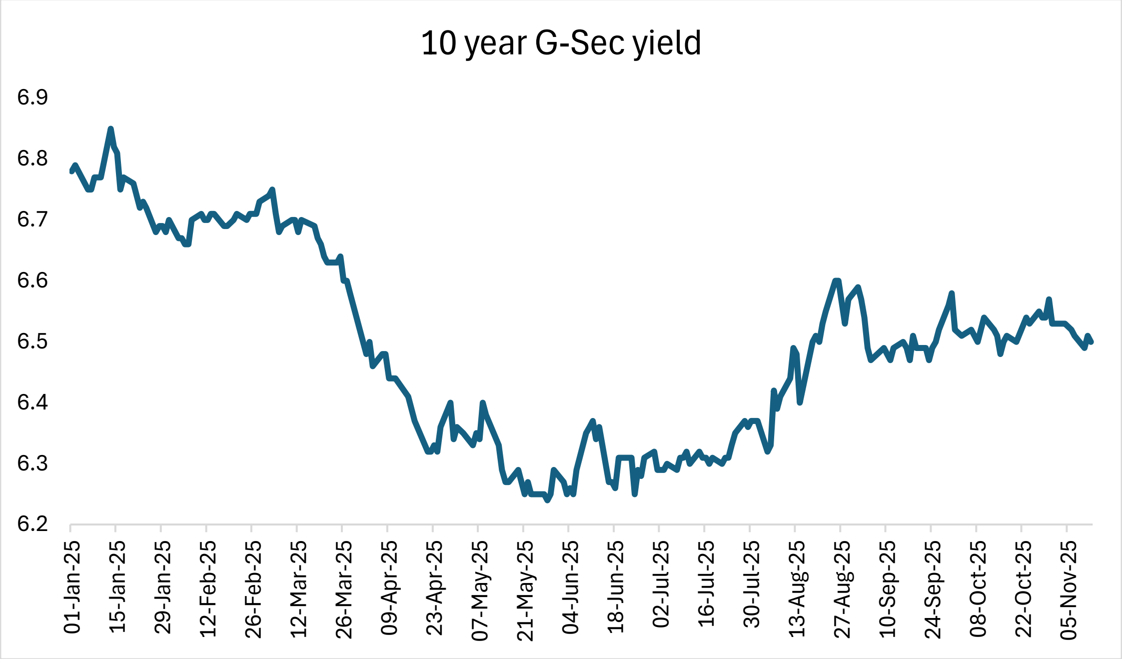
- It absorbed Rs 21.2 lakh crore cumulatively during this period through VRRR auctions

- On the other hand, it stopped the daily Variable Repo Rate (VRR) auctions since 11 June 2025 as the liquidity turned into surplus. But it continued to conduct VRR auctions intermittently since July 2025. It injected liquidity worth Rs 12.5 lakh crore through VRR auctions since then

Liquidity injection/absorption by RBI				
Auction type	**Tenor (Days)**	**Notified Amt(Rs lakh cr)**	**Amt Accepted (Rs lakh cr)**	**WAR %**
VRRR auctions	1	2.25	1.58	5.49
	2 to 7 days	9.5	6.85	
	7 days+	32.5	12.8	
	Total	**44.25**	**21.23**	
VRR auctions	1	14.55	8.08	5.52
	2 to 7 days	9.25	4.43	
	Total	**23.8**	**12.51**	
Source: RBI Press release				

Higher G-sec yield since June despite 50 bps repo rate cut

- Yields hardened since June’25 with the escalation of trade barriers and levy of additional tariffs on most exports that had a sobering effect on growth dynamics initially….10-year G-Sec yield has been hovering around ~6.5% on date and has not moved down commensurate with the Repo rate cuts which has moved down by 100 bps in 2025. In comparison, 10- year G-sec has softened by around 30 bps so far, kind of reversing the trend post early January’25. The G-sec yield has increased by 21 bps since June policy despite 50 bps cut in Repo rate
- As with any prudent Central Bank, RBI is not comfortable with higher yields on G-Sec (and the volatility) as is clearly reflected in the cancellation of auction of seven-year Government bonds earlier this month because of higher yield demand… In SDL space too, the reluctance to accept higher cut-offs remains palpable…. **However, in recent times there has been a scale down of SDL borrowings to adjust supply**



Source: Bloomberg, SBI Research

Beyond the high headline correlation of TREPS and WACR…

- The unconditional correlation between the collateralized TREPS rate and the uncollateralized call money rate is estimated to be significant (~ 0.96), **which prima facie suggests tight co-movement across the two segments of the overnight market and hence targeting call rate ensures TREPS rate and others are also targeted indirectly**
- We compute semi-partial correlations after controlling for key microstructural drivers of short-term rate dispersion such as daily turnover in each market, the relative collateralized vs. uncollateralized market structure and liquidity injections/absorptions
- The semi partial correlation coefficient is given as

$$\rho^{semi}_{treps,call}|Z = \frac{\mathrm{cov}(treps_t, \hat{U}_{call}, t)}{\sqrt{Var(treps_t)Var(\hat{U}_{call,t})}}$$

- **The semi-partial correlation falls to 0.853, with the squared contribution dropping to 0.728, implying that nearly 27% of the apparent co-movement in TREPS is accounted for by variations in control variables.** Similarly, semi partial correlation of Call rate on TREPS and control variables shows a similar pattern with correlation coefficient at 0.827. **This shows that the unconditional correlation overstates underlying rate alignment**

Semi-Partial Correlation coefficient of TREPS			
	Semi-partial Correlation	Semi partial Corre^2	p-value
Call rate	0.853	0.728	0.0023
Semi-Partial Correlation coefficient of Call Rate			
	Semi-partial Correlation	Semi partial Corre^2	p-value
TREPS	0.827	0.684	0.0016

Fund Flows into Financial Markets

Corporate credit requirement remains healthy… Bank credit too signals uptick against sticky deposits growth

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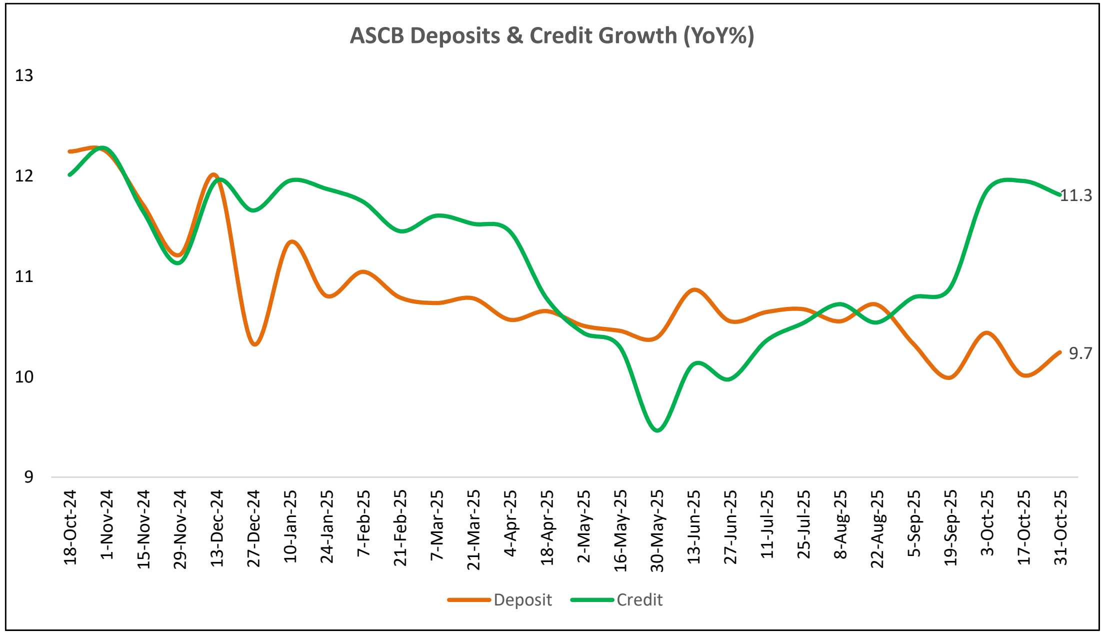
- Corporate bond issuances increased 8% yoy to Rs 6.3 lakh crore in FY26 (till Oct), while CP issuances also increased by 13% yoy to Rs 9.8 lakh crore during the same period

- ASCB bank credit also increased 16% yoy during FY26 (till Oct) while on YTD basis the credit growth has been ~6.3%. On deposit front, yoy growth during FY26 (till Oct) is 2.6% while on YTD basis deposit growth has been 7.1%. Bank credit growth was 11.3% for the fortnight ended 31 Oct'25, while deposit growth increased to 9.7% from 9.5% during the same period. **The green shoots of growth in credit against lagging deposit growth calls for more proactive liquidity management**

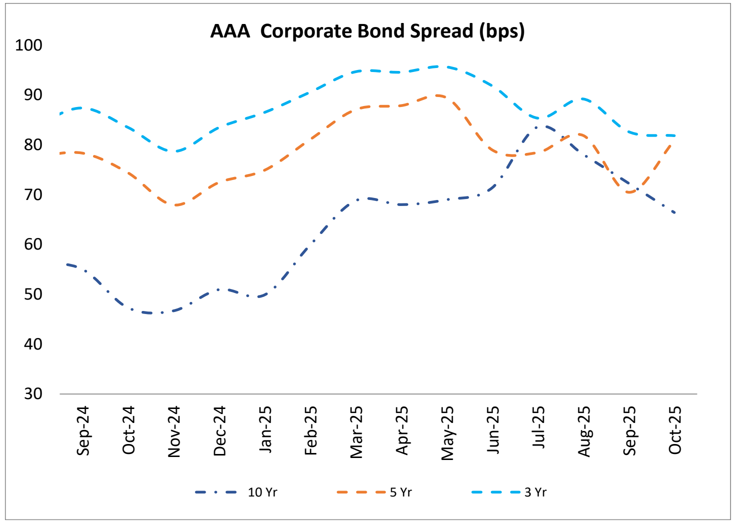
Snapshort of Debt/Credit Market (Rs lakh crore)					
Description	FY24	FY25	FY25 (till Oct)	FY26 (till Oct)	FY26 (till Oct) (YoY%)
Corporate bond issuance	10.2	10.6	5.79	6.26	8.1
Commercial Papers primary issuance	13.7	15.7	8.63	9.76	13.1
ECB Registrations#	4.0	5.2	2.1	1.6	-23.8
ASCB Bank Credit	27.6	18.1	9.9	11.5	16.1
Total Flow	**55.6**	**49.6**	**26.35**	**29.05**	**10.2**
Source: SBI Research; Prime database; RBI, #ECB registrations for FY26 is Apr- Aug					

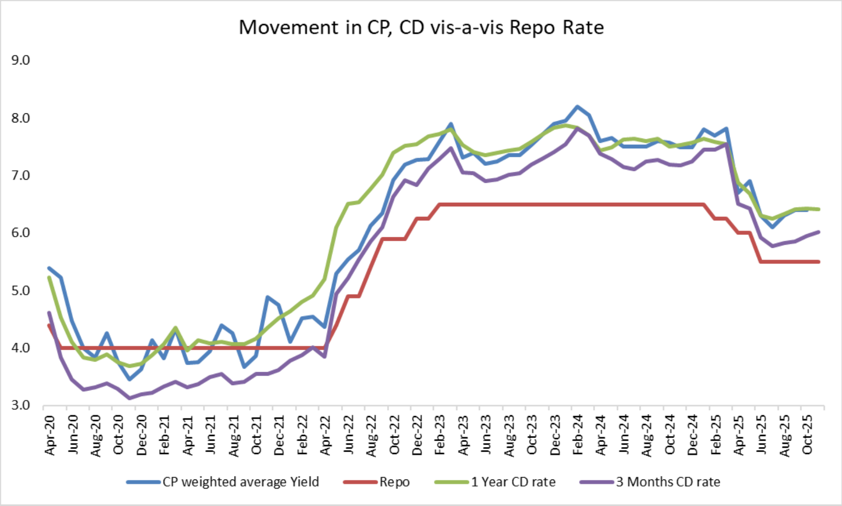


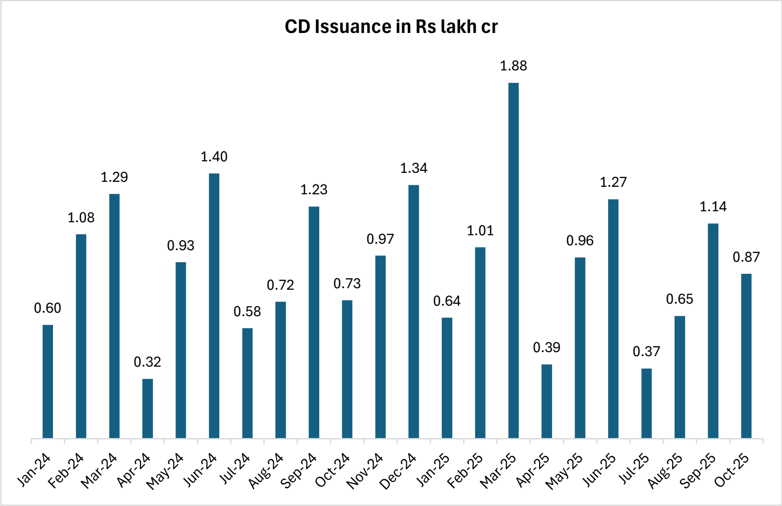
Source: RBI WSS, SBI Research

Corporate Bonds show divergence across tenor….

- Spread between 10-year AAA corporate bond and G-sec continues to decline since August, however for 5 year bond and G-sec it has increased in October
- Spread between Repo and CP (weighted average rate) which was negative during FY21 increased to 114 in FY25 and is now 90 bps in Oct-25
- Similarly, spread between Repo and 3 months CD which was negative during FY21 increased to around 83 bps in FY25 and is now 45 bps in Oct-25



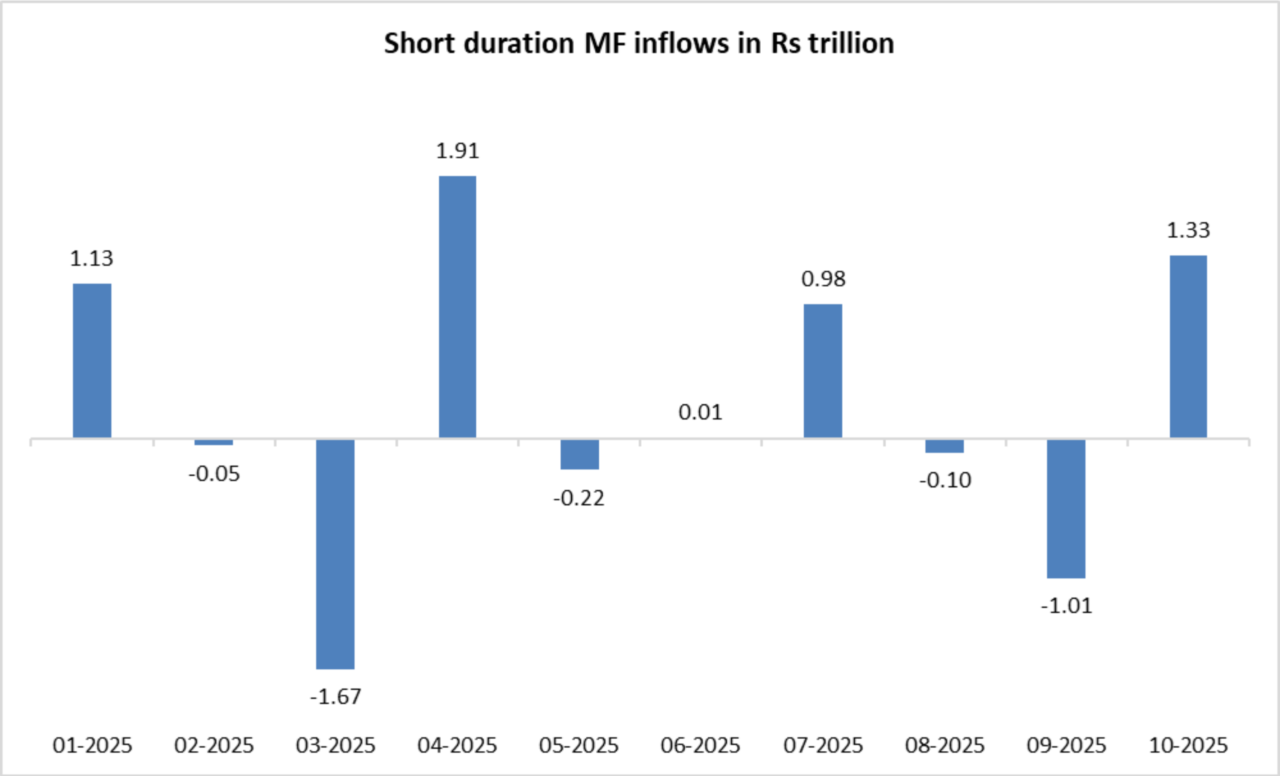




Source: Bloomberg, FIBIL, RBI WSS, SBI Research

Mutual Funds seem Long Term Agnostic…..

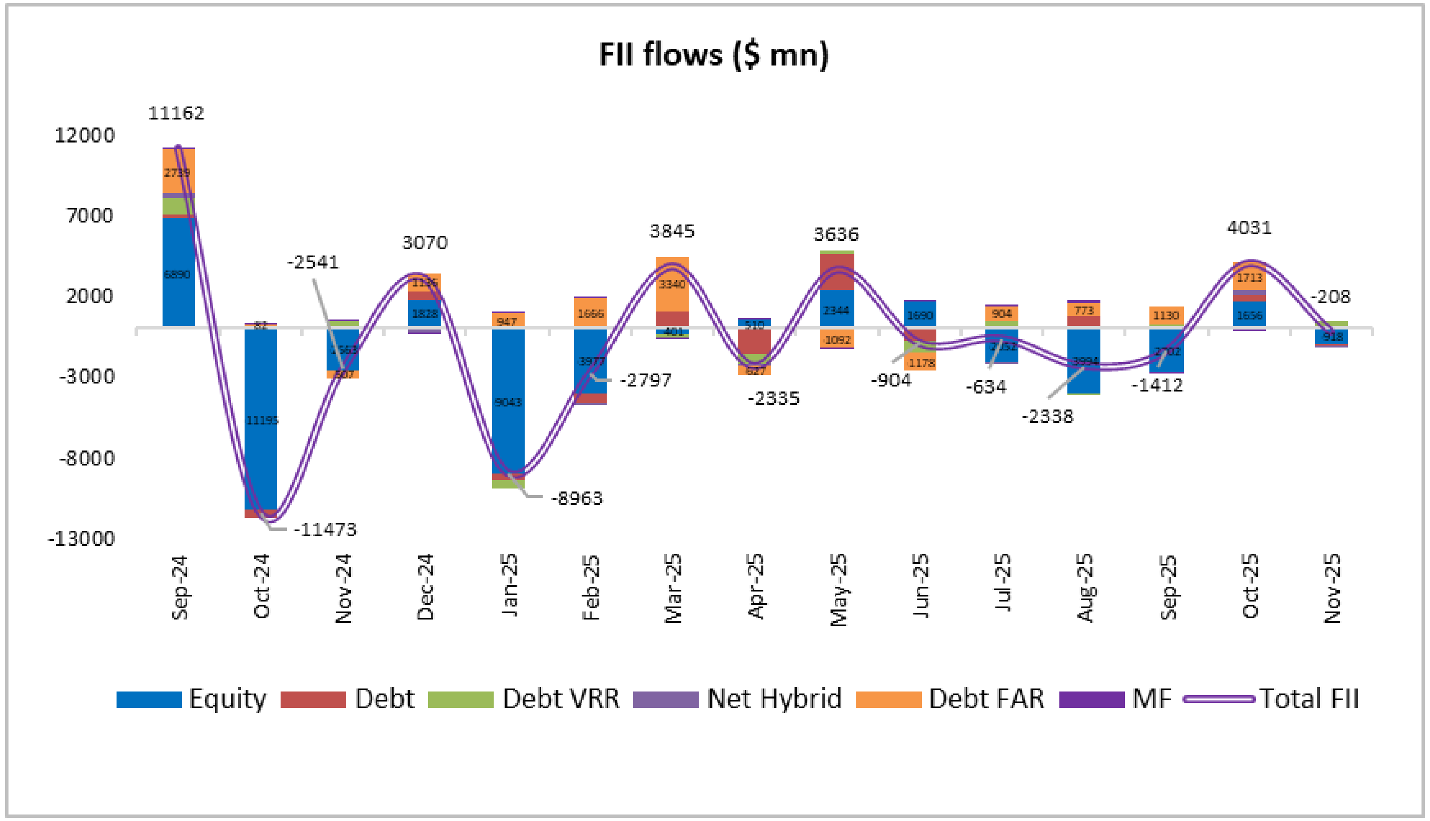
- Mutual Funds witnessed gush of liquidity in short term instruments during October25, totaling Rs1.33 lakh crore, reversal of fortunes after a big outflow in September and a somewhat negative August before that, indicating flows are preferring a short termism…….



Source: AMFI, Short duration funds are considered for calculation: Liquid Fund, Ultra Short Duration Fund, Low Duration Fund, Money Market Fund, Short Duration Fund and Medium Duration Fund

FII Inflows indicate preference to Debt over Equities….

- FPIs have been cautious on emerging markets in general of late as pangs of volatility rocked the flow of capital and investments… However, the flows in various debt segments have bucked the trend and remained in positive terrains for most months vindicating their trust in GoI's macro fundamentals and reforms being ushered in



Source: NSDL FPI Monitor, SBI Research

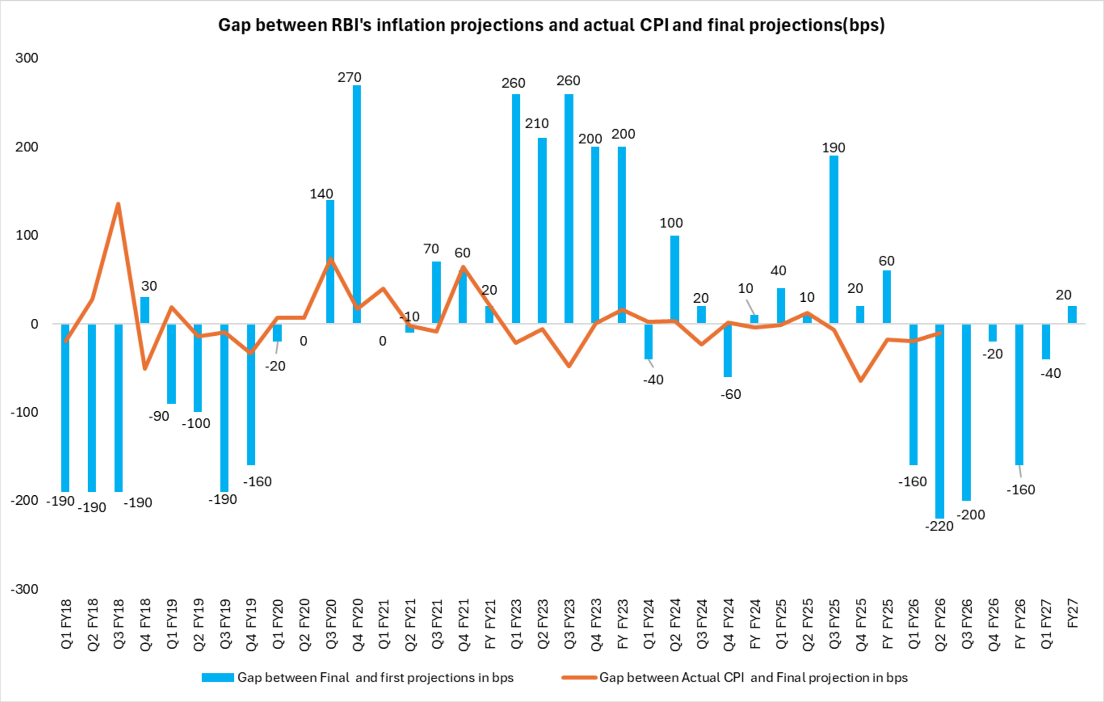
Food for thought

Gap remains between actual CPI and inflation projections by RBI

- **In a world characterized by uncertainty, inflation projection by market participants as well as RBI have consistently undershot and overshot actual inflation numbers**

- **The average downward revision between final and first RBI projection of inflation forecast is -120 bps…even after such downward revisions, there is still a gap between the actual CPI and the final projection as the accompanying graph shows**

- Interestingly, the average upward revision also comes at 110 bps. ***Such gap complicates monetary policy decisions and results in Type 1 as well as Type-II error….***



Source: RBI MPC statements, SBI Research

Type-I and Type-II error in Monetary policy

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- Monetary policy can be statistically framed as hypothesis testing problem

H0: Inflation undershooting is transitory

HA: Inflation undershooting is not transitory

- The expected loss from monetary policy decisions under uncertainty can be expressed as:

$$E[L]=\alpha \cdot C1+\beta \cdot C2$$

Where
- α = probability of Type I error
- β = probability of Type II error
- C1 = cost associated with inflation overshooting target
- C2 = cost associated with output and employment loss due to policy inaction

- **Empirical Evidence (Ball(1994), Blinder(1998)) suggests that missed easing cycles have a more damaging impact than easing early i.e. C2>C1 and hence expected loss from easing is lower than expected loss from non-easing underscoring the asymmetries in policy error costs. Thus, a cut now would minimize expected loss**

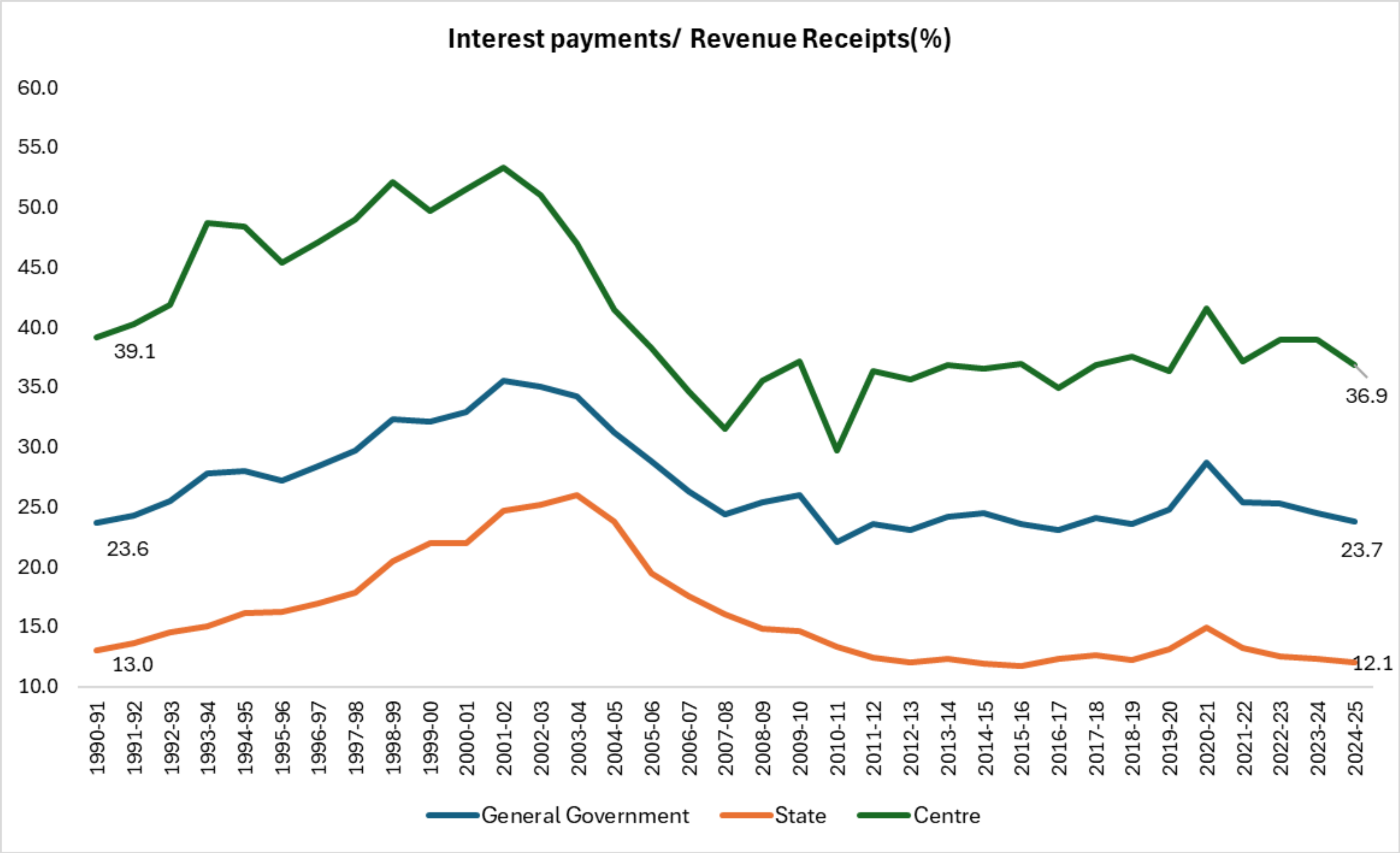
Hypothesis Testing		
Hypothesis	Cut Now	Wait
Inflation undershooting is transitory	Type-I error	Correct Decision
Inflation undershooting is not transitory	Correct Decision	Type -II error

Type-I error: A Type I error occurs when the central bank rejects the null hypothesis, believing that inflation is persistently undershooting and thus cuts rates but in reality the inflation undershoot was temporary or due to noise

Type-II error: A Type II error occurs when the central bank fails to reject the null hypothesis, assuming that the inflation undershoot is temporary, and hence does not cut rates — but in reality, inflation remains persistently low and output gap continues to weaken….

Type II error is often considered more harmful in applied statistics because it reflects low test power—failing to detect a true effect—which can lead to costly inaction. We must avoid Type 2 error and cut now…

Interest Payments to Revenue Receipts of Centre and States at close to a quarter…Centre at a staggering 37%...Thus it is of paramount importance to ensure a low term structure of G-secs…



Source: Statistics on Public Finance, RBI DBIE, SBI Research

Communication could be the key in current times……

- Back till the early 90s, monetary policy was largely swayed by Robert Lucas' argument that monetary policy affected real variables only if the policy changes were unanticipated, thus batting for obscurity over openness and clarity….In essence, back then, monetary policy was thought to be effective only through an unanticipated surprise, which was to be achieved through non-transparent communication

- RBI has shown great forbearance in choosing the twin guidance as per evolving times; shifting between time-based and state-based guidance as its stance changed

- Interestingly, the RBI has also invariably given a guidance of a guaranteed liquidity in the secondary market. Such assured liquidity support is a clear resemblance to developed market central banks and helps market participants move away from short termism

- **The central bank could continue to navigate through the chequered road much successfully if its communication continues to create an unwavering culture of openness, consistency and confidence in sync with its jurisprudence and formidable actions that have ensured Indian markets have grown sans volatility**

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Contact Details:
Dr. Soumya Kanti Ghosh
Member, 16th Finance Commission &
Group Chief Economic Advisor
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
:@kantisoumya