

Wishing you all a Happy Navaratri!

SBI Research

Prelude to MPC Meeting: Sep 29 - Oct 1, 2025

Central Banks' communication sans cacophony, is a policy tool unto itself amidst all the chaos.... No point in committing a Type 2 error (No rate cut with Neutral Stance) in September also...A 25 bps rate cut in September is the best possible option for RBI

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- ❑ Rate action by various Central Banks showcases the perplexity, a plateau after aggressive cuts, as new data emanating from a plethora of sources does little to bring much needed clarity.... **Central Bank communications are the key amidst all the cacophony...**
- ❑ **Central Bank Communication is a crucial toolkit for monetary policy... post June policy such communication has played a major role in yields hardening...**
- ❑ Across the world, benchmark yields have somewhat hardened, India is no exception since the June policy.....**the spread vis-à-vis policy rates vaulting in recent days, specifically SDL rates**
- ❑ Post June'25 rate cut, GST rationalization creating multiplier effects and benign inflation trajectory....there is a need to recalibrate stance to mitigate market confusion regarding future path for monetary policy...

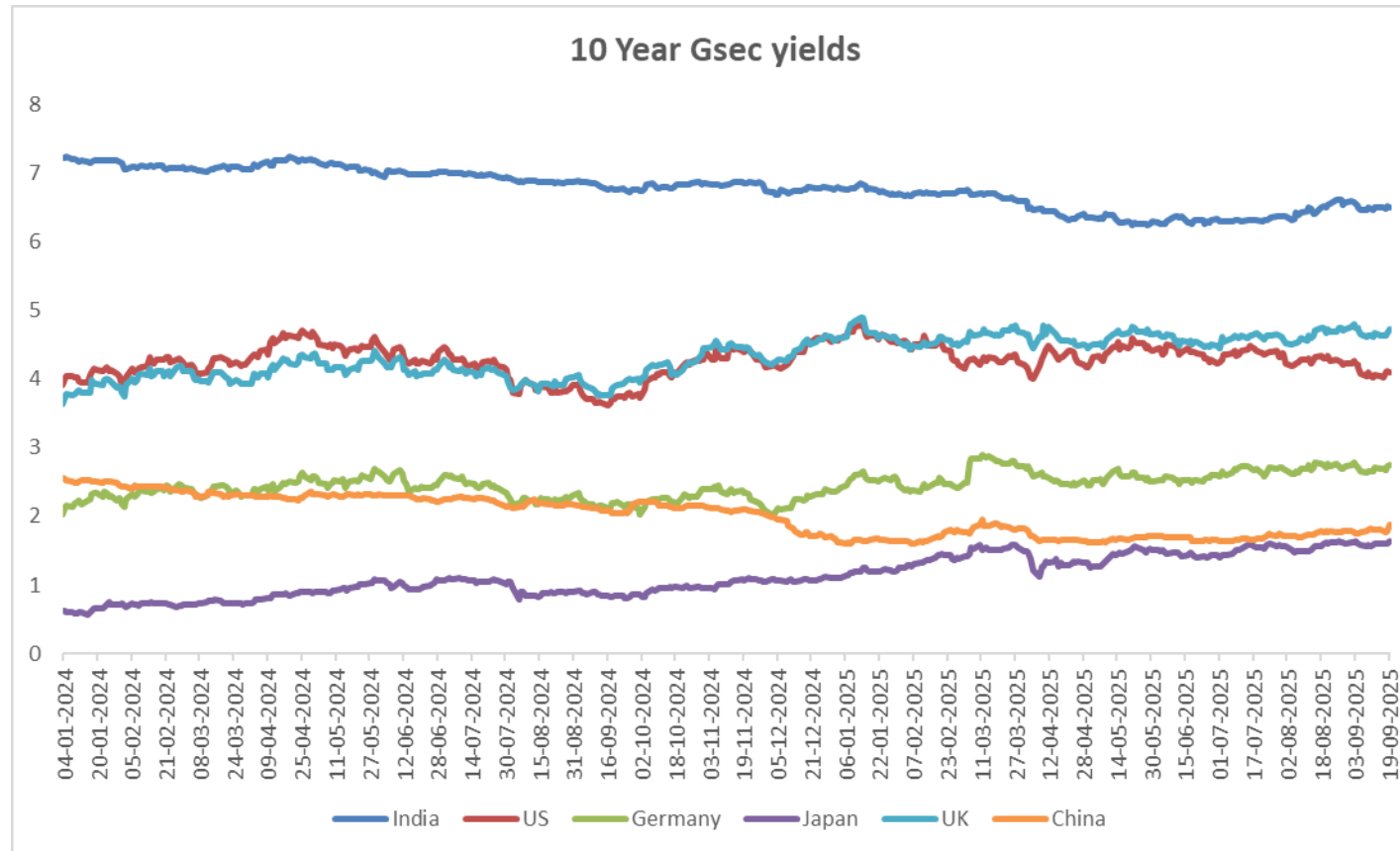
RATE DECISION IN SEPTEMBER

- ❑ **There is merit and rationale in going for a September rate cut.. This will but require calibrated communication by the RBI as post June, the bar for rate cut is indeed higher.. But there is no point in committing a Type 2 error again (No rate cut with Neutral Stance) by not cutting rates in September as inflation will continue to remain benign even in FY27 and without a GST cut, it is tracking below 2% in September and October.....CPI FY27 numbers are now tracking ~4% or less, with GST rationalization, October CPI could be closer to 1.1%... Lowest since 2004**
- ❑ **A rate cut in September is the best possible option for RBI which also projects it as forward-looking central bank**

Global Developments

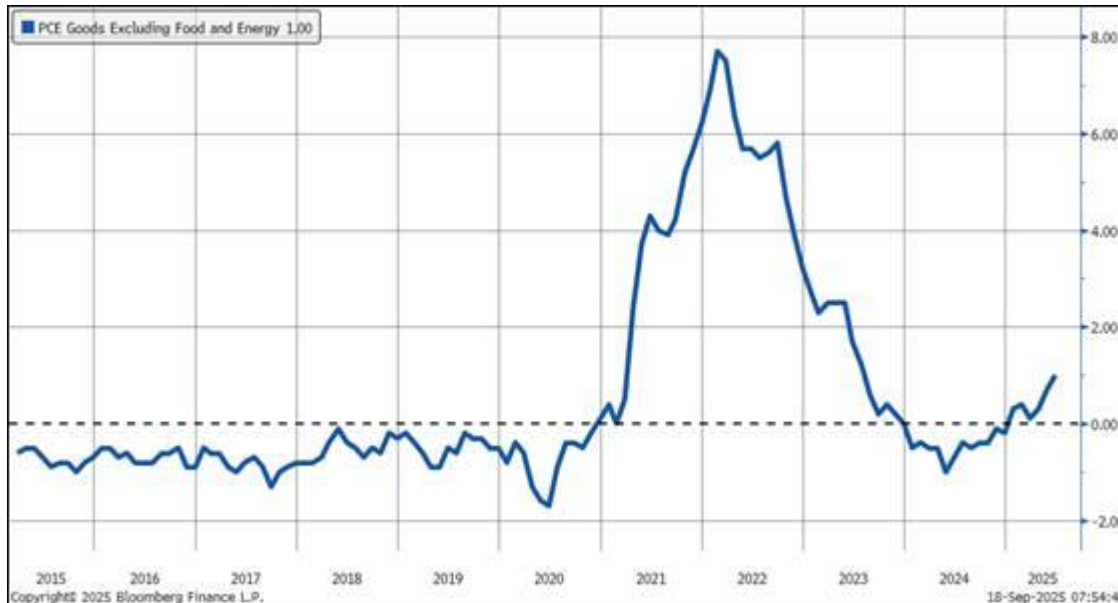
Yield Hardening now seems a Global Phenomenon, India not an exception....

- ❑ Yields incline towards hardening almost across the globe, pricing in divergent risks and elevated borrowings, as the world order undergoes a catharsis, preparing for yet another MoT (Moment of Truth)
- ❑ **Rate action by various Central Banks showcases this perplexity, a plateau after aggressive cuts, as new data emanating from a plethora of sources does little to bring much needed clarity.... Central Bank communications are the key amidst all the cacophony**



- ❑ The Fed lowered the Fed Funds Rate (FFR) by 25 bps to a target range of 4.00%-4.25%. The Fed indicated that the revisions to the NFP numbers and the lower labor supply swayed the Committee decision to cut the rates
- ❑ According to FOMC, the lower labour supply is happening due to lower immigration and a lower participation rate. Labour demand is soft, and it appears that it is running below the breakeven rate needed to keep the Unemployment rate (UR) low. The Committee believes the tariffs will be a one-time shift in the price level. Fed also sees long-term inflation expectations consistent with the 2% inflation objective
- ❑ Fed Chairman called this as a “risk management” cut. Furthermore, the rise in Core PCE this year has come from the goods category. Goods inflation over the last year is about 1.2% contributing between 0.3%-0.4% to core PCE inflation
- ❑ On the services side of inflation, Chair Powell said the disinflation trend seems to be holding. As long as the impacts of the tariffs remain “slower and smaller” with Services disinflation holding Fed will be comfortable cutting moderately over the next year

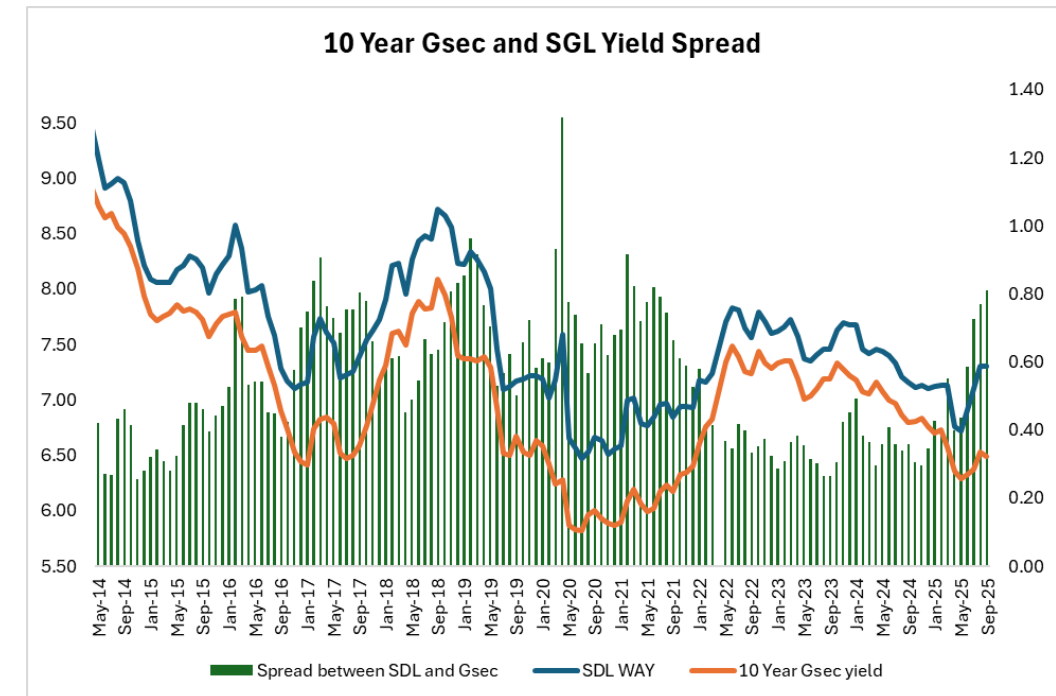
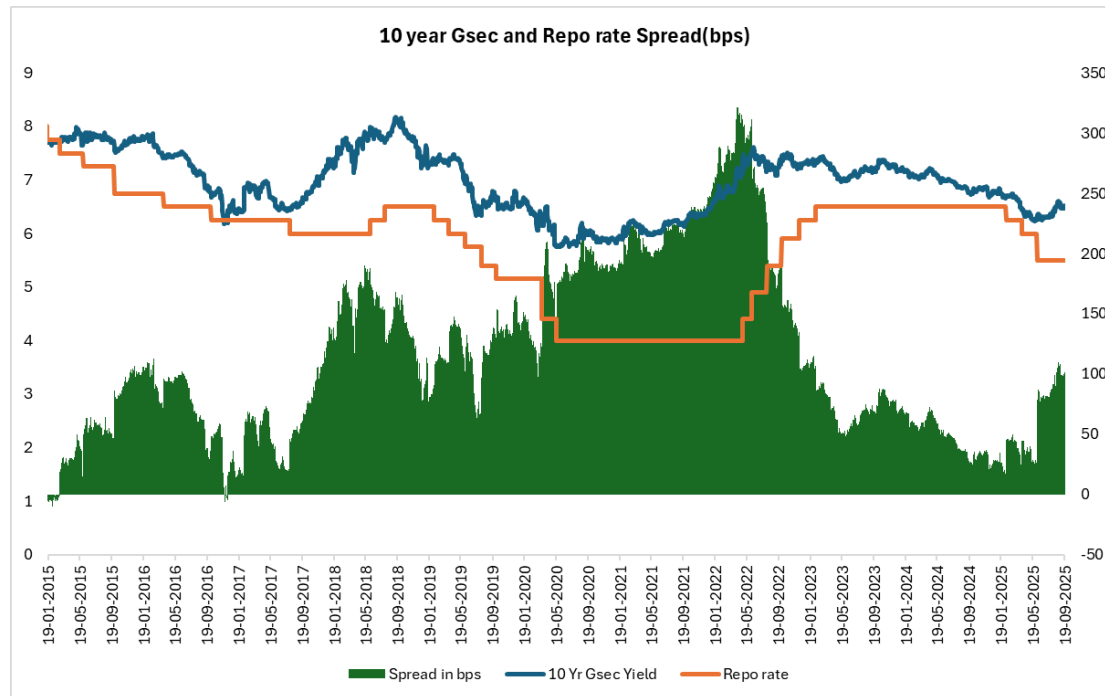
- ❑ Real issue of the Fed seem to be lying elsewhere viz. higher house prices (median prices remained above \$4,00,000 in August'25) checkmating generic fall in mortgage (ARM) rates, or the embargo on Mexican tomatoes altering the entire supply chain of home-grown green house tomatoes wherein gains of Florida seem to be loss for Arizona and Texas!
- ❑ With the Treasury likely to reduce Fed's economic footprint (Gain of Function) in the post Powell era (reducing ~\$6 trillion of holdings of Treasuries and mortgage-backed securities in a non disruptive way too), the battle ground could test uncharted waters across liquidity and investment decisions, apart from cascading to currencies and alternate assets minefield



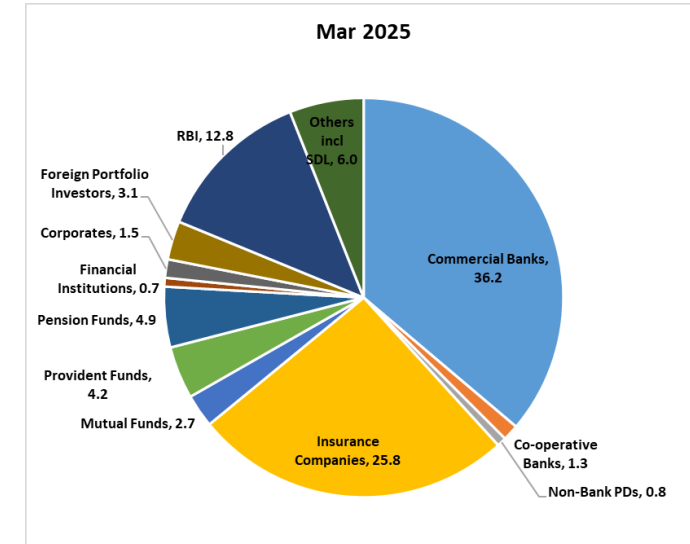
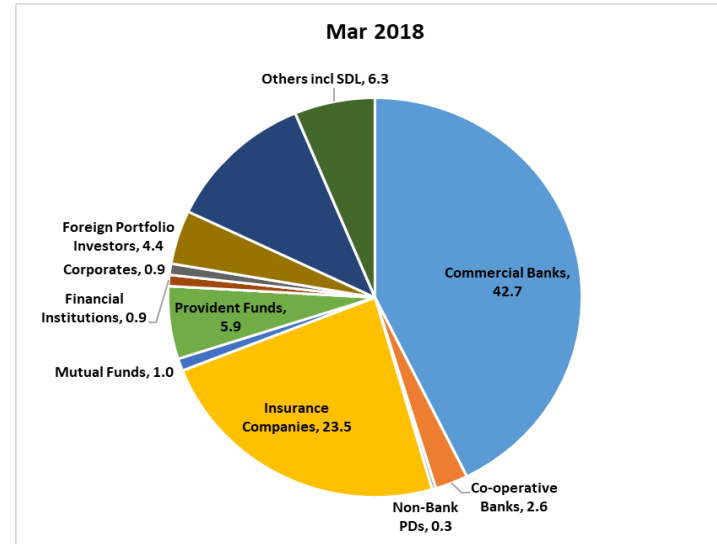
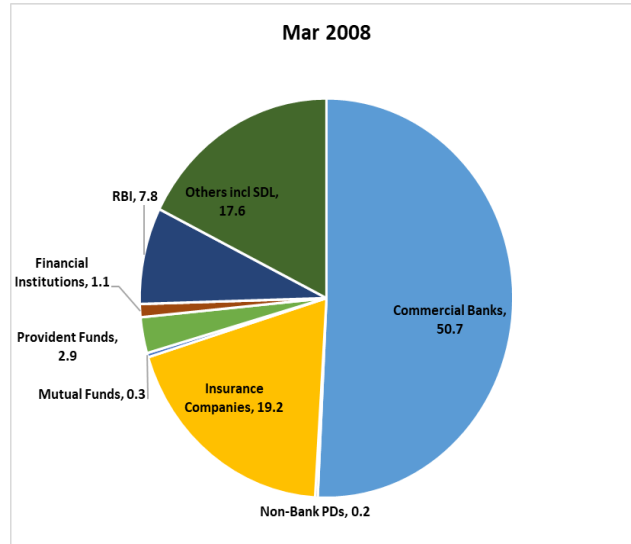
In its latest FOMC meet, 9 of the 19 participants indicated just one more reduction this year, while 10 saw two, implying more rate cuts coming at the FOMC's October and December'25 meets....

**Prelude to September Policy, Volatility & Hardening of Treasury
Yields rates remain in focusreasons of which are many and
would require multiple reforms...**

- ❑ Benchmark yields locally have somewhat hardened, the spread vis-à-vis policy rates vaulting in recent days, specifically SDL rates
- ❑ Debt markets are also facing challenges from changing preferences of institutional allocators towards riskier assets, their appetite whetted by increased demand from younger investors buying for higher returns... Insurance firms to pension funds have upped the ante, buoyed by sweeping regulatory landscape, a direct corollary seen in reduced preferences for select papers that earlier found favor with such long term investors

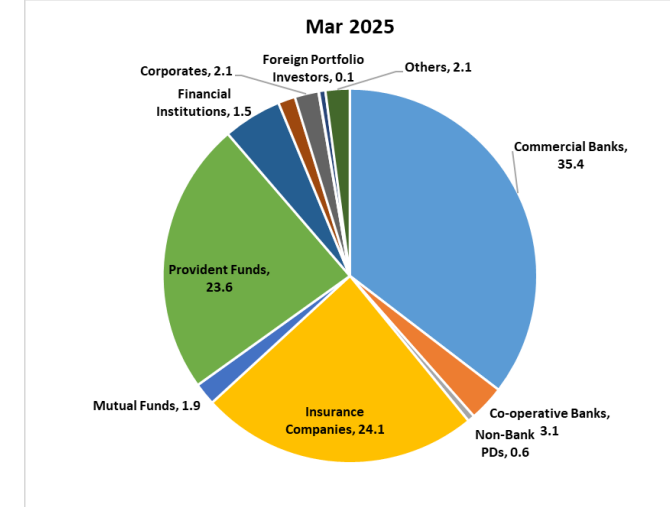
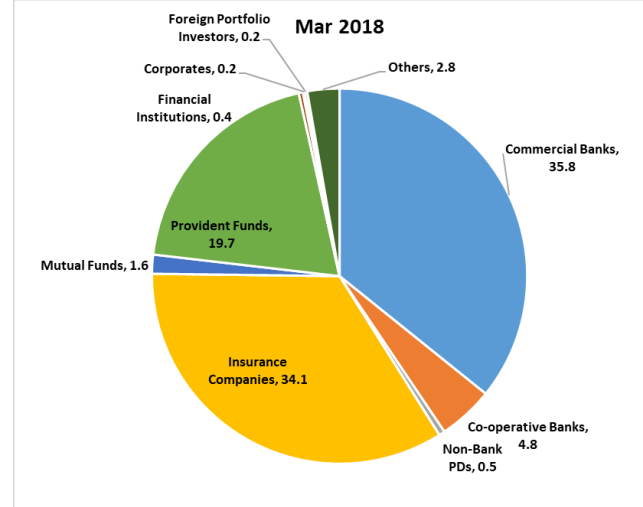
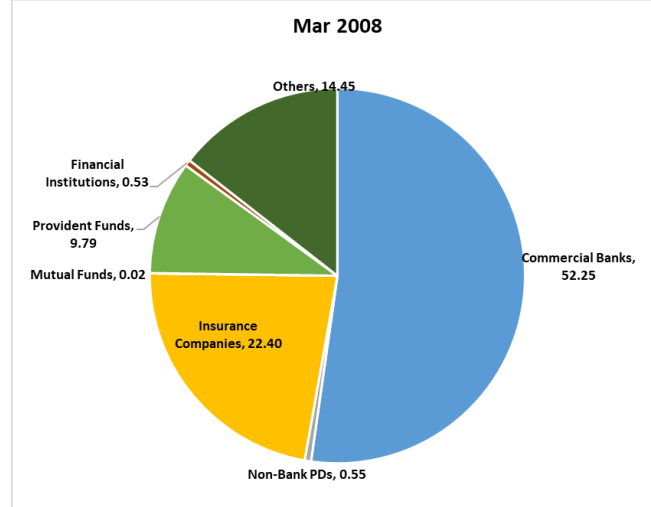


..While ownership pattern of Central Government Securities shows diversity



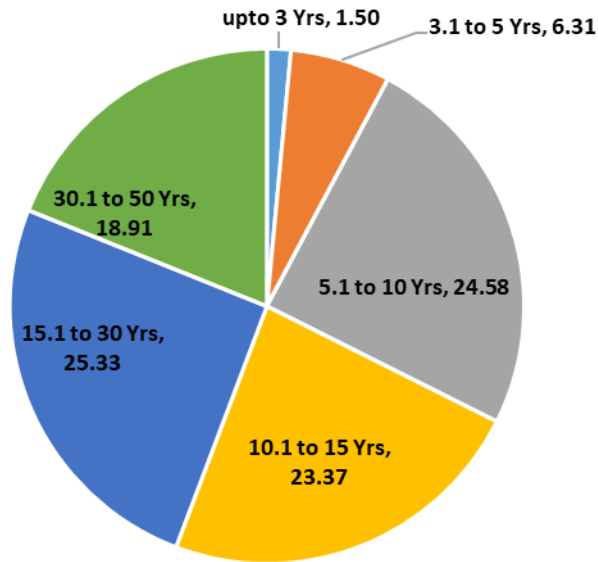
- ❑ The Central government dated securities outstanding was ~54 lakh crore as on March'18 which rose to ~Rs 116.4 lakh crore by Mar'25 (~11.6% CAGR), largely unchanged today (~117 lakh cr). The holding pattern shows a gradual fall in the share of commercial banks, while insurance companies stepped up their purchase. Pension funds, non-existent in 2018, became fifth largest holder of CG dated securities while provident funds too have scaled up overall holding
- ❑ **The cumulative holding of three largest players came down to ~74.8% in 2025, from a high of ~87% in March'08.** Mutual funds, while increasing their shares, have not been quite Gung-ho while FPIs overall share has dipped. Share of RBI is currently at 12.8% /...**Overall, the ownership now appears more diverse and evenly balanced**

..In contrast, ownership pattern of SGLs shows concentration risks with dearth of liquidity as the primary factor...



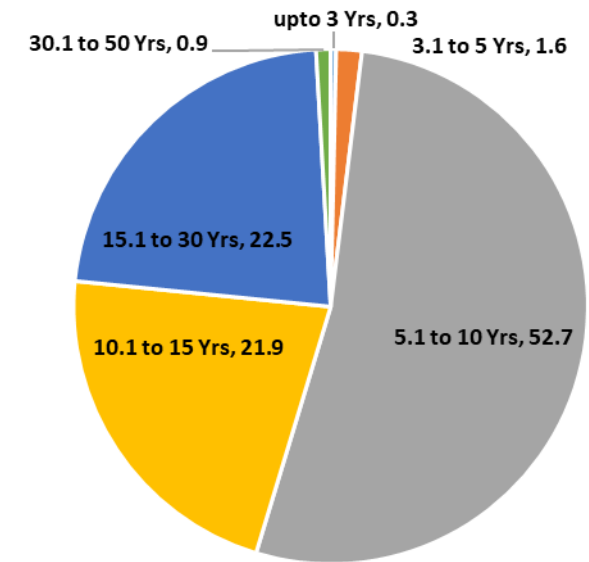
- ❑ While commercial banks, led by PSBs, have kept their SGL holding pattern nearly constant during the intermittent period of 2018-25 (to smoothen the pandemic effect, March'18 has been chosen as a completely normal/neutral year), the share of insurance companies has concomitantly come down. Provident funds have increased their holdings just a little, paving way for Pension funds to fill the void created by diminishing holding of insurance companies
- ❑ Mutual funds, with little control over anticipated liquidity mismatch as bulk of liquidity for debt funds comes from non-retail holdings and are redeemable 'on-tap', have kept their share comparatively small despite overall AUM rising handsomely through 2008-2025
- ❑ **Top 3 largest holders' share comes to ~83.1% (Mar'25), marginally down from ~89% (March'08), indicating a substantially higher concentration still an innate factor for SGLs debt management**

Maturity pattern of O/S Gsec, % share



- As on date (Aug'25), the share of outstanding securities with maturity up to 5 years was kept low at 7.80%, while the benchmark securities (5-10 years) share stood at 24.58%. Longer tenor securities (10-30 years) formed 48.70% of outstanding stock while ultra long-term securities (above 30 years) found their shares increasing to 18.91% as **Gol strived to elongate the maturity profile of its outstanding debt, one of the strategies used being switch that replaces the short tenor securities with long tenor debt of matching proportion**

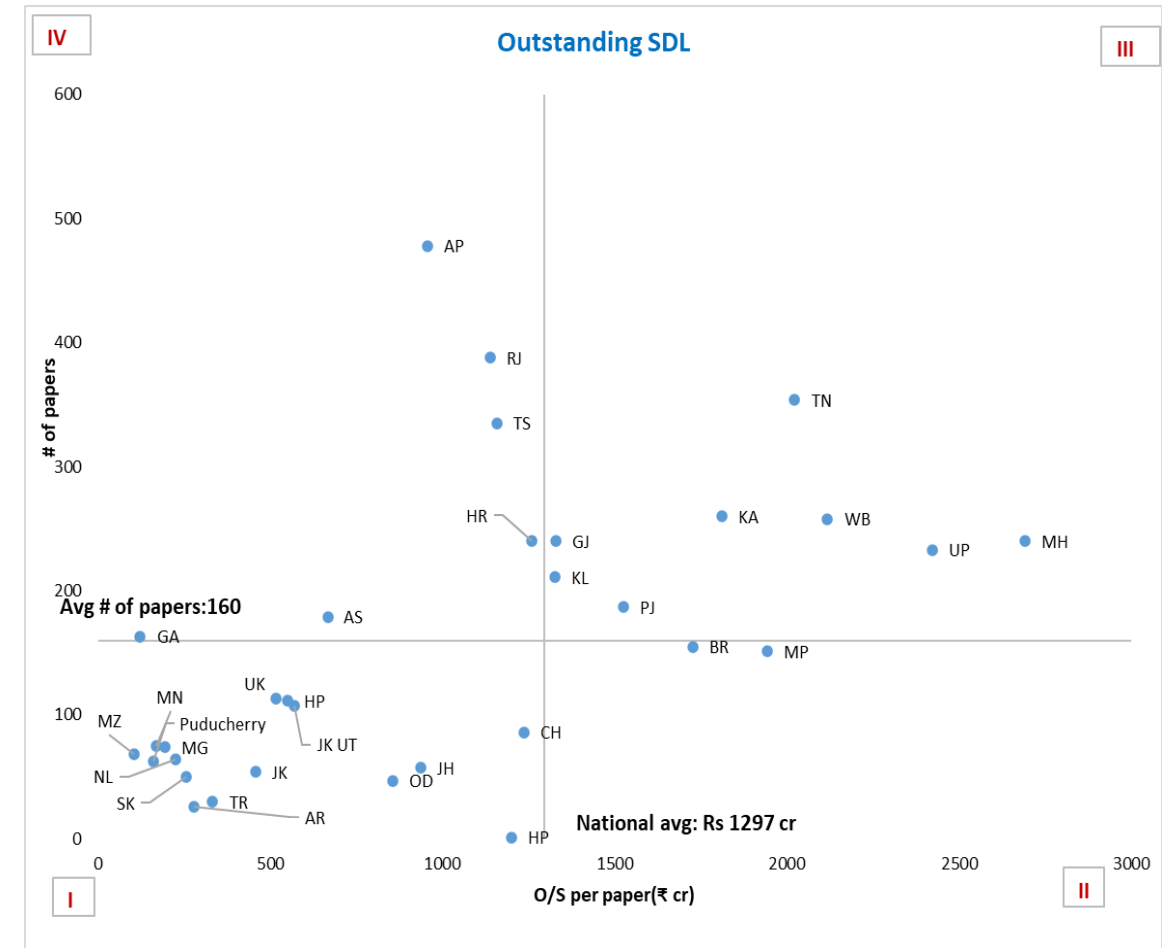
Maturity pattern of O/S SDLs, % share



- Despite attempts to elongate the maturity profile of debt, nearly 54.7% of SDLs are at present concentrated along 10 years, making the redemption quite challenging for state governments. **Switch can enable taking off the pressure to a good extent, paving the path for fiscal consolidation, yield optimization and helping states raise adequate finances**

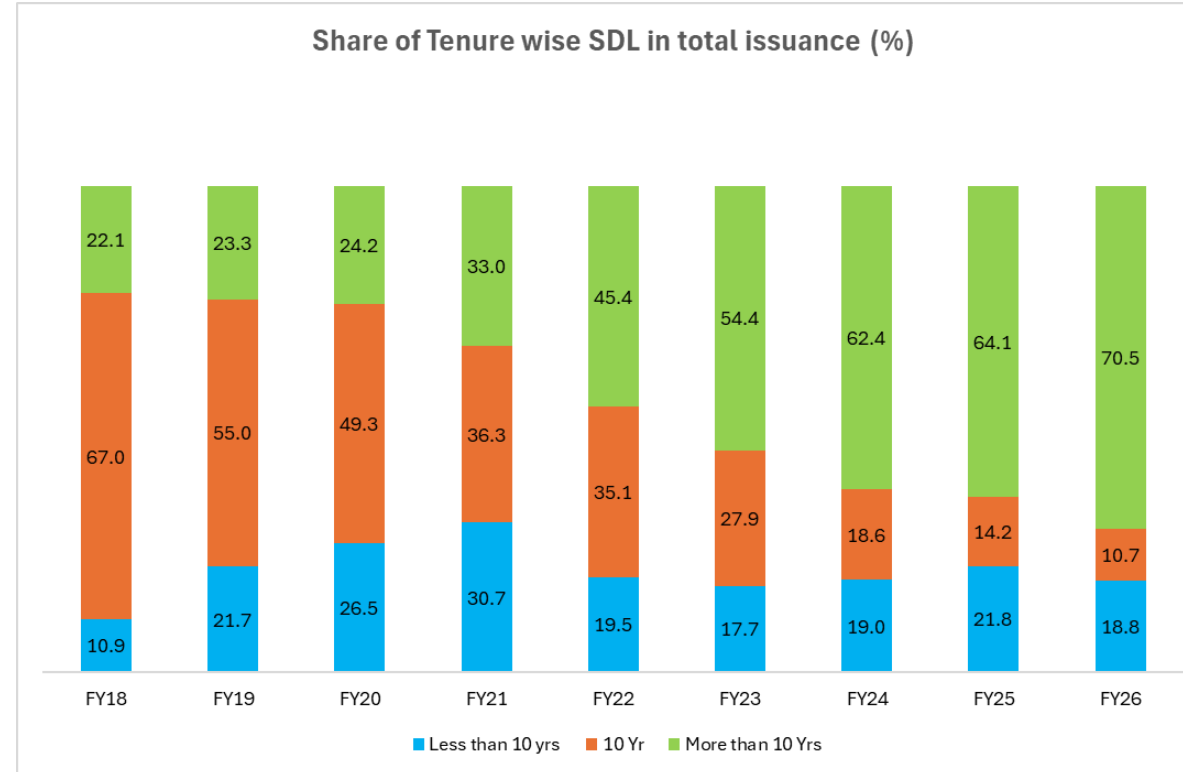
Low liquidity a result of multiple SDL papers of states with average issuance of 160 papers and average O/S per paper is Rs 1297 cr

- With States contributing ~ 43 % of total gross borrowings in the year 2024-25 (while the last 5 years average is 39%) and the pace of their borrowing expected to rise in coming years to bridge the fiscal deficit, we estimate an inflection point by the year Wherein State borrowings could eclipse Centre's borrowing
- Higher incremental borrowing by States can lead to a steady debt pile up, wherein investors may demand surplus margins (interest) for new issuances (or yields may gyrate non-linearly in secondary markets)
- Under different scenario of growth, thrust on capital expenditure, rise in Own revenues and other fiscal conditions, we have modelled the projected trajectory for States' borrowings
- While a similar issue is being faced in corporate bond market, SEBI had issued guidelines to rationalise the number of ISINs issued by a corporate that would mature in any year, a major move aimed at improving the demand and liquidity. Rationalisation of ISINs and thereby improved liquidity in specific papers could also lead to some spillover demand for trading by domestic and FPI clients alike.**
- The SDL market also needs new investors as states have limited recourse (the Centre has a lot of room for maneuverability across NSSF and T-bills, not available to States)
- AP has issued highest no of papers(478) with Rs 956 cr O/S per paper followed by Rajasthan (388 papers, Rs 1138 Cr O/S per paper)
- However, Maharashtra has highest O/S per paper (Rs 2693 Cr, 240 papers) followed by UP(Rs 2423 Cr, 233 papers)



- I : Low O/S per paper and low no. of papers
- II : High O/S per paper and low no. of papers
- III: High O/S per paper and high no. of papers
- IV: Low O/S per paper and high no. of papers

- ❑ Compared to evenly dispersed G-sec issuances (with smart switches and buyback strategies to align the net borrowings towards achieving FRBM goals), SDLs issuances in longer tenors (>10Y) have spiked off late pushing back near immediate redemptions
- ❑ Coupled with higher tenacity to borrow, the challenge for broader markets is to decipher the end usage of borrowings (financing revenue vis-à-vis capital expenditure) and the 'Fat Tail' effect in the making where interest costs servicing could go up substantially post an inflection point in a "Higher for Longer" regime... the impact for fiscally weaker states could be more straining as a substantial amount could go towards servicing the sticky debt profile



- ❑ FAR (Fully Accessible Route) of identified securities provides better investment portfolio calibration by non-resident entities as they can invest in a particular issuance/duration sans limits
- ❑ The utilization of allocated limits, *in toto*, saw major uptick in 2023 and 2024, substantial inflows coming on account, and in anticipation, of inclusion in global bond indices... FPIs holdings stands at ~3 lakh cr now... On the other end, FPIs investment in equities constitute ~16% of M-cap
- ❑ As per the RBI's FY25–26 guidelines, current FPI investment limits for Indian bonds are: G-Sec (6% of total outstanding stock), State development loans (SDLs): 2% and Corporate bonds: 15%
- ❑ With interest differential between US and India likely to grow in coming months, and talks of Indian bonds inclusion in Global indices (not just EM indices) the debt part could benefit from higher flows though currency movement would be playing a crucial part in investment decisions by global allocators

FAR holding status					
	31-03-2023	31-03-2024	30-06-2024	31-03-2025	19-09-2025
Indicative Value Of Aggregate Holding Of FPIs (₹ cr)	76815	173826	186416	306249	302577
Outstanding Position Of Govt# Securities (₹ cr)	2796589	3866241	4055573	4336792	4511268
Sec Holdings (%)	2.7	4.5	4.6	7.1	6.7

FAR Holdings as on 11.09.2025				
ISIN	Security Description	Indicative Value Of Aggregate Holding Of FPIs (₹ Cr)	Outstanding Position Of Govt# Securities (₹ Cr)	Sec Holdings (%)
IN0020210012	05.63 GS 2026	14414	86505	16.66
IN0020210186	05.74 GS 2026	8619	52631	16.38
IN0020220037	07.38 GS 2027	16538	110100	15.02
IN0020230010	07.06 GS 2028	14086	100183	14.06
IN0020230085	07.18 GS 2033	24946	201000	12.41
IN0020230051	07.30 GS 2053	23963	195000	12.29
IN0020240076	07.02 GS 2031	7042	64000	11
IN0020240159	06.79 GOI SGRB 2034	1058	10000	10.58
IN0020240019	07.10 GS 2034	18849	180000	10.47
IN0020230101	07.37 GS 2028	6993	67000	10.44
IN0020230077	07.18 GS 2037	13856	172000	8.06
IN0020230135	07.32 GS 2030	5500	70000	7.86
IN0020220060	07.26 GS 2032	11104	148000	7.5
IN0020250067	06.01 GS 2030	3035	45000	6.74
IN0020220151	07.26 GS 2033	9322	150000	6.21
IN0020220011	07.10 GS 2029	9771	158598	6.16
IN0020210244	06.54 GS 2032	9473	156000	6.07
IN0020240126	06.79 GS 2034	10825	184000	5.88
IN0020240183	06.75 GS 2029	4962	87000	5.7
IN0020240050	07.04 GS 2029	4915	88000	5.59
IN0020180454	07.26 GS 2029	6859	124709	5.5
IN0020210095	06.10 GS 2031	8256	152366	5.42
IN0020230036	07.17 GS 2030	4831	103000	4.69
IN0020200278	05.15 GS 2025	4487	98178	4.57
IN0020250026	06.33 GS 2035	6594	150000	4.4
IN0020200153	05.77 GS 2030	5360	123000	4.36
IN0020250059	06.28 GS 2032	1411	33000	4.27
IN0020220102	07.41 GS 2036	6580	155080	4.24
IN0020220029	07.54 GS 2036	6509	153904	4.23
IN0020190362	06.45 GS 2029	4642	114840	4.04
IN0020220136	07.10 GOI SGRB 2028	314	8000	3.93
IN0020200252	06.67 GS 2050	5561	149162	3.73
IN0020220086	07.36 GS 2052	6025	161967	3.72
IN0020220144	07.29 GOI SGRB 2033	279	8000	3.49
IN0020240191	06.79 GS 2031	1925	63000	3.06
IN0020200070	05.79 GS 2030	3058	111619	2.74
IN0020230176	07.37 GOI SGRB 2054	270	10000	2.7
IN0020200294	05.85 GS 2030	3116	120832	2.58
IN0020210194	06.99 GS 2051	3519	148359	2.37
IN0020230150	07.24 GOI SGRB 2033	101	5000	2.02
IN0020190032	07.72 GS 2049	1668	84540	1.97
IN0020200054	07.16 GS 2050	1896	102696	1.85
IN0020230143	07.25 GOI SGRB 2028	44	5000	0.88

Central Bank Communication is a crucial toolkit for monetary policy... post June policy such communication has played a major role in yields hardening

Communication is an important element in a central bank's monetary policy tool kit. The rationale for transparency in communication lies in helping economic agents gauge the current and future economic outlook of the MPC so that they can form their own expectations

"Given these uncertainties, and after having reduced the policy rates by 100 bps in quick succession since February, in the prevailing growth-inflation scenario and the outlook, monetary policy will be left with very limited space to support growth"
– **Governor's statement June MPC**

This indicates that the bar for further easing is higher than it would have been if the stance was accommodative

June MPC

Stance: Changed from Accommodative to Neutral

"I also support retaining the neutral stance as it would provide monetary policy the necessary flexibility to respond to the evolving domestic and global economic conditions" – **Governor's statement- Aug MPC**

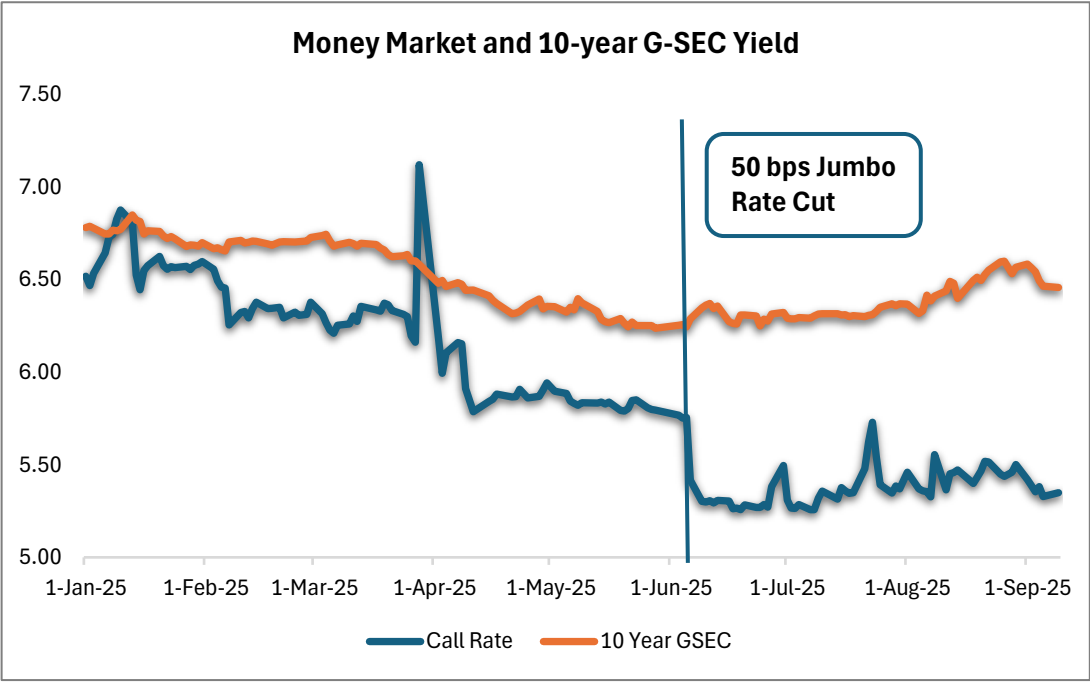
Aug MPC

Stance: Kept at Neutral

Heterogeneity in the MPC structures globally has reflected preferences, views of members and differences in skills and backgrounds all of which has imparted diversity in voting. **This drives the Committee to adopt an eclectic approach which serves to limit the risk that a single viewpoint or analytical framework might become unduly dominant (Bernanke, 2007)**

Consistent with Blinder et al.’s emphasis on the importance of central-bank communication in shaping market expectations, we implement an event-study framework to quantify the effect of the RBI’s 6 June 2025 repo announcement on money-market yields. We identify the structural shifts in interest rate series using the Bai–Perron multiple breakpoint test to check for statistically significant regime changes. This highlights a clear breakpoint coinciding with the June 2025 rate cut announcement. **Building on this, we employed an event-study design to quantify the impact of the regime shift of the jumbo rate cut and the surprise change in rate stance**

Bai- Perron Multiple Breakpoint Test Estimation		
Break Test	F-statistic	Value**
0 vs. 1 *	611.9853	8.58
1 vs. 2 *	221.4363	10.13
2 vs. 3 *	109.2284	11.14
* Significant at the 0.05 level. ** Bai-Perron (Econometric Journal, 2003) critical values.		
Estimated Break Dates		
04-09-2025		
06-06-2025		



- ❑ Monetary policy communication shapes expectations not only through formal rate decisions but also through the coherence of narratives articulated by committee members. Even though in both Jun'25 and Aug'25 MPC meetings there was a unanimous decision, however there were thematic differences within members which would help us evaluate how communication influences short term yields volatility
- ❑ To quantify thematic divergence among MPC members in their communications, we applied a weighted thematic divergence index (WTDI). **We identify major themes across June and Aug MPC minutes which includes (growth, inflation, global risks, Transmission, Food / Vegetable deflation, forward guidance, frontloading etc.),**
- ❑ We computed the raw mean of member scores to capture the central tendency of opinions in a given month

$$\bar{M}_{k,t} = \frac{1}{6} \sum_{i=1}^6 s_{ikt}$$

Where k denotes the themes

- ❑ The theme-level means were squared and normalized across themes to generate weights, ensuring that themes with larger average emphasis contribute more to the divergence measure. **To assess individual deviations, we then computed the consensus on each theme excluding the focal member, providing a benchmark that reflects peer opinions without self-influence**

$$Divergence = |s_{ikt} - \bar{s}_{-ikt}|$$

- The absolute difference between a member's score and this peer consensus was multiplied by the corresponding theme weight, and summing across all themes yielded the WTDI for each member

$$WTDI = W_{tk} * Divergence$$

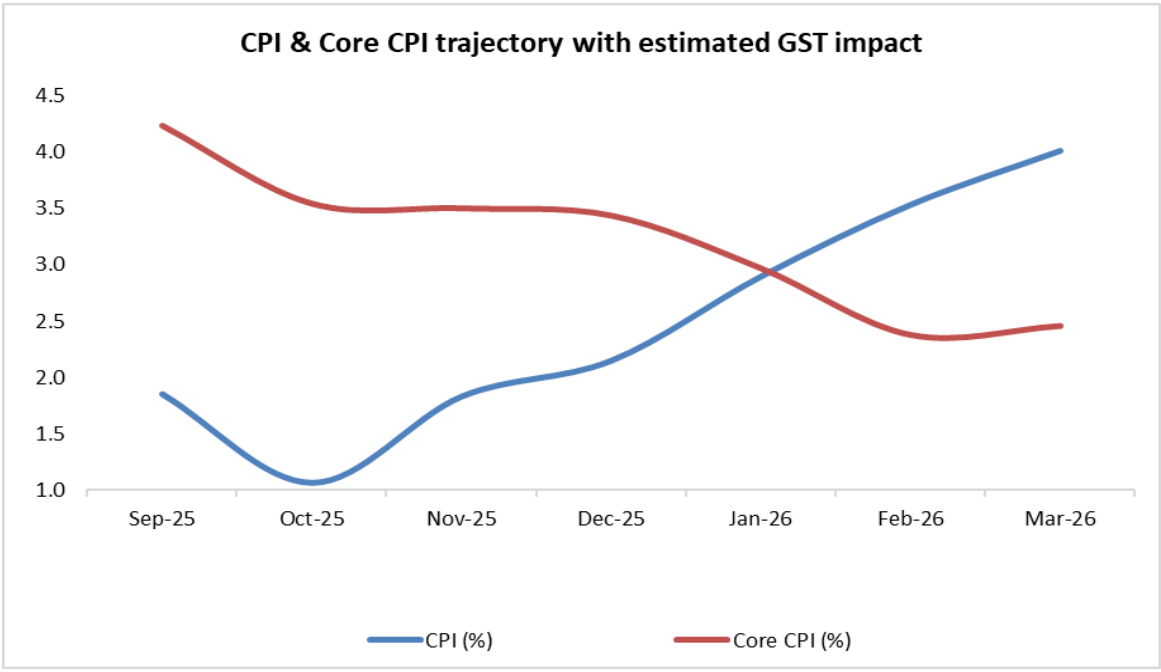
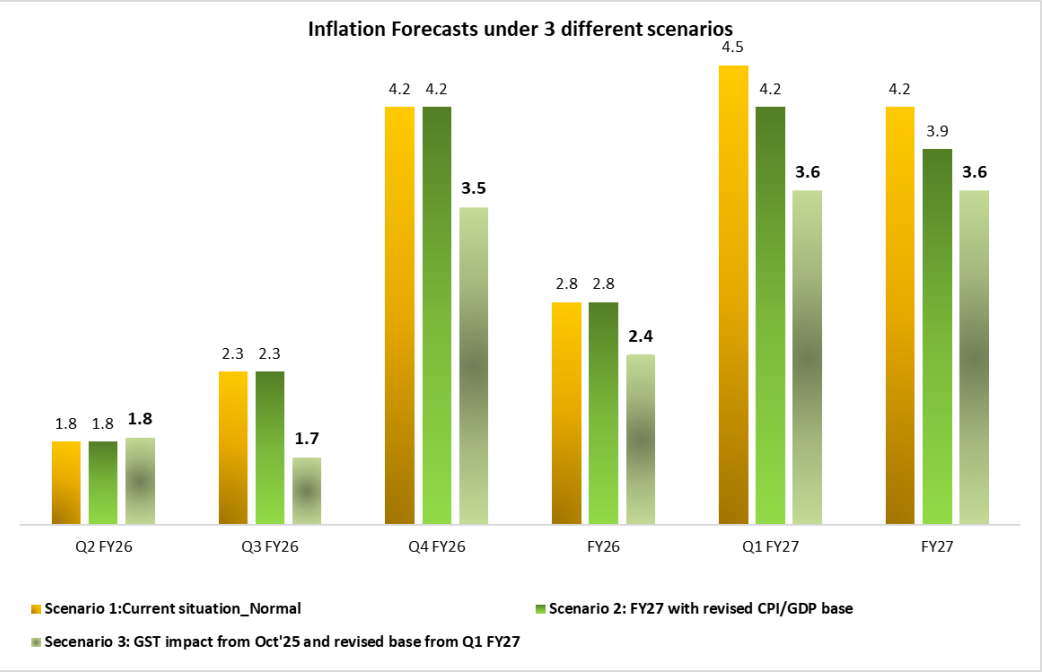
Where W reflects the theme wise normalised weight

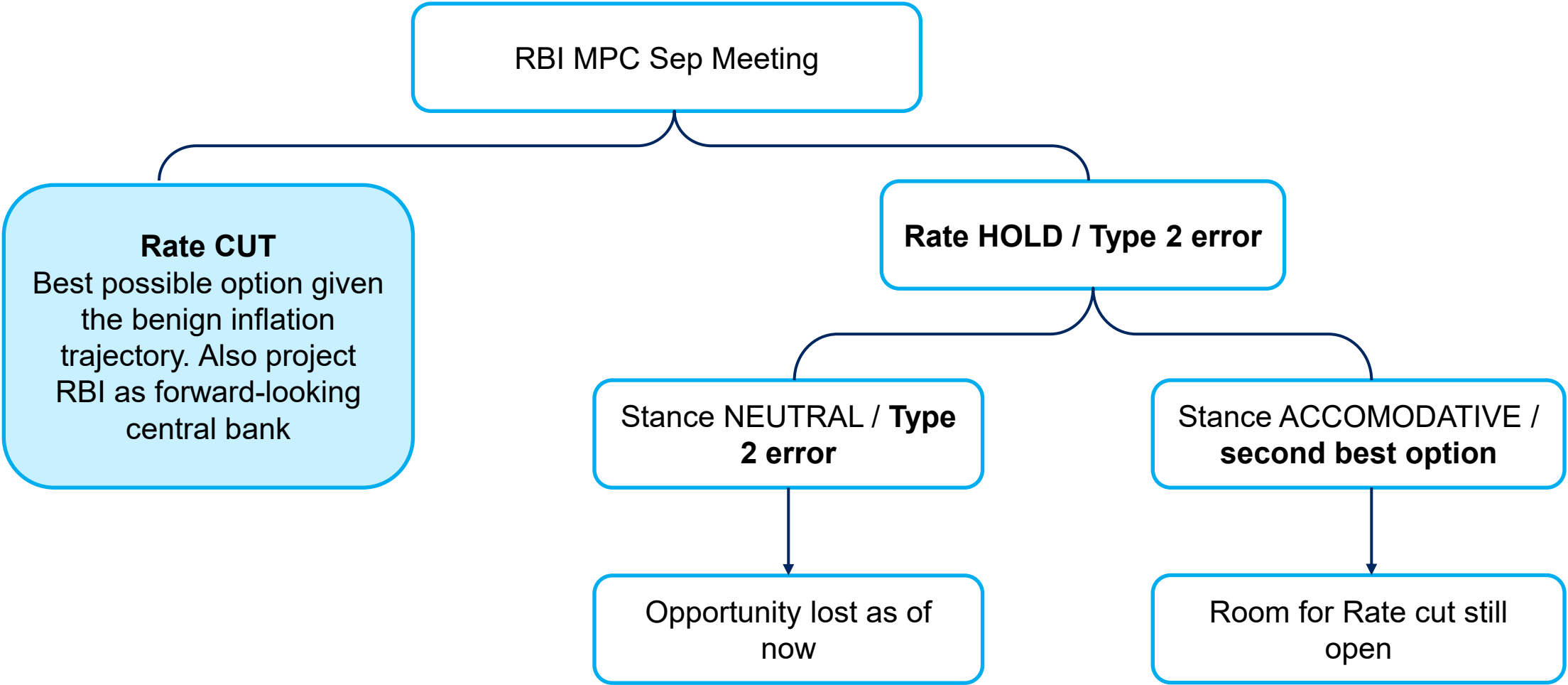
- Comparing average WTDIs across months, we observed that August exhibited higher thematic divergence than June, indicating that MPC members' views were more heterogeneous in August across key policy themes. We then relate this measure to a standard event-study outcome—the volatility of call money rates in a ± 4 day window around the release of MPC minutes defined as the standard deviation of the daily call rate
- We find that while both MPC meetings recorded unanimous voting outcomes, narrative coherence differed markedly: June's discussion clustered around front-loading and transmission, yielding lower divergence and subdued volatility (~ 1.3 bps). By contrast, **August saw greater dispersion of emphasis, with most members stressing global risks, while other members prioritizing food and vegetable deflation, some other members transmission... all these differentiated opinion produced** higher divergence on central themes rise in volatility (≈ 3.6 bps)
- This is consistent with the empirical literature showing that dispersion in committee communication amplifies market noise: Ehrmann and Fratzscher (2007) document this effect for the ECB, Rosa (2011) for the FOMC, and Hansen, McMahon, and Prat (2018) for the FOMC's deliberations. Taken together, our evidence supports the hypothesis that market volatility is positively associated with thematic divergence in MPC discourse, reinforcing the principle that ***effective policy communication requires not only consensus in voting but also coherence in the underlying reasoning***

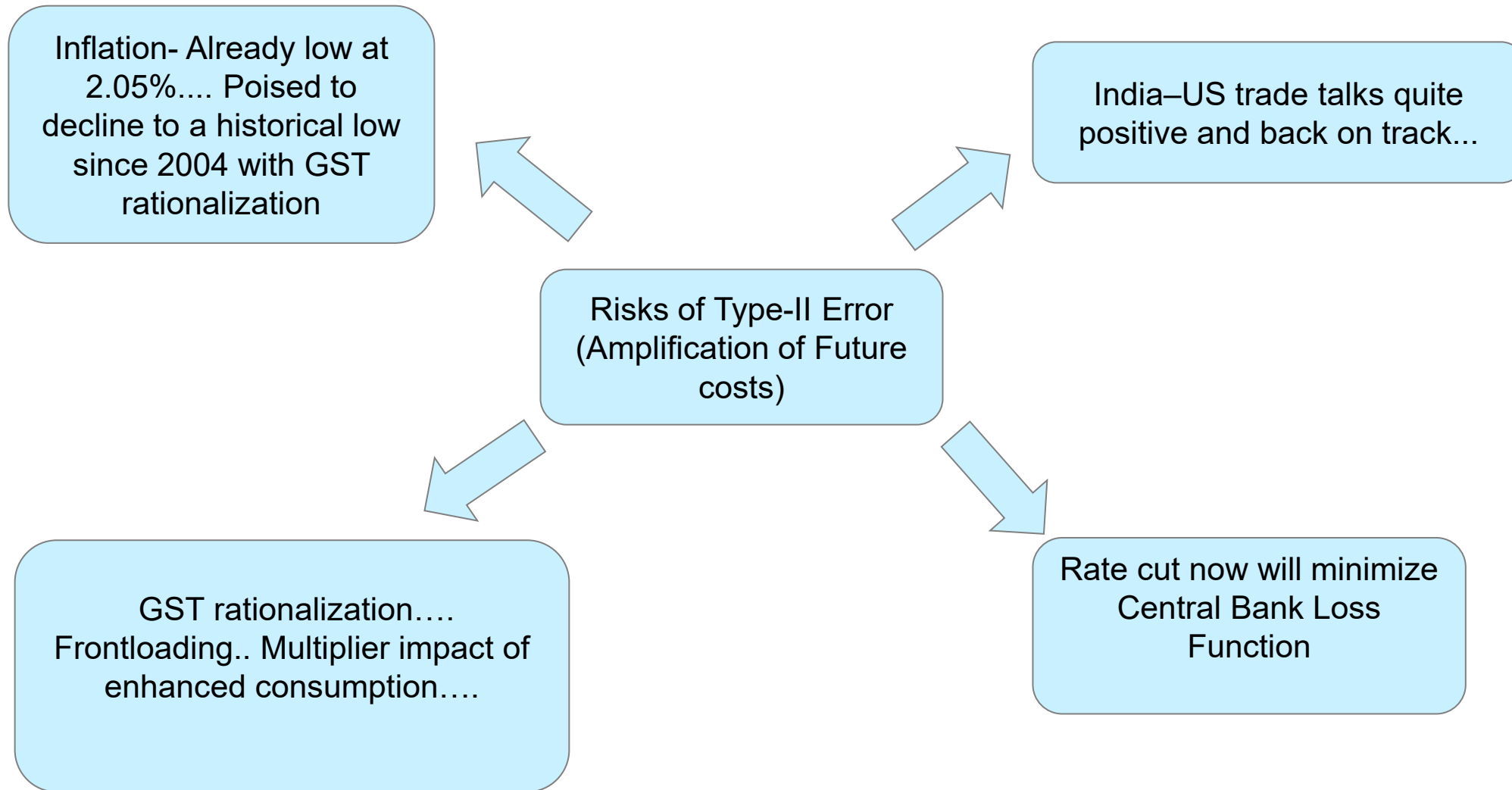
September Policy too close to call...but

CPI bottom not yet reached...CPI FY27 numbers are now tracking ~4% or less.. even without GST impact, Sep - October CPI now tracking at <2%..with GST rationalization, October CPI could be closer to 1.1%

- ❑ We believe that the bottom of CPI inflation may not yet reached, and it may further decline by 65-75 bps due to the huge GST rationalization. Experience of 2019 also indicate that the rates rationalization (primarily focused on reducing rates for common goods to 18% from 28%) led to almost 35 bps decline in overall inflation in just couple of months
- ❑ Additionally, with new CPI series we expect further moderation of 20-30 bps in CPI. All these factors (GST, base revision) indicate that CPI inflation will remain around lower end of inflation target ($4 \pm 2\%$) for entire FY26 and FY27







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