ICRA

Liquidity and Interest Rates

Phased CRR cut, VRRs to support liquidity ahead of seasonal currency leakage; G-sec yield curve to remain steep in near term

SEPTEMBER 2025

Highlights - I

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EXHIBIT: Transmission to Banks' Deposit and Lending Rates

Period	Feb'19-Mar'22	May'22-Jan'25	Feb'25-Jul'25
Repo rate	-250	250	-100
WADTDR – Fresh	-234	241	-94
WADTDR - O/s	-188	199	-18
WALR - Fresh	-232	181	-60
WALR- O/s	-150	115	-42

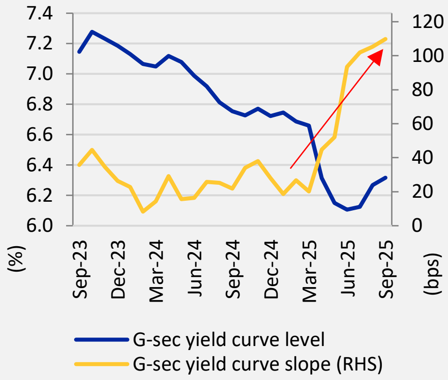
O/s: Outstanding; WADTDR: Weighted Average Domestic Term Deposit Rate; WALR: Weighted Average Lending Rate; Source: RBI; ICRA Research

The systemic liquidity surplus has cooled in September 2025 after remaining sizeable during June-August 2025, largely dampened by advance tax outflows. After injecting Rs. 0.6 trillion in the first tranche, the pending cash reserve ratio (CRR) cut of 75 bps during October-November 2025 is likely to support liquidity conditions, offsetting the pressure from currency leakage during the festive season, even as the RBI may continue to conduct Variable Rate Repos (VRR) to manage intermittent tightness. The Monetary Policy Committee (MPC) is likely to maintain status quo on rates in October 2025, although it may pare its inflation forecasts to factor in the impact of the GST rejig. ICRA expects India's 10Y G-sec yield to trade at 6.40-6.60% in the near term, amid expectations that the Centre will stick to its borrowing plan for FY2026. With long-term yields likely to remain sticky amid fiscal concerns, expectations of an extended pause on rate cuts, and the prevailing demand-supply concerns, the yield curve may remain steep in the near term.

- **Liquidity to remain comfortable in near term:** Liquidity conditions have remained comfortable since June 2025, with average systemic liquidity surplus rising from 0.7% of net demand and time liabilities (NDTL) in May 2025 to 1.2-1.3% of NDTL in each of the months during June-August 2025, aided by the RBI's measures. Thereafter, it has cooled in September 2025 (+0.7% of NDTL), largely owing to advance tax and GST payments, notwithstanding the CRR cut-led infusion of ~Rs. 0.6 trillion in the early part of the month. The durable liquidity surplus also remains quite ample, although the extent of the same eased mildly to Rs. 4.7 trillion as on September 5, 2025, from Rs. 5.8 trillion as on June 27, 2025. Notwithstanding the intermittent tightness, liquidity conditions are expected to remain benign in the near term, aided by the pending CRR cut of 75 bps during October-November 2025 and redemption of G-secs worth ~Rs. 1.0 trillion in early-November 2025, which would ease pressure of higher cash demand during the festive season.
- **Further transmission of rate cuts to lending rates may remain limited in near term:** While the transmission of the cumulative 100 bps rate cut during February-June 2025 to fresh deposits (-94 bps during February 2025-July 2025) is nearly complete, that to outstanding deposits has been quite muted (-18 bps). Similarly, while the weighted average lending rates on fresh loans fell by 60 bps in February-July 2025, that for outstanding loans eased by 42 bps. Going ahead, the muted pace of repricing of the older deposit base as well as the expected uptick in credit demand during the festive season, is likely to constrain further transmission to lending rates over the next few months.

Highlights - II

EXHIBIT: India's G-sec yield curve level and slope^*



**Average of yields of 91-day T-bill, and 3, 5, 10 and 30-year G-secs; ^10Y G-sec yield minus 91-day T-bill yield; Data for September 2025 is up to September 24; Source: CMIE; RBI; ICRA Research*

- **Repo rate cut unlikely in the October 2025 policy review:** ICRA believes that the GST rationalisation could dampen the headline CPI prints by 25-50 bps during Q3 FY2026-Q2 FY2027 relative to our earlier estimates. While the average CPI inflation for FY2026 is now likely to print around 2.6% (vs. 3.0% earlier), and the October-November 2025 prints may mark a fresh low, the trajectory subsequently remains upward sloping. This, in conjunction with the stronger-than-expected GDP growth in Q1 FY2026, and the positive impact of the GST reforms on demand, suggest a status quo for the repo rate in the October 2025 policy review.
- **India's 10Y G-sec yield to range between 6.40-6.60% in near term:** While the impact of the GST rationalisation on the Centre's and states' fiscal position have raised concerns of an overshooting in state government securities (SGS) issuances, the demand side appears to be weighed down by regulatory changes and the halt in open market operations (OMO) purchases, after surplus liquidity in Q2 FY2026, with the favourable impact of the latter on G-sec yields dissipating. ICRA expects the 10Y G-sec yield to trade at 6.40-6.60% in the near term, amid expectations that the Government of India (GoI) is likely to stick to its borrowing plan for FY2026, with no increase in supply in H2 FY2026.
- **India's yield curve expected to remain steep in near term:** India's yield curve steepened considerably by end-September 2025 compared to the year-ago levels amid a sharp fall in the shorter-end yields, even as the longer-end of the curve was elevated. Besides, the curve has steepened in September 2025 compared to end-June 2025, with the level of the same also shifting upwards between these months. Going ahead, comfortable liquidity conditions owing to the phased CRR cut and expectations of an extended pause on rate cuts would keep short term rates steady in the near term. Besides, long-term yields may also remain relatively sticky amid fiscal and demand concerns. Consequently, the yield curve is likely to remain steep in the near term.
- **Spread with UST widened after Fed cut rates:** After an extended pause in 7M CY2025, the US Fed cut rates by 25 bps to 4.00-4.25% in September 2025. The latest 'dot plot' also projected the median federal funds rate to ease to 3.6% by end-CY2025 from the current 4.0%, implying two more rate cuts in this year. Nevertheless, the 10Y US Treasury yield rose to 4.14% on September 19, 2025 from 4.06% before the US Fed meeting, taking the spread between the 10Y India G-sec and UST yield to 236 bps from 209 bps at end-June 2025 (5-year average: ~358 bps).

Analytical Contact Details

Name	Designation	Email	Contact Number
Aditi Nayar	Chief Economist, and Head- Research and Outreach	aditin@icraindia.com	0124- 4545 385
Rahul Agrawal	Senior Economist	rahul.agrawal@icraindia.com	022 – 6114 3425
Aarzoo Pahwa	Economist	aarzoo.pahwa@icraindia.com	0124 – 4545 835
Tiasha Chakraborty	Economist	tiasha.chakraborty@icraindia.com	0124- 4545 848
Isha Sinha	Associate Economist	isha.sinha@icraindia.com	022 – 6114 3445

Business Development/Media Contact Details

Name	Designation	Email	Contact Number
L Shivakumar	Chief Business Officer	shivakumar@icraindia.com	022-61693304
Sai Krishna	Head - Research Sales and Investor Connect	sai.krishna1@icraindia.com	9840774883
Rohit Gupta	Head Business Development – Infrastructure Sector	rohitg@icraindia.com	0124-4545340
Vivek Bhalla	Head Business Development – Financial Sector	vivek.bhalla@icraindia.com	022-61693372
Vinita Baid	Head Business Development – East	vinita.baid@icraindia.com	033-65216801
Shivam Bhatia	Head Business Development – Corporate Sector – North & South	shivam.bhatia@icraindia.com	0124-4545803
Sanket Kulkarni	Head Business Development – Corporate Sector – West	sanket.kulkarni@icraindia.com	022-6169 3365
Naznin Prodhani	Head - Group Corporate Communications & Media Relations	communications@icraindia.com	0124-4545860

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Thank You!