



## RBI's Liquidity Management- A Review

### Highlights:

- ✓ *Effective transmission of monetary policy by the central bank is ensured by efficient liquidity management.*
- ✓ *One of the primary functions of the central bank is to address the liquidity deficit and surplus in such a way as to be optimal for the functioning of the economy by way of appropriate credit flows.*
- ✓ *The implementation of 24x365 payments and Just-in-time release of funds in government cash operations has led to system liquidity tightness.*

Since December 2024, RBI has taken many liquidity measures, to ensure that flow funds remain adequate for productive segments at the same time liquidity remains non-inflationary. Recent movements in USDINR have resulted in the RBI's dollar selling creating tightness in rupee liquidity and giving rise to expectations around the RBI announcing open market operations -i.e. bond purchases to sterilize the dollar sales. The previous episode of RBI bond buying ended in May 2025. USDINR faces risks from the external environment and system liquidity has been narrowing in the previous fortnight even as RBI has bought G-sec on screen giving rise to expectations of a formal OMO announcement in the near term.

The last decrement of the 100-basis point worth of cash reserve ratio (CRR) cut announced in the August 2025 MPC meeting was implemented from the fortnight ending 29<sup>th</sup> November 2025, releasing approximately ₹2.50 lakh crore into the banking system. Since 4<sup>th</sup> November, the RBI has begun buying G-sec on the screen or on NDS-OM, and the markets sentiments are being driven by expectations of a formal announcement of OMO purchase by RBI given the liquidity tightness despite the CRR cut. USDINR has now breached ₹90 to a dollar and has likely led to further intervention by the central bank in the dollar markets.

RBI or any central bank will resort of open market operations (OMOs) to inject liquidity when the durable liquidity is in deficit. This can happen due to any one of the three of major drivers of autonomous liquidity straining banking system liquidity. The three main drivers are

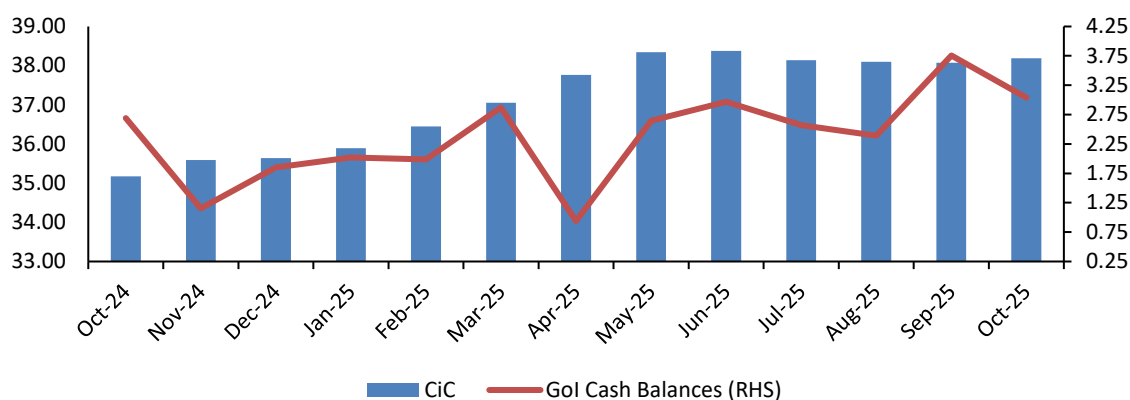
1. Government Cash Balances
2. Currency in Circulation
3. Capital Outflows

The term autonomous attached to these variables is because these These three factors are entirely exogenous to the banking system, and the central bank has little or no control on them.



For example, currency in circulation is the cash in vaults of banks and currency with the public. This is a function of the total currency demand in the economy, linked with aggregate demand. This currency demand over period exhibits natural seasonality as the demand for cash depends on specific events such as festivals and elections when the demand for cash usually tends to increase. Of late, a pattern change in seasonality might be visible due to the reduction in usage of cash from around 12 percent of GDP to below 10 per cent of GDP, owing to the plethora of payment modes available to the public. The most recent examples of increase in currency in circulation were during the general and state elections, during festivals and during the Mahakumbh.

**Chart 1: Currency-in-Circulation (CiC) & Government Cash Balances**  
(in ₹ lakh crore)



Source: RBI, STCI PD Research

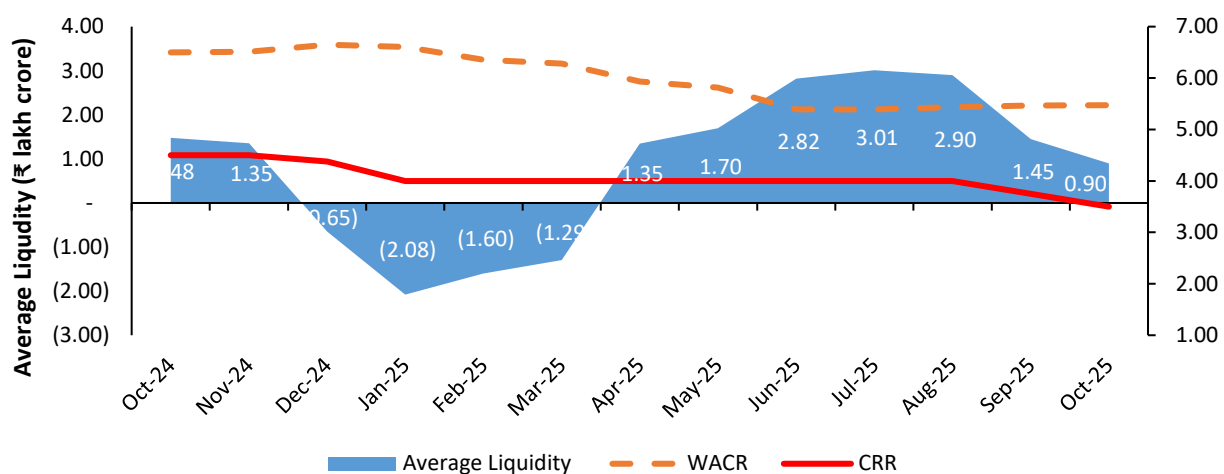
Similarly, government cash balances are government deposits of cash held with RBI and are subject to the vagaries of government receipts via taxes and auctions and government expenditures which happen both periodically and sporadically throughout the year. Government spending tends to be lumpy and hence presents challenges in liquidity forecasting. Capital outflows depend on the external risk environment and investor appetite and are by nature extremely volatile especially the portfolio flows earning the moniker of “hot money.” These actions by public, investors and governments create the ebb and flow in banking system liquidity, and managing these flows in a way that is non-disruptive to the economy is a primary function of the central banks around the world.

**RBI's Liquidity Management:** Q3 FY2024-25 witnessed sharp capital outflows on the back of the US elections that affected all the emerging markets. For India, these capital outflows were during the onset of the busy season preceded by significant build-up of cash balances by the central government which kept a very restrained spending profile as during the general elections creating a situation of marked liquidity tightness. RBI

remedied the liquidity deficit by easing the CRR and conducting OMOs to inject durable liquidity into the system to sterilize its dollar buying. To an extent, these interventions by the central bank also alleviated the liquidity tightness created by the build-up of government cash balances.

RBI cut CRR by 50 basis points in December 2024 anticipating the confluence of the increase in currency in circulation, strong capital outflows post the US-Election results in November 2024 and the significant build-up of government cash balances. During this period RBI was a net seller of USD, creating further tightness in INR liquidity. All these factors taken together, could not entirely moderate rupee depreciation which took a sharp turn around April-2025 as rupee depreciated by 3 per cent within the quarter. This was the period of the announcement of the Liberation Day tariffs by the Trump administration levying import tariffs on multiple countries, with one of the highest rates of 25 per cent being imposed on India.

**Chart 2: Banking System Liquidity and WACR (₹ lakh crore and per cent)**



Source: RBI, STCI PD Research

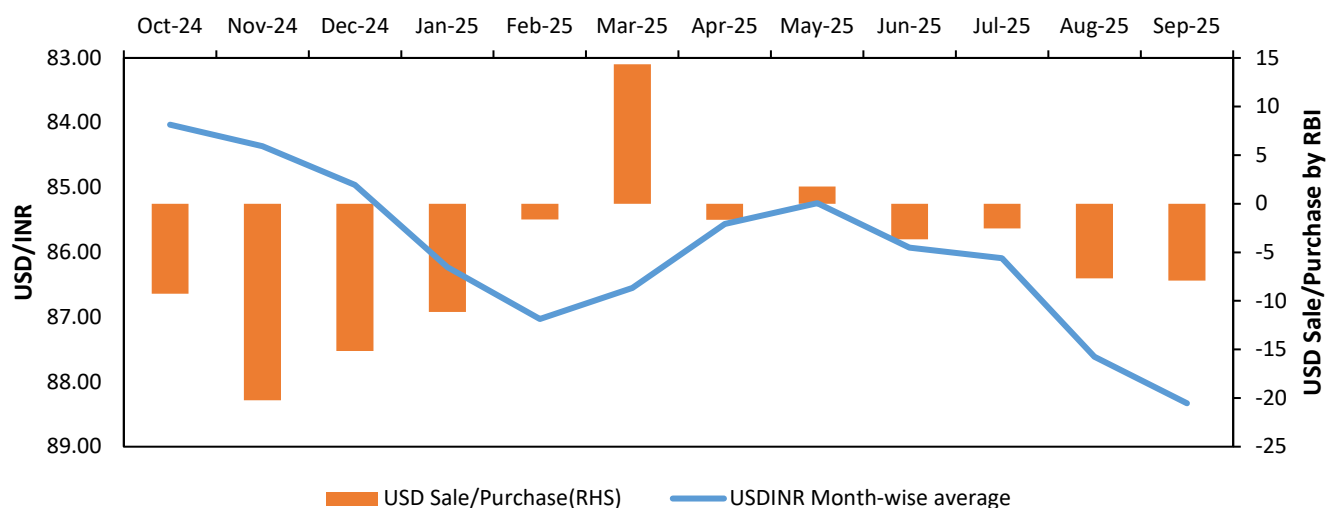
RBI's liquidity management since October 2024 onwards and especially since January 2025 entailed purchasing government securities by ways of OMOs worth ₹ 4.8 lakh crore between January 2025 to May 2025, almost nullifying the effect of the net dollar sales. Owing to relative stability on the external front and the liquidity operations by RBI along with a resumption of government spending, banking system liquidity swung to a surplus peaking at around ₹3.0 lakh crore on average in June 2025. The central bank has since stopped doing any open market purchases as the strain on system liquidity remained manageable with fine tuning operations such as VRR/VRRR.



**Liquidity - Durable or Transient?** RBI clearly distinguishes liquidity on the nature of the balances in the system. For example, transient liquidity is the liquidity in the banking system while liquidity with the government in the form of government cash balances is considered durable. While this distinction is based on the nature of balances and their respective effects on the banking liquidity, there is no reason based in economic theory why government cash balances should be termed as durable, when they themselves are subject to erratic movements over time as cash flows are expended and absorbed by the government as per the economic currents during the period.

But before attention is turned to government cash balances it is advisable to look at other autonomous drivers of liquidity i.e. currency in circulation and foreign capital flows, which can be regulated only to an extent by the central bank and the flow cannot be controlled by any authority as it is almost entirely at the discretion of the domestic economic agents and foreign investors. System liquidity can be adversely affected if there is a rapid withdrawal of cash from the banking system into the hands of the public, i.e. the largest component of currency with public, and system liquidity shall be flushed with cash if the public wants to deposit cash instead of keeping it at home, as was observed during the demonetization phase in 2016-17. The new 24x365 retail payments system implemented since 2020 and the Just-in-Time (JIT) release of funds (SNA-SPARSH) adopted in July 2023, in the centrally sponsored schemes (CSS) have also augmented pressures on system liquidity.

**Chart 3: RBI's Dollar Interventions (USD Bn) & USDINR**



Source: RBI, STCI PD Research (USDINR Values are in reverse scale)



**Current Liquidity Conditions:** RBI has cut both the policy repo rate and the CRR by a significant 100 basis points or 1 per cent each. The CRR cut has injected approximately ₹2.5 lakh crore worth of durable liquidity into the banking system. The ongoing pressure on the domestic currency on account of the uncertainty of the US-India trade deal has led RBI to intervene in the foreign exchange market and hence resulted in significant liquidity tightness in November 2025. It is significant to note that, considering only the spot market, RBI has net sold ~USD 64.7 billion since October 2024, which in INR terms turns out to be approximately ₹5.53 lakh crore. RBI has also conducted OMOs purchases worth ₹5.22 lakh crore between January 2025 to May 2025.

As the external uncertainty over the US-India trade deal and other geo-political and geoeconomic conditions evolve, banking system liquidity will undergo bouts of tightness, owing to RBI's intervention. Generally, the liquidity level for deficit to prompt any remedial action by the central bank is liquidity deficit breaching the +/- 0.25-0.50 per cent of system net demand and time liabilities (NDTL). NDTL of +/- 0.25-0.50 as of 31<sup>st</sup> October amounts to ₹0.65-1.3 lakh crore. If the autonomous drivers of liquidity such as foreign capital outflows, RBI's exchange intervention, leakages via increase in currency-in-circulation, along with regular GST outflows lead system liquidity to breach the 0.5 per cent NDTL level in terms of deficit in a persistent pattern, RBI would likely announce G-Sec purchases via open market operations to the tune of ₹ 0.6-1.5 lakh crore to balance the liquidity deficit and get the system liquidity back into a neutral zone.

**STCI Primary Dealer Ltd.**

CIN: U67110MH2006PLC165306

A/B1- 801, A Wing, 8th floor, Marathon Innova, Marathon Next Gen Compound,  
 Off. Ganpatrao Kadam Marg, Lower Parel (w), Mumbai 400013.

Dealing Room: (022) 66202217-20 • Settlements: (022)66202262-64, Fax (022) 66202288

Delhi Office: (011) 47676557-58 • Kolkata Office: (033) 40611435-36 • Bengaluru Office: (080) 42183166/1021

Please mail your feedback to [stcipc@stcipc.com](mailto:stcipc@stcipc.com)

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