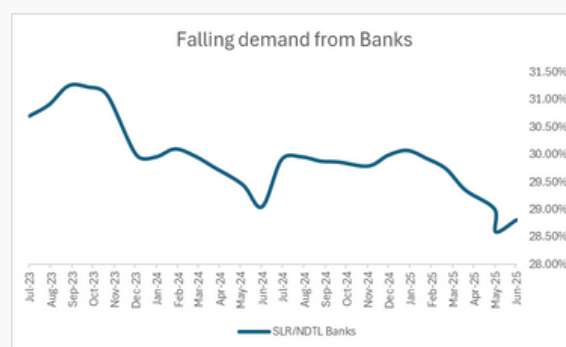


WHY ARE BANKS NOT BUYING G-SECS?

As we mentioned in our earlier note, the banks have hardly been buying the G-secs. As this chart shows, the bank purchases has reduced significantly.

This reduced purchase has led to a demand/supply crisis as the market struggles to cope with the auctions

The reduced demand is due to (i) HTM regulations put in place in Apr 2024, and (ii) LCR regulations put in place from Apr 2026.



WHAT ABOUT HTM REGULATION?

What was the old HTM regulation?

Banks purchase Gsecs in HTM (Hold to maturity), AFS (Available For Sale) & HFT (Held For Trading) books. Of these, the HTM book is not marked to market. Thus banks preferred to keep G-secs in this book as there was no loss or gain.

However, the RBI allowed the banks to reclassify the HTM bonds (*read as sell HTM bonds from hereon*), usually to book profit

- Any size of HTM bonds once a year, and
- 5% of the HTM bonds throughout the year.

If the banks were in profit in these HTM bonds, they could book profit and purchase fresh set of bonds from market to replenish the HTM book. If in loss, they would keep the bonds in HTM book with no loss.

What has changed?

Under the new regulations, since 2024 the banks can only sell 5% of the HTM bonds in a year. Now, if the banks buy in HTM they probably will need to hold it till maturity. Thus they will not buy large amounts in HTM books, as they will not be able to sell and the capital is blocked. The banks will purchase more in AFS and HTM books, where they can sell easily.

How does it impact the banks behaviour?

Higher volatility: The banks behaviour has changed to a traders from an investors.

- Earlier banks would buy in a large G-sec fall and catch the falling knife. If they captured the bottom, they could sell from HTM the next year. If the market kept crashing - they did not need to show losses. Now banks have reduced HTM book, so they are no more there to buy when market crashes.
- Similarly, when the market will rally, the banks will buy in AFS and HFT books to make capital gains. This will increase volatility in the rallies.

Lower purchase in duration: The banks earlier used to buy duration in HTM because of (i) higher yields, and (ii) larger possibility of capital gains few years down the line. However, now banks would not want to buy sizeable long bonds as the AFS book is more prone to mark-to-market. Moreover, there is no incentive to buy in HTM books, as they cannot sell in future to book profits.

WHAT ABOUT LCR REGULATION?

What has changed in LCR regulations?

New LCR guidelines are effective from April 2026. As per the new guidelines the run off factors for different segments have been lowered reducing the LCR requirement for banks.

How does it change banks behaviour?

This means lower mandatory G-sec buying by banks as bonds required to maintain LCR will reduce by ~6% and hence reduce additional requirements to that extent. **Thus a total of around 4 lac cr of banks purchase is wiped off (6% of SLR holdings).** However, this impact is largely a one-off as markets realign. From next year the impact will be minimal (only in incremental NDTL).

SO WHAT DOES IT MEAN?

Expect trading volatility

Remember how yields moved from 6.80% to 6.30% in a matter of few months? Or how they moved back to 6.60%? Large part of this can squarely be put on the banks actions of buying and not buying Gsecs based on their trading view.

Expect low liquidity

With no Banks to provide support in sell offs the market sell offs will be vicious in low volumes. Similarly with banks now becoming traders, the rallies will be similarly vicious.

OUR VIEW?

We had anticipated this lower demand from banks way back in Apr/May. We used to discuss in team meetings and client meetings, yet we were taken off-guard by this selloff. Why? Because we underestimated the impact of tariff and RBI commentary. In normal times the banks would have purchased around 6.35%-6.40%, but this time it was a whiplash impact.

The banks have continued to remain out of Gsec market. Their underinvestment is similar to running a short position. Thus, they are deep in the money and there is no reason for them to do a panic buying.

We expect a positive news from tariffs (if it comes), or a confirmed fiscal discipline to make the bond markets rally and consolidate. When this happens, the banks may be motivated to purchase Gsecs (for trading gains) - and that may lead to a whiplash rally (mirror or recent sell-off) closer to 6.25%. But for that - **the markets will need a positive event.**