

RBI DIVIDEND MAKES ITS IMPACT ON MONEY MARKETS!

We are operating under a cloud of persistent headwinds: lingering geopolitical tensions, rising crude oil prices creeping slowly into inflation, along with a weakening Rupee putting pressure on external balances and complicating import costs further.

WHERE IS THE GLIMMER OF HOPE?

Thankfully, for the fixed-income and money market segments the seasonal beacon of light arrives every year in May/June post RBI declaring its dividend. This year RBI paid out a surplus of INR 2.87 lakh crore as dividend to the government.

This single largest structural injection of durable liquidity into the banking ecosystem leads to tactical downtick in money market yields. In this note we analyze the gap between the

A RARE OPPORTUNITY? TIGHT BANKING LIQUIDITY, ABUNDANT UNSPENT GOVERNMENT CASH, MULTI-YEAR-HIGH CD YIELDS!

3m CD Repo spreads are at multi year high with a ~190bps spread over repo. The current money market landscape reveals a clear macro dislocation. We've seen an unusually strong credit growth, as with mounting geopolitical pressures and rising crude prices led to higher working capital borrowing needs. Banks ended up aggressively paying up for short-term funding to support this.

Liquidity Metric	Current Value (INR)
RBI Surplus Dividend Transfer (Fiscal Catalyst)	2.87 Lakh Crore
Durable Liquidity Pool	~5.75 Lakh Crore
Active Banking System Liquidity	~1.25 Lakh Crore

Simultaneously, the government is sitting on a massive pool of unspent cash. The Government actively spends through the intense month-end and early-June salary/pension cycles. Banking liquidity structurally normalizes into a durable surplus.

HOLDING PERIOD RETURN?

Avenue	Current Yield	Scenario over 30 days	Holding Period Return
Overnight (TREPS)	5.25%	Flat	5.25%
3-month CD	7.20%	-20 bps	7.50%
6-month CD	7.65%	-15 bps	8.16%
9-month CD	7.75%	-15 bps	8.45%

THERE ARE NO FREE LUNCHES, SO ALL THIS DOES COME WITH ELEMENTS OF RISK.

Aggressive RBI FX Intervention: Continuing depreciation pressure on the Rupee may prompt the RBI to sell dollars, which absorbs Rupee liquidity and could partially offset government spending benefits. This is our primary monitored risk vector.

Government Spending Delays: A temporary holdback of budgeted spending is possible but historically rare beyond a few weeks due to mandatory operational obligations (salaries, state transfers).

Outsized MPC Hawkishness (June 4-6): A hawkish policy surprise has a very low probability; if it occurs, it would reduce the capital-gains component but preserve a highly attractive entry carry.

Elevated June CD Supply: Approx. Rs. 1.6 lakh crore of bank CDs mature in June 2026. If banks roll over the full amount, yields could remain sticky. However, May data showed banks undersupplied maturities by ~Rs. 50k crore, indicating moderate rollover pressures.

Crucially, even if these risk scenarios were to play out the accrual would make up for sustenance of yields are existing levels.

SO WHAT SHOULD BE YOUR PORTFOLIO STRATEGY?

Our portfolio was already positioned for this move. We have seen a 30bps compression in 3m CD rates from highs of 7.5% of late to 7.20% post dividend. It has also started transcending into the rest of the curve. 6m and 9M CD rates have moved down in this period by 10-15bps.

Deploying into the Ultra Short and Money Market categories with current YTM's close to 7.60% offers a good risk to reward as spreads are still high.