India: *Three burning questions on liquidity & transmission*

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BANKING RESEARCH TEAM

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1. **Why is deposit/ credit growth easing despite liquidity flush in banking system?**
   a. *RBI must be complimented for significant liquidity steps totaling ~Rs 11 lakh cr since Dec'24 apart from providing assurance of ~1% of NDTL, a gamechanger (in line with our research proposal).*
   b. *Despite the liquidity "supply", both deposit and credit growth have slipped to sub-10% levels in the latest fortnight. This is because of weak credit "demand" amid global and domestic geopolitical uncertainty.*
   c. *RBI research shows that causality runs from GDP to credit rather than other way round. Weak credit demand apart from precautionary demand for money is driving banks to park money in SDF on a daily basis thereby limiting "net" liquidity impact of RBI steps.*
   d. *Consequently, growth in reserve money (led by liquidity "supply" by RBI) is lagging at 4.7% (7% adjusted for CRR cut). Interestingly, while money multiplier has inched up post CRR cut, growth in money supply (led by "demand" for credit) has eased.*

2. **What is impeding the transmission of rate cuts into MCLR & deposit rates?**
   a. *Transmission into non-repo linked lending rates like MCLR is still lagging even as deposit rate cuts have started.*
   b. *While historically, there are time lags in transmission, in the current context, lags can increase with quantum of repo rate cuts passthrough capped, in our view.*
   c. *This is related to the issue of persistence of inequitable distribution of liquidity viz. widening gap between "Haves and Have nots". Hence, the weakest link i.e. the biggest 'Have not" that commands pricing power in funding and deposit rates.*
   d. *Despite liquidity switch to surplus, "Haves" are still parking a large amount with the RBI in SDF. Meanwhile, "Have nots" having suffered from fight for deposits in last 2-3 years are hesitant to cut deposit rates and hence even MCLR thereby hindering transmission process.*
   e. *This issue is also keeping the funding spreads like 1yr CD-Tbill spread elevated at ~90bps despite sharp correction in recent months*

3. **What is the expectation on liquidity measures from 4-6th June MPC meeting?**

   a. *In our view, the RBI led MPC is likely to repeat another 25bps rate cut with terminal rate seen at 5.50%, with next rate cut in August. More importantly, the operative target (weighted avg call rate, WACR) has already slipped further by 25bps to lower end of policy corridor as the RBI has already undertaken significant measures related to liquidity in order to facilitate transmission.*

   b. *Hence, in the June policy meeting this week, we do not see any further steps apart from clarity, if any, on the revised liquidity management framework apart from commentary on transmission. We believe that while policy transmission is work in progress, it is also adversely affected by inequitable liquidity distribution with the "have nots" commanding pricing power in the rates market*

   c. *In this regard, we recommend the following:*

      i. *Promote inter-bank lending using an uncollateralised term money market product for 15/30 day period offers a solution, in our view. Benchmarks like SORR (Secured Overnight Rupee Rate) discussed in Dec'2024 MPC may be considered for developing such product solutions*

      ii. *Since banks may typically get 10-15 bps over overnight call money rates, "Haves" would be incentivised to lend to "Have nots"*

      iii. *To further encourage banks to partake their surplus liquidity under this product, the RBI may provide an emergency liquidity line against the lending done in the 15/30 day term money market. The banks may also be permitted to keep a collateral carved out from their regulatory SLR holdings for this facility with RBI.*

      iv. *This will help solve 3 problems in our view:*

         - *Gap between "Haves" and "Have nots" will be plugged which may help lower funding spreads (1-yr CD-Tbill spread down from >100bps in end Mar'25 to 60-70bps currently and may slip further)*
         - *Precautionary demand for liquidity for "Haves" will be addressed as banks are unable to accurately forecast liquidity*
         - *It will help develop term money market, a long standing ask from the RBI and part of liquidity management framework as well*

RBI must be complimented for liquidity measures supporting switch in banking system liquidity to surplus

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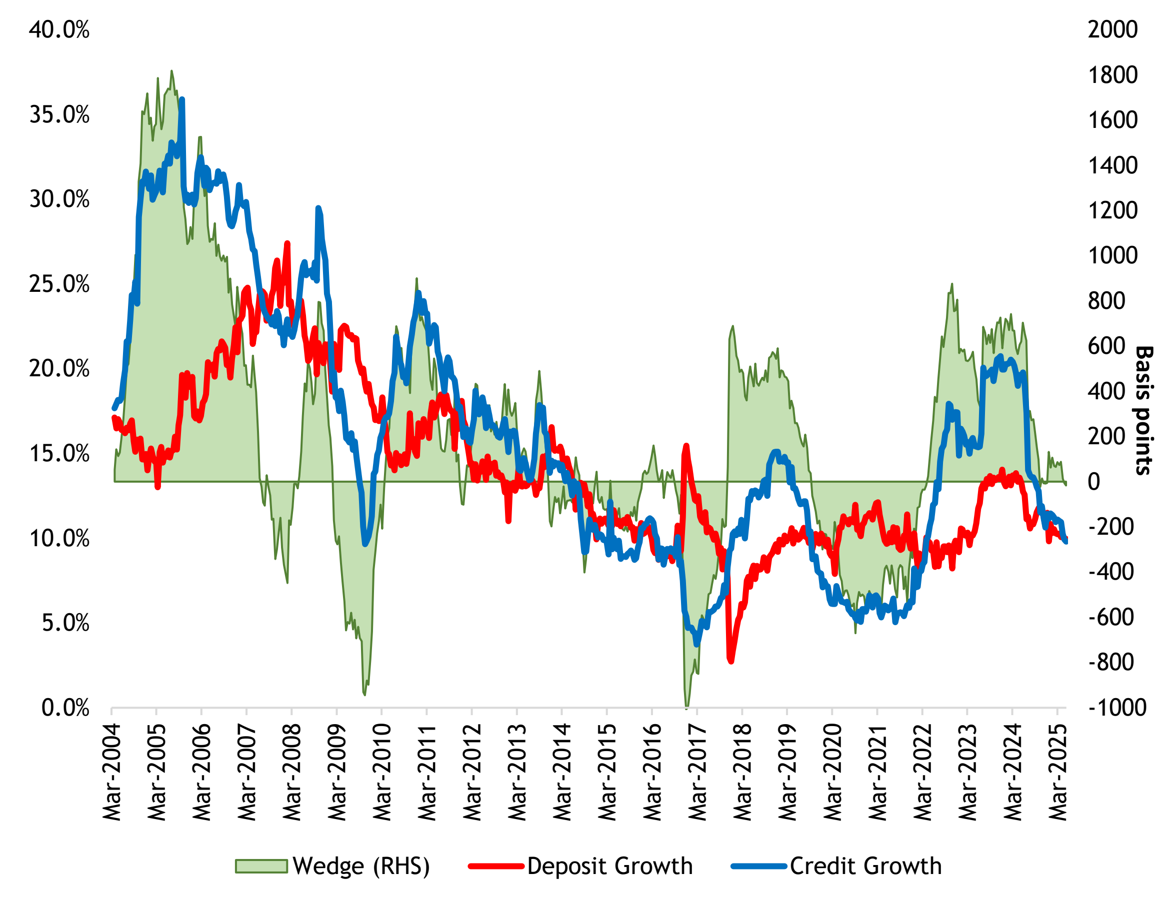
RBI liquidity measures since Dec'24 have totaled ~Rs.11 lakh crore

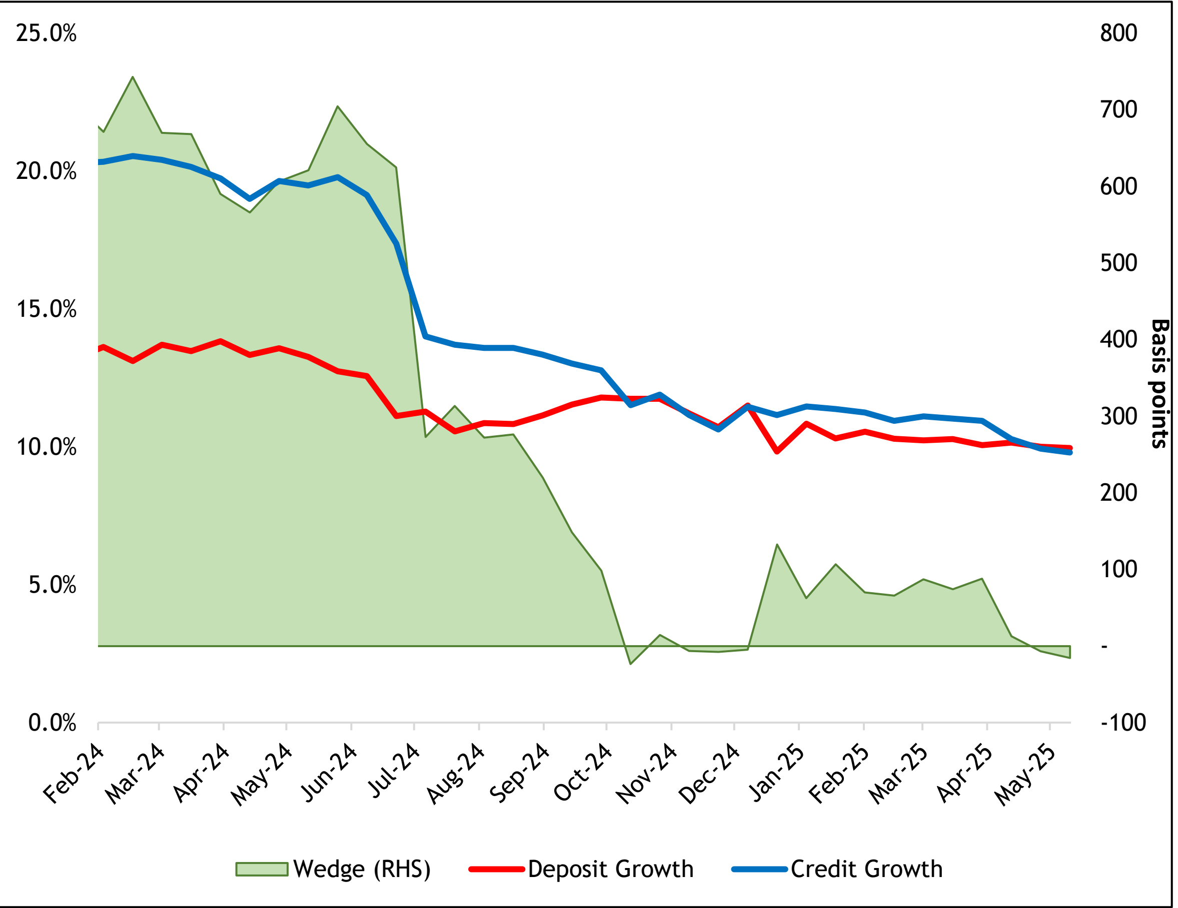
Measure	Mode	Date	Amount (Rs. In Lakh Crore)
CRR Cut		Dec-24	1.16
OMO Purchases	NDS-OM	Jan-25	0.39
OMO Purchases	Auction	30-Jan-25 13-Feb-25 20-Feb-25 12-Mar-25 18-Mar-25 25-Mar-25 01-Apr-25 17-Apr-25 28-Apr-25	0.20 0.40 0.40 0.50 0.50 0.45 0.80 0.40 1.19
Term Repo Auction	56-Day VRR 49-Day VRR 45-Day VRR 43-Day VRR	07-Feb-25 14-Feb-25 21-Feb-25 17-Apr-25	0.50 0.75 0.58 0.25#
USD/INR Buy/Sell SWAP	6 Month 3 Years 3 Years	31-Jan-25 28-Feb-25 24-Mar-25	0.44 0.88 0.86
	Total		10.65

#Announced for Rs.1.5 lakh crore, allotment for Rs.0.25 lakh crore; Source: RBI, UBI Research

Structural liquidity deficit has switched with credit-deposit growth gap turning negative

Credit-deposit growth wedge has narrowed, with a –ve gap of ~20bps clocked in latest fortnight ended 16th May'25





Source: CEIC and UBI research

Yet weak credit (demand) may not be addressed by surplus liquidity (supply)

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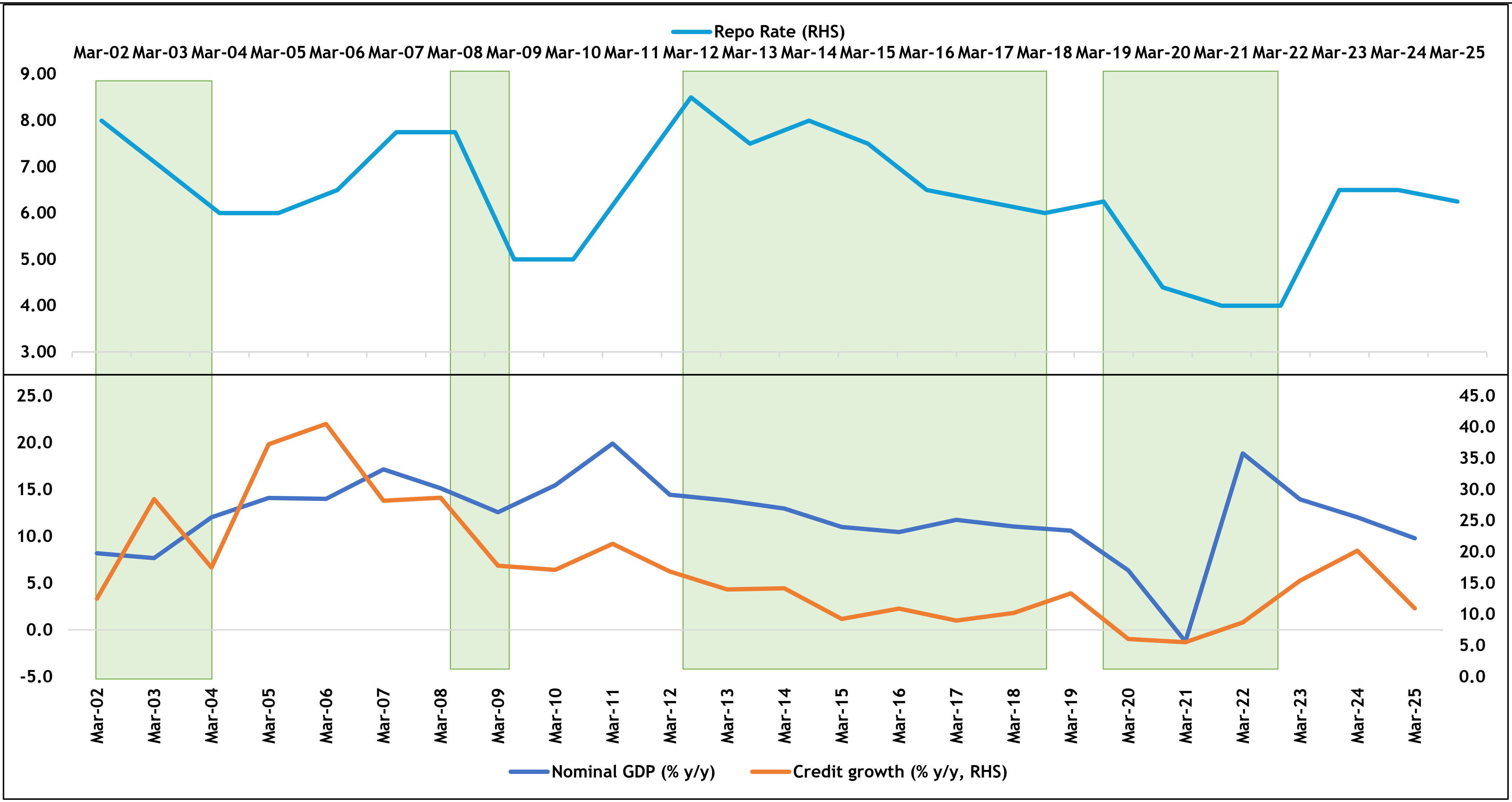
RBI analysis shows absence of causality from credit to output growth, hence demand for credit contingent on pickup in economic activity



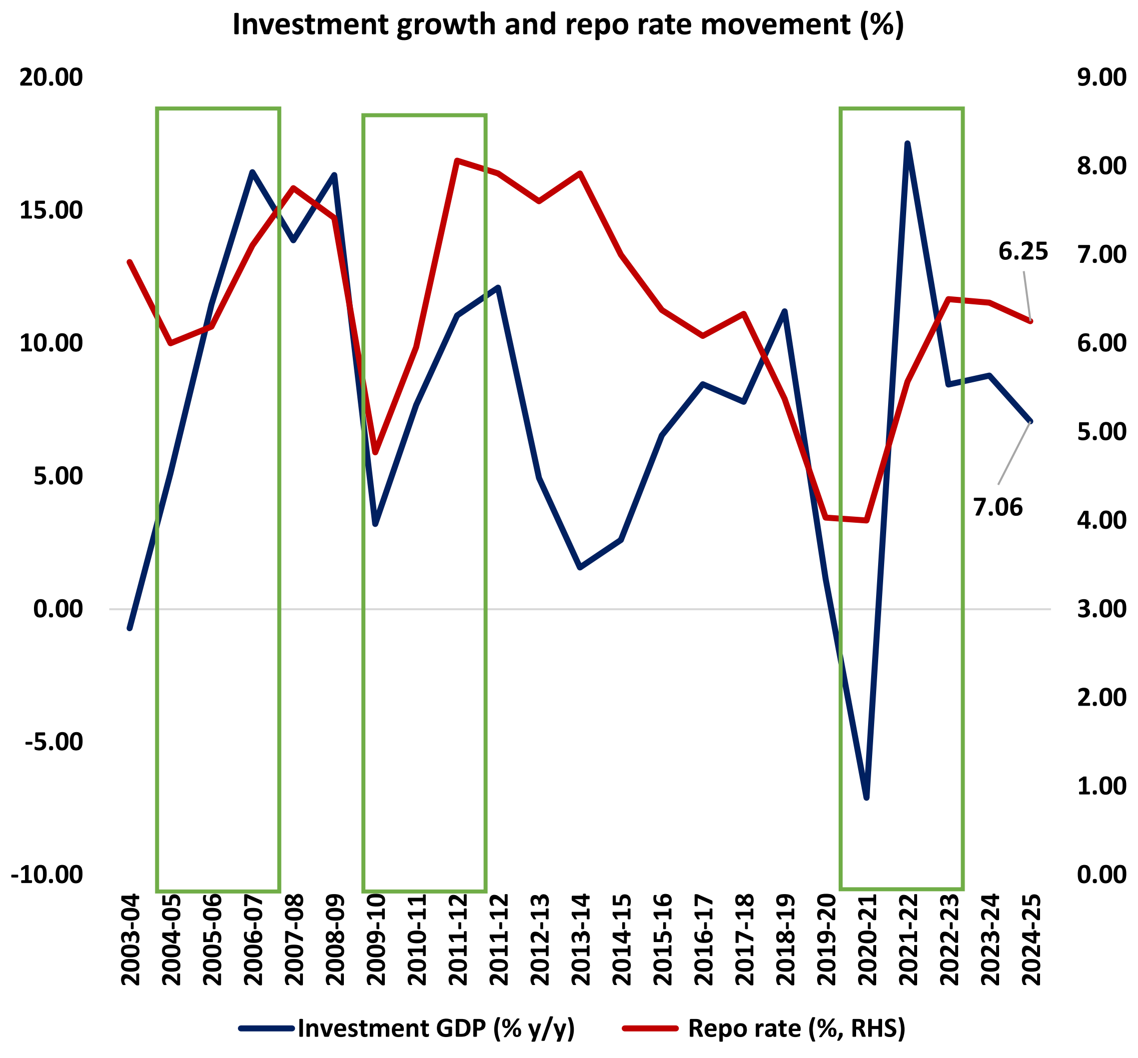
Rate Cutting Cycle

Source : RBI & UBI research

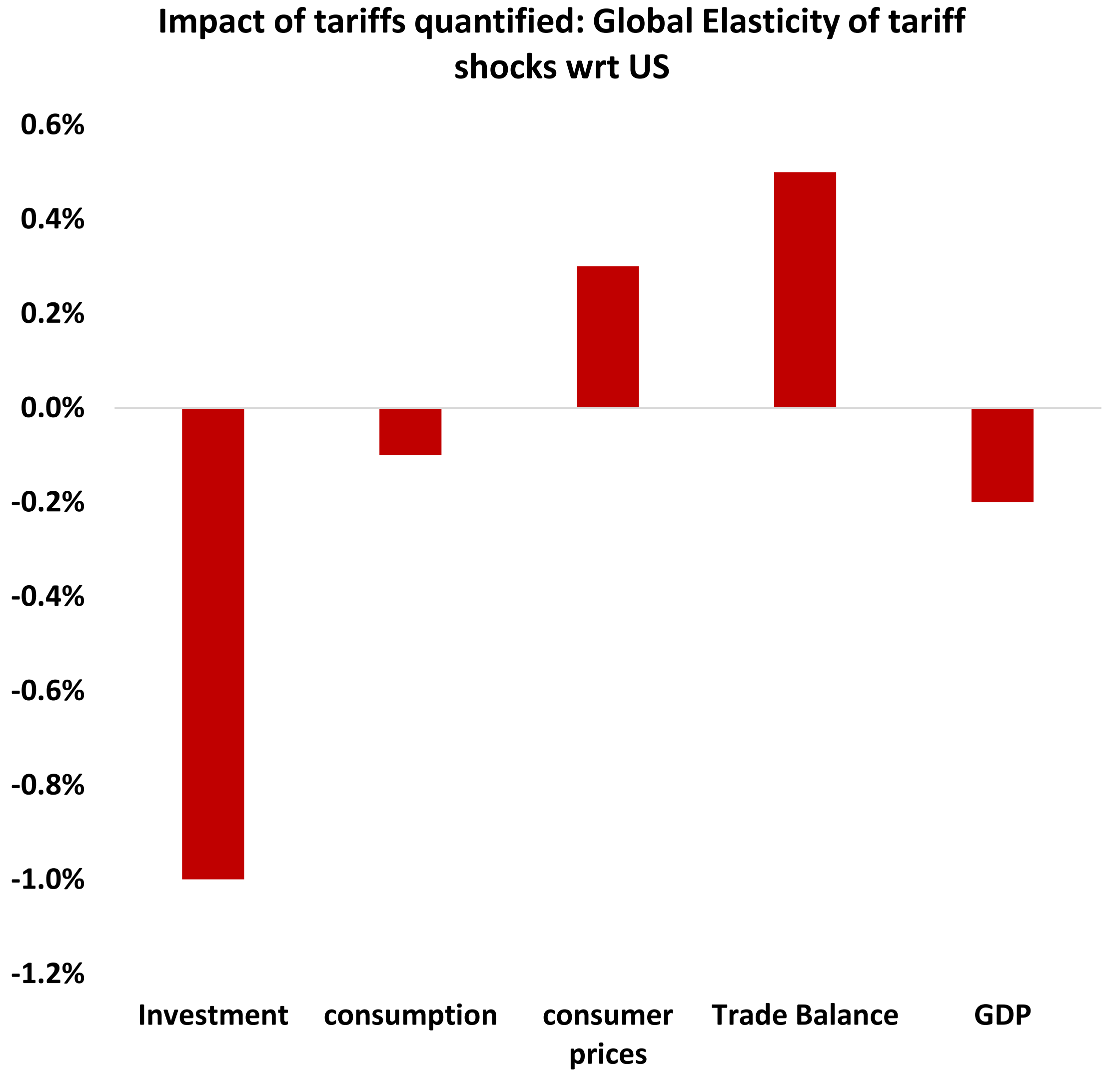
Classification: Public

Investment sensitivity to repo rate cuts is limited and may be further constrained by tariff related uncertainty

Investment growth usually trends upwards in high growth & rate hike periods



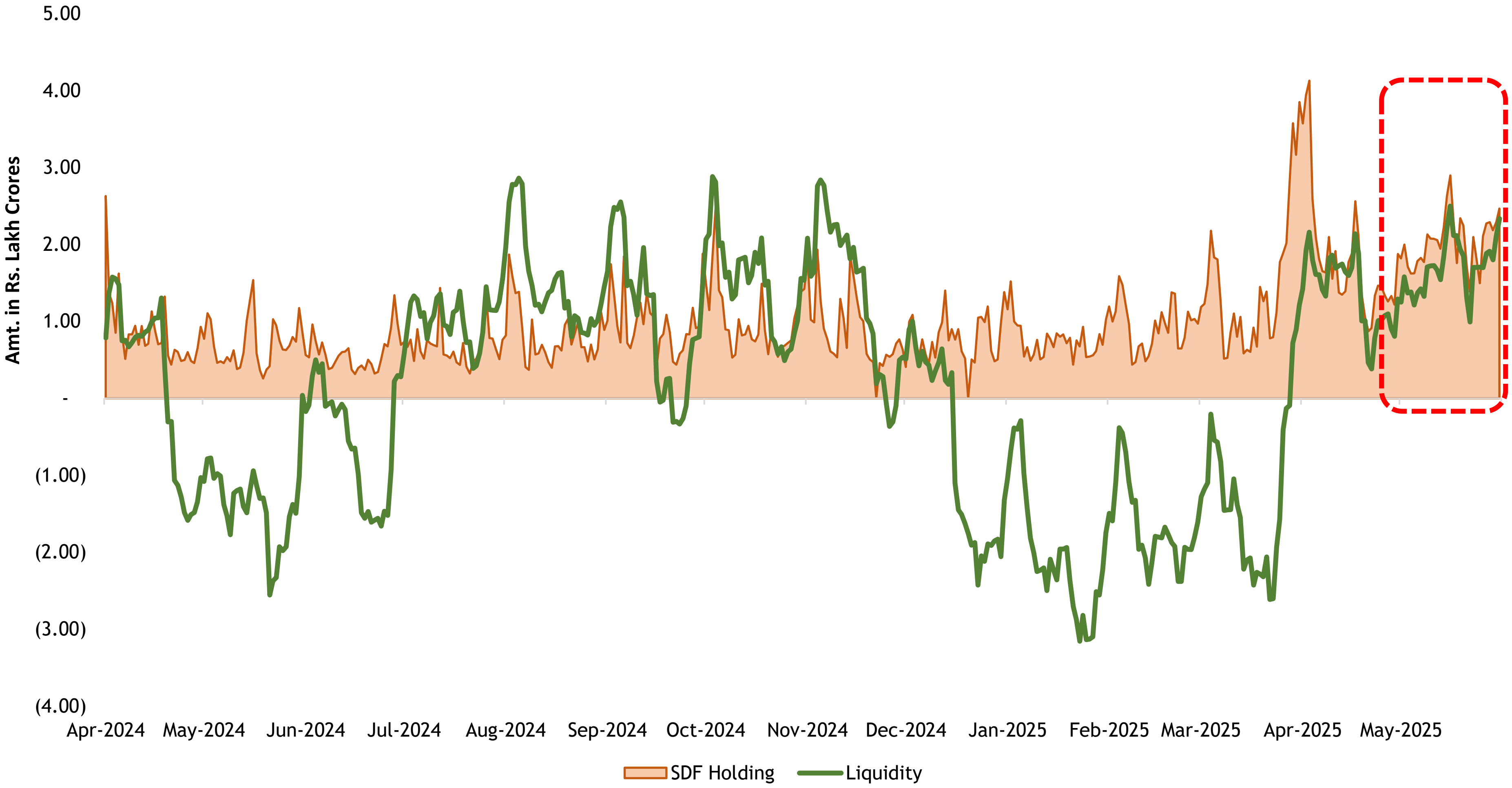
Apart from trade, the key channel of impact of tariff hike on economy will be weak investment sentiment



Source: IMF, NBER, CEIC, UBI Research

Banks mostly parking excess liquidity with the RBI in SDF

High SDF Holdings signal weak credit demand & elevated precautionary liquidity demand for Banks



Average liquidity balance for the banking system in May'25 had surplus of Rs. 1.71 lakh crore, while banks with surplus liquidity parked Rs. 2.03 lakh crore (Apr'25 average) in SDF with the RBI showing the money moving back to RBI.

Source : RBI & UBI research

WACR has slipped to the lower end of the corridor due to liquidity flush in the banking system

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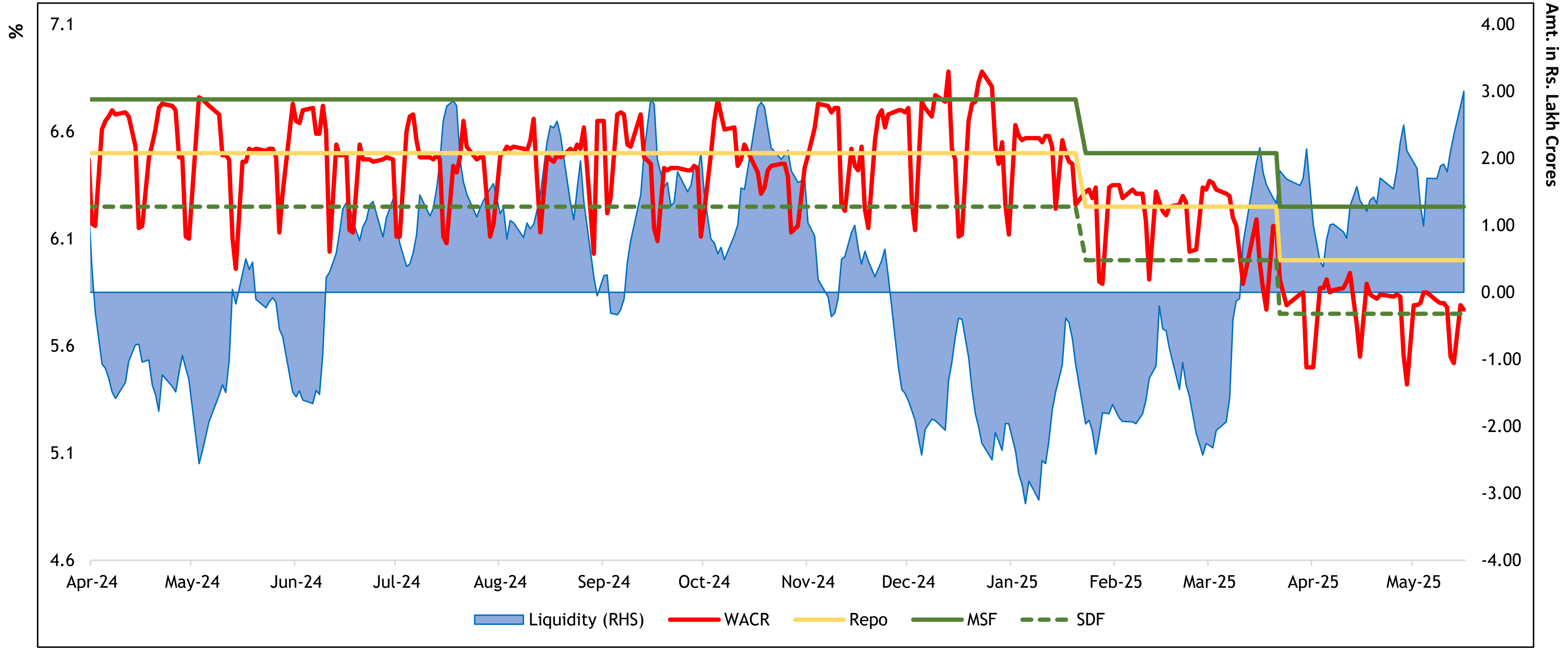
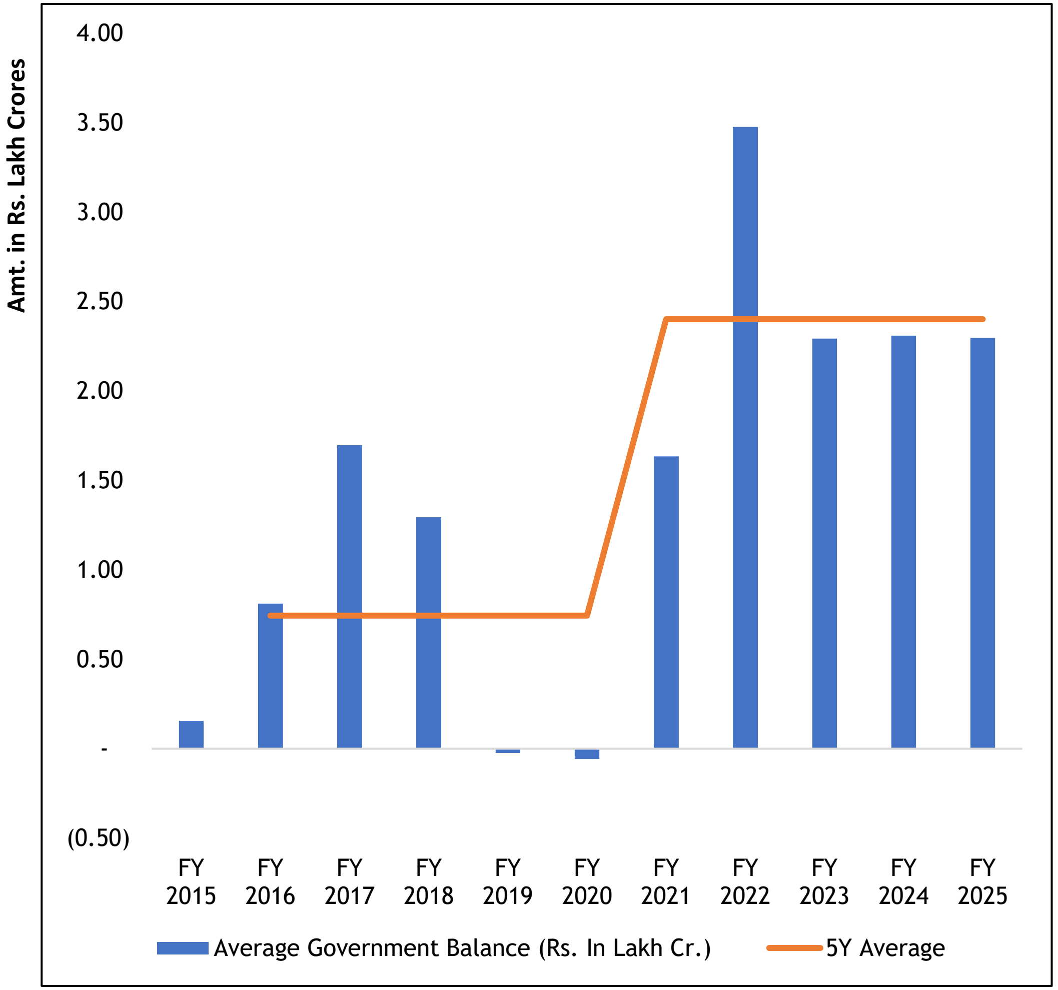


Source : RBI & UBI research

Elevated and volatile govt balance with RBI also adding to liquidity pressures & precautionary demand for liquidity

Govt balance has seen a threshold shift probably on implementation of 'Just in Time'

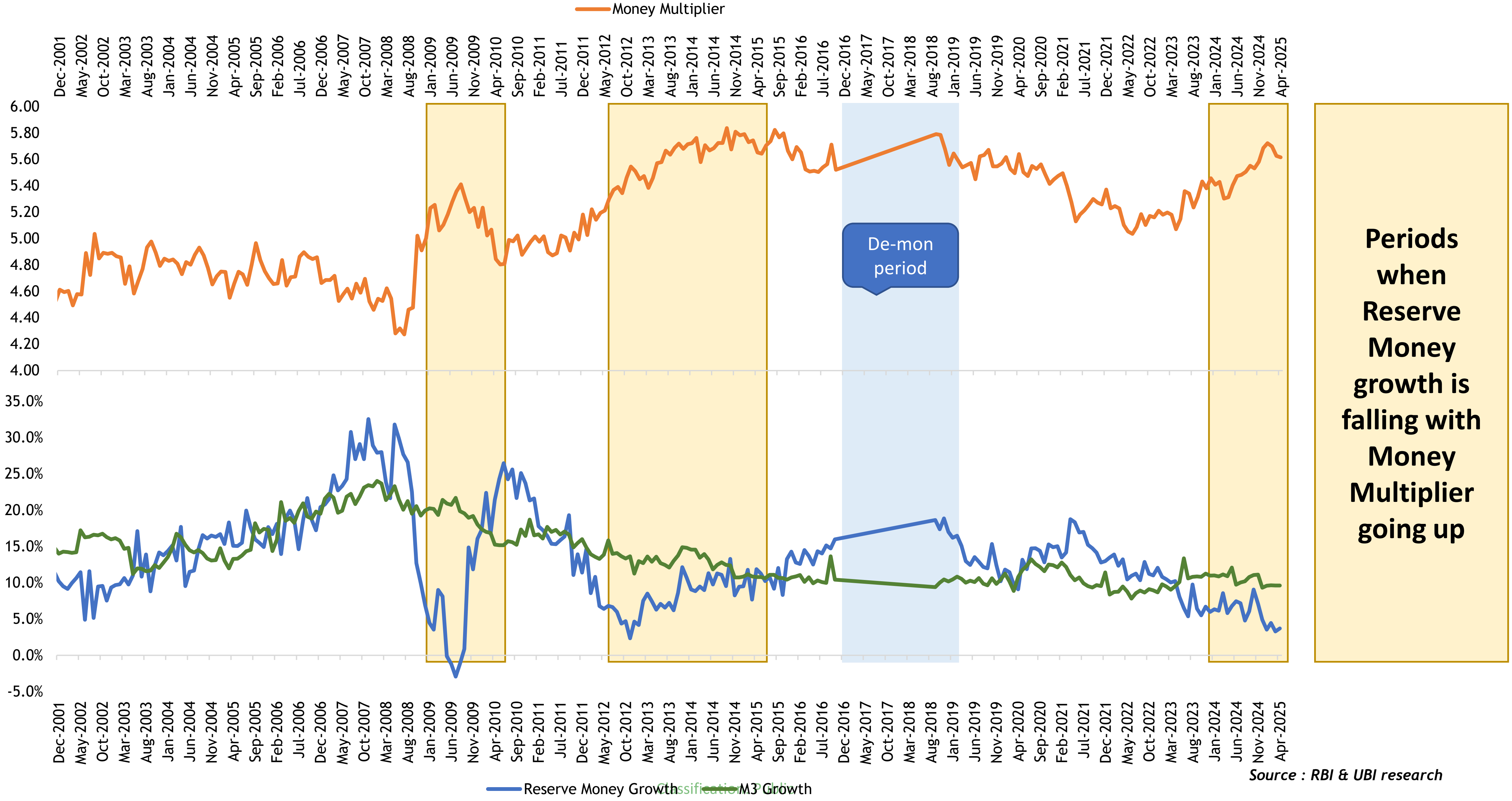


High volatility in govt balance with RBI has been a key drag on liquidity dynamics

Month	Avg. Liquidity	Avg. Govt. Bal.*	Avg. Core Liquidity	VRR	VRRR
Apr-23	1.19	-0.61	0.58	-	-1.45
May-23	0.66	0.94	1.59	0.47	-0.08
Jun-23	1.2	1.55	2.75	0.75	-2.15
Jul-23	1.47	2.1	3.57	-	-5.58
Aug-23	1.06	1.7	2.76	-	-0.57
Sep-23	-0.17	2.58	2.41	-	-0.25
Oct-23	-0.47	3.52	3.05	-	-0.12
Nov-23	-0.55	2.98	2.43	-	-0.43
Dec-23	-1.03	3.18	2.15	4.5	-0.22
Jan-24	-2.07	3.76	1.69	7.5	-
Feb-24	-1.86	3.52	1.66	6.85	-1.76
Mar-24	-0.39	2.51	2.12	4.66	-2.68
Apr-24	0.2	1.5	1.7	3.22	-2.29
May-24	-1.38	3.43	2.05	8.8	-0.26
Jun-24	-0.55	4.02	3.47	3.5	-0.44
Jul-24	1.03	2.74	3.77	-	-4.93
Aug-24	1.51	2.42	3.93	-	-5.51
Sep-24	1.01	3.07	4.08	2.08	-3.63
Oct-24	1.5	2.34	3.84	0.25	-5.41
Nov-24	1.39	0.78	2.16	1	-6.26
Dec-24	-0.68	1.47	0.79	9.36	-
Jan-25	-2.04	1.67	-0.37	19.91	-
Feb-25	-1.67	1.63	-0.04	20.9	-
Mar-25	-1.24	2.5	1.26	10.57	-
Apr-25	1.4	0.57	1.97	2.39	-
May-25	1.71	1.95	3.66	0.98	-

**Data estimated available on Weekly Basis*
Source: RBI, CEIC, UBI Research

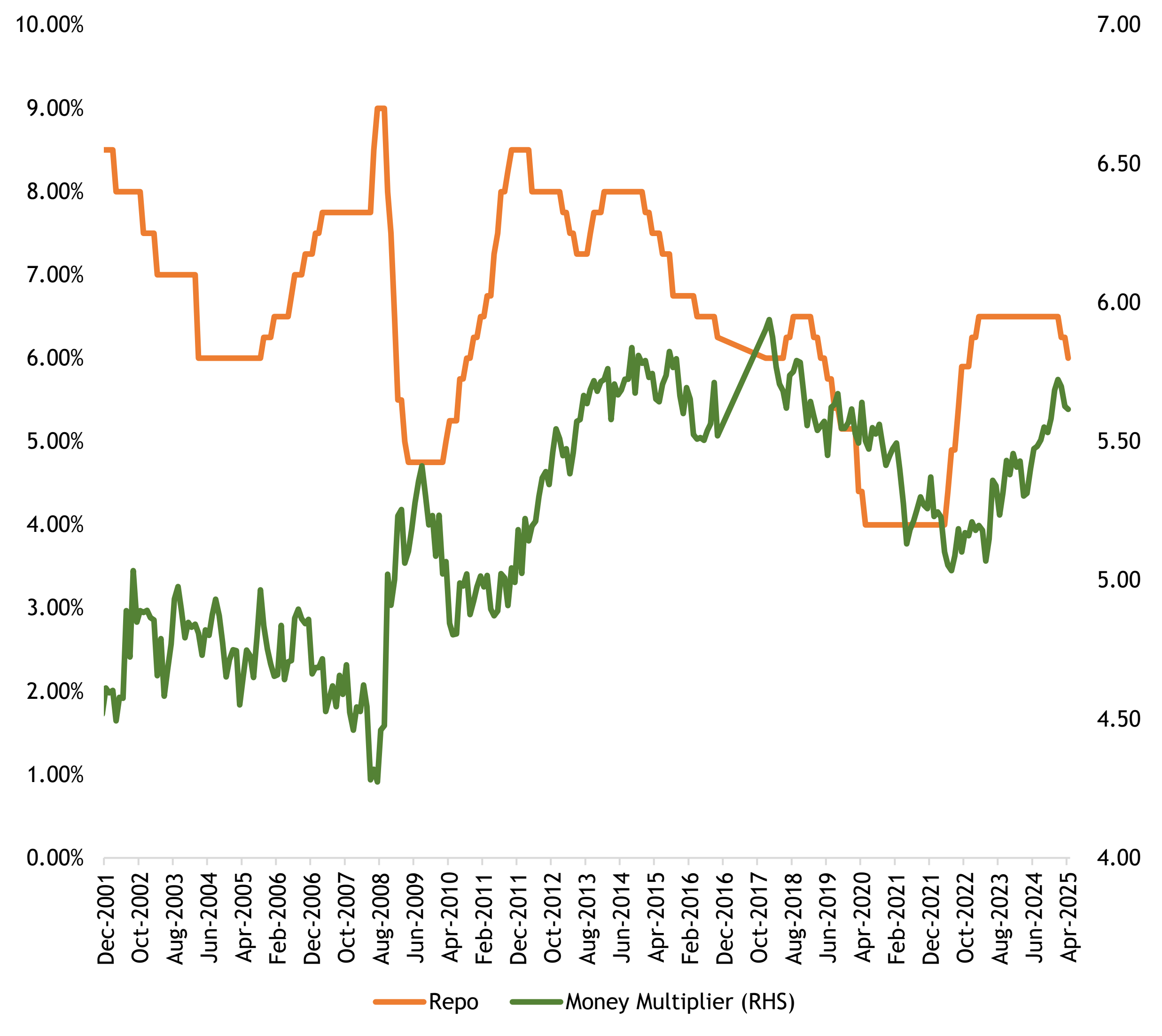
Despite liquidity steps, Reserve Money growth muted as banks parking surplus with RBI



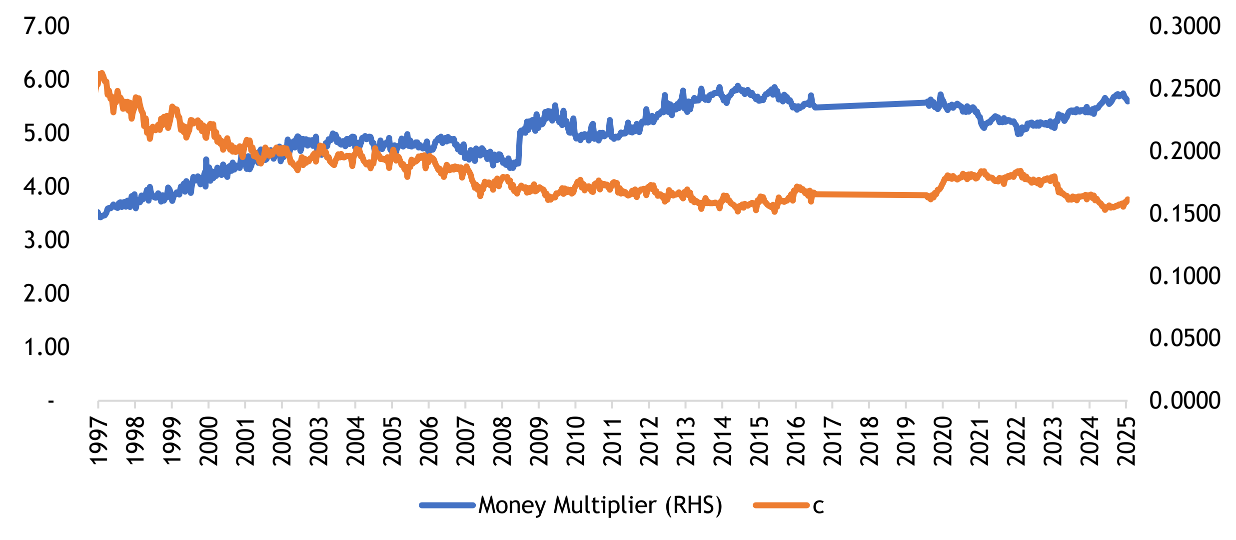
Source : RBI & UBI research

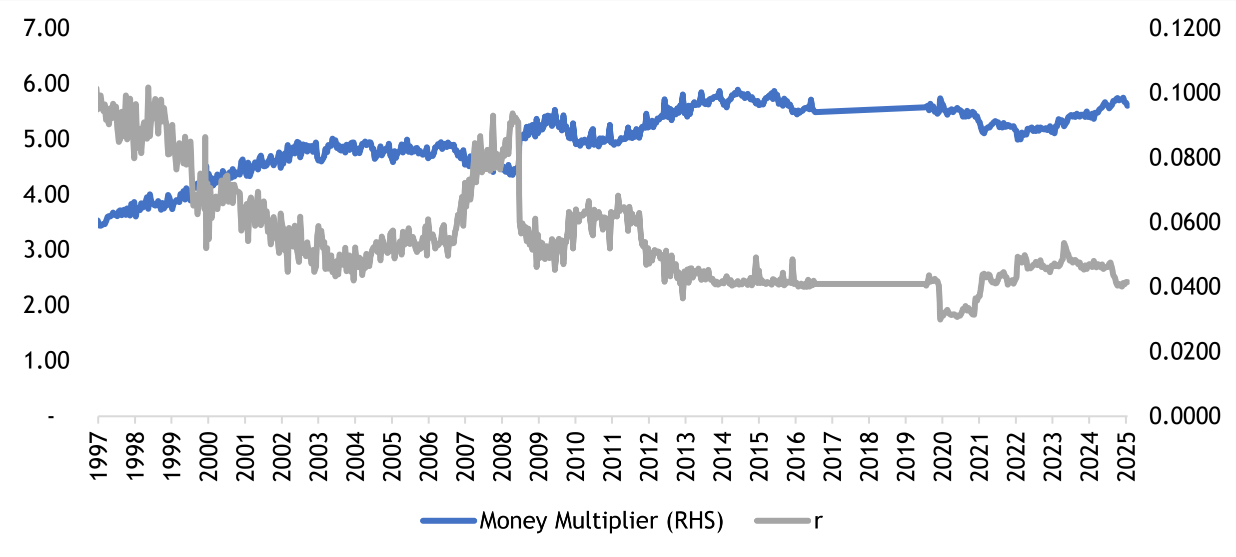
Money supply growth under pressure from muted reserve money growth despite uptick in money multiplier

Money multiplier (MM) usually slips in rate cutting cycle or low growth phase; deposit growth sensitivity to MM



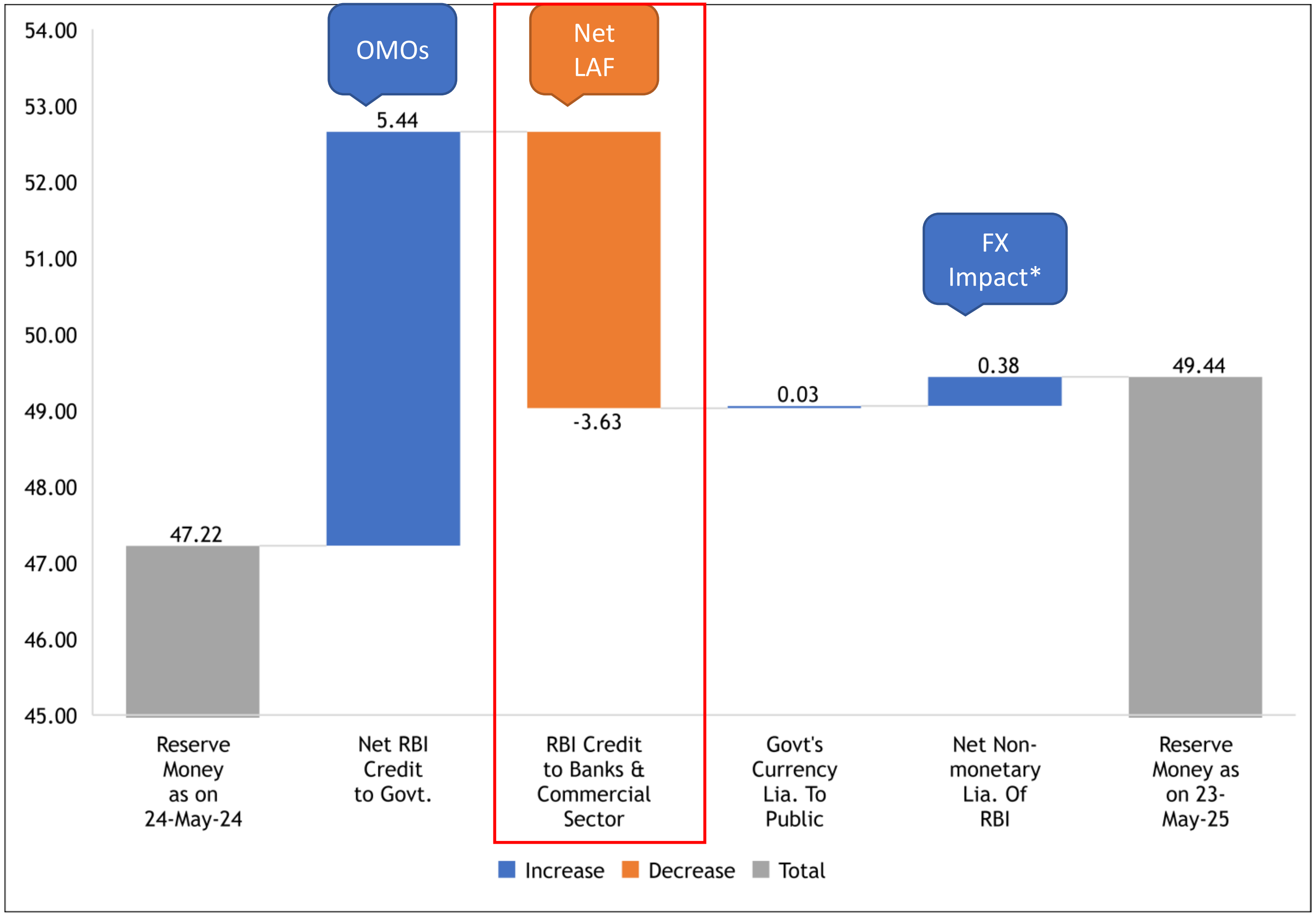
CRR (r) cut has helped drive an uptick in MM despite slight increase in currency demand (c)





Money multiplier = (1+c)/(c+r), where 'c' is the currency deposit ratio and 'r' is the reserves-deposit ratio.
Source : RBI & UBI research

Reserve money accretion being weighed down by rise in SDF, thereby limiting money supply growth



**Adjusted for Net Foreign Exchange Assets of RBI*
Source : RBI & UBI research

Transmission is usually lagged in deposit rates during rate cutting cycle

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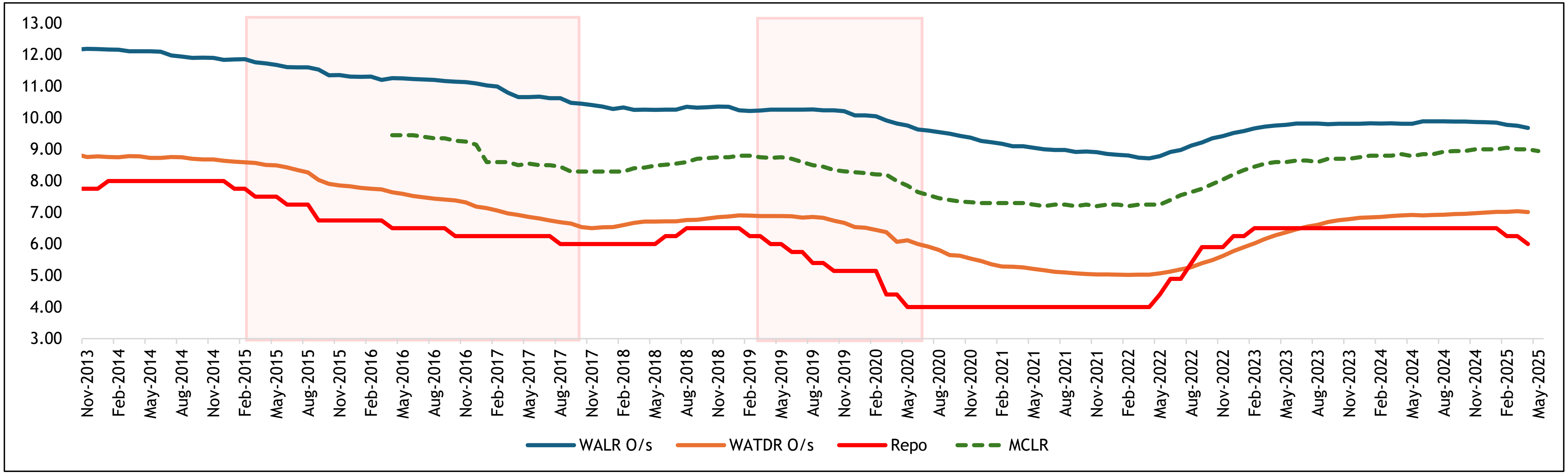

Transmission to Banks' Deposit & Lending Rates (Variation in bps)								
Period	Repo rate	Term Deposit Rates		Lending Rates				
		WADTDR-Fresh Deposits	WADTDR-Outstanding Deposits	EBLR	1-Yr MCLR	WALR - Fresh Loans	WALR - Outstanding Rupee Loans
Easing Phase *(Feb'25 to Apr'25)*	-50	-27	-1	-50	-5	-6	-17
Tightening Phase *(May'22 to Jan'25)*	+250	253	199	250	178	181	115

WALR: Weighted Average Lending Rate; WADTDR: Weighted Average Domestic Term Deposit Rate;
MCLR: Marginal Cost of Funds-based Lending Rate; EBLR: External Benchmark-based Lending Rate; Source: RBI, CEIC, UBI Research

Transmission likely to be led by bulk deposits/EBLR while lagged in retail deposits/MCLR

Transmission during historical rate cycles

(in bps)	Repo rate	10yr G sec yield	3M T-Bill	5yr AAA rated Corp bond	WADTDR o/s deposits	WALR fresh Rupee Loans	WALR o/s loans	1 yr median MCLR	1 yr CD rate
16th Apr’12 to 03rd May’13	-125	-71		-85			-44		-150
19th Sep’13 to 28th Jan’14	75	58		23	-6		-1		69
15th Jan’15 to 02nd Aug’17	-200	-135		-148	-199	-203	-136		-210
06th Jun’18 to 01st Aug ’18	50	-11	22	-7	6	27	7	8	19
07th Feb’19 to 22nd May’20	-250	-161	-338	-217	-91	-166	-61	-95	-388
04th May '22 to 6th Feb'25	250	-72	243	17	199	181	113	175	224
07th Feb'25 to 03rd Jun'25	-50	-40	-89	-65	-1*	-6*	-17*	-5	-109

^move during entire rate cycle; *Data for WADTDR of Apr-25 & MCLR is as of May-25;
Source: RBI, CEIC, UBI Research

~70% of incremental deposit garnered by SBI & top 3 PVBs

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Deposits For Top 8 Banks (5PSBs & 3PVBs)						
YoY Growth				Share in YoY Incremental		
	Mar-2023	Mar-2024	Mar-2025	Mar-2023	Mar-2024	Mar-2025
TOP 5 PUBLIC SECTOR BANKS	10.1	10.3	10.2	60.0	56.0	58.1
SBI	9.2	11.1	9.5	26.5	29.0	26.2
PSBs EX SBI	10.9	9.6	10.8	33.5	27.0	31.9
TOP 3 PRIVATE SECTOR BANKS	16.3	18.6	15.7	40.0	44.0	41.9
TOP 8 BANKS	11.9	12.8	11.9	100.0	100.0	100.0

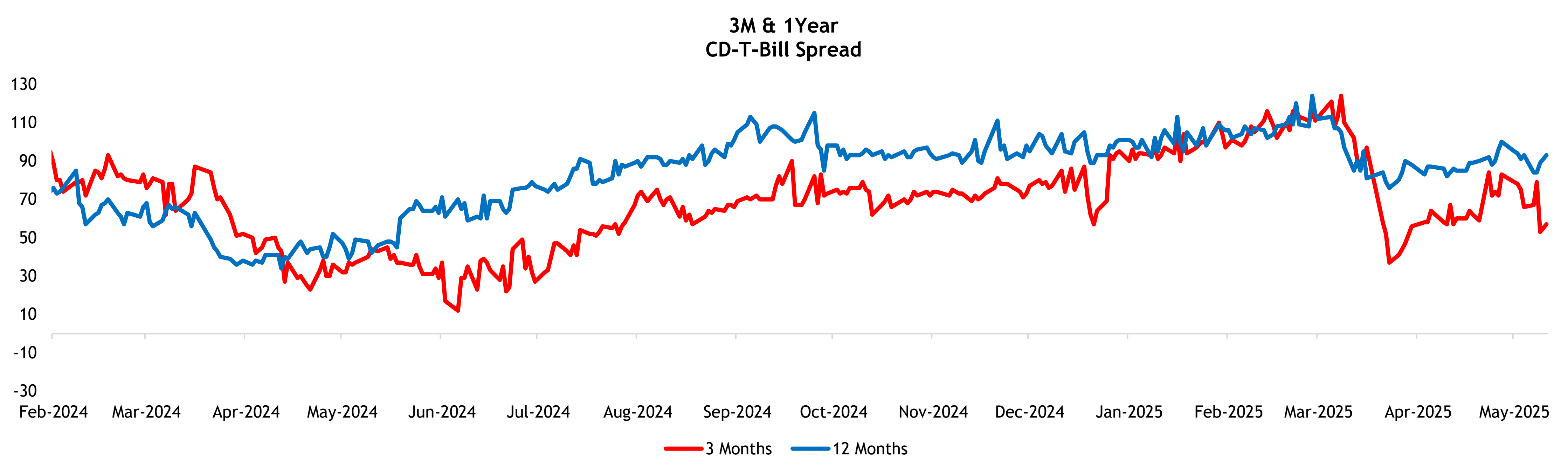
Credit For Top 8 Banks (5PSBs & 3PVBs)						
YoY Growth				Share in YoY Incremental		
	Mar-2023	Mar-2024	Mar-2025	Mar-2023	Mar-2024	Mar-2025
TOP 5 PUBLIC SECTOR BANKS	15.6	13.4	11.9	63.9	55.5	62.9
SBI	16.0	15.2	12.0	31.4	30.4	31.1
PSBs EX SBI	15.2	11.7	11.8	32.5	25.2	31.8
TOP 3 PRIVATE SECTOR BANKS	17.6	21.0	12.9	36.12	44.46	37.05
TOP 8 BANKS	16.3	16.0	12.2	100.0	100.0	100.0

Source : RBI & UBI research

Funding rates and spreads stay elevated as 'Have Nots' command pricing power

Bank segment wise Net issuances of Certificate of Deposits

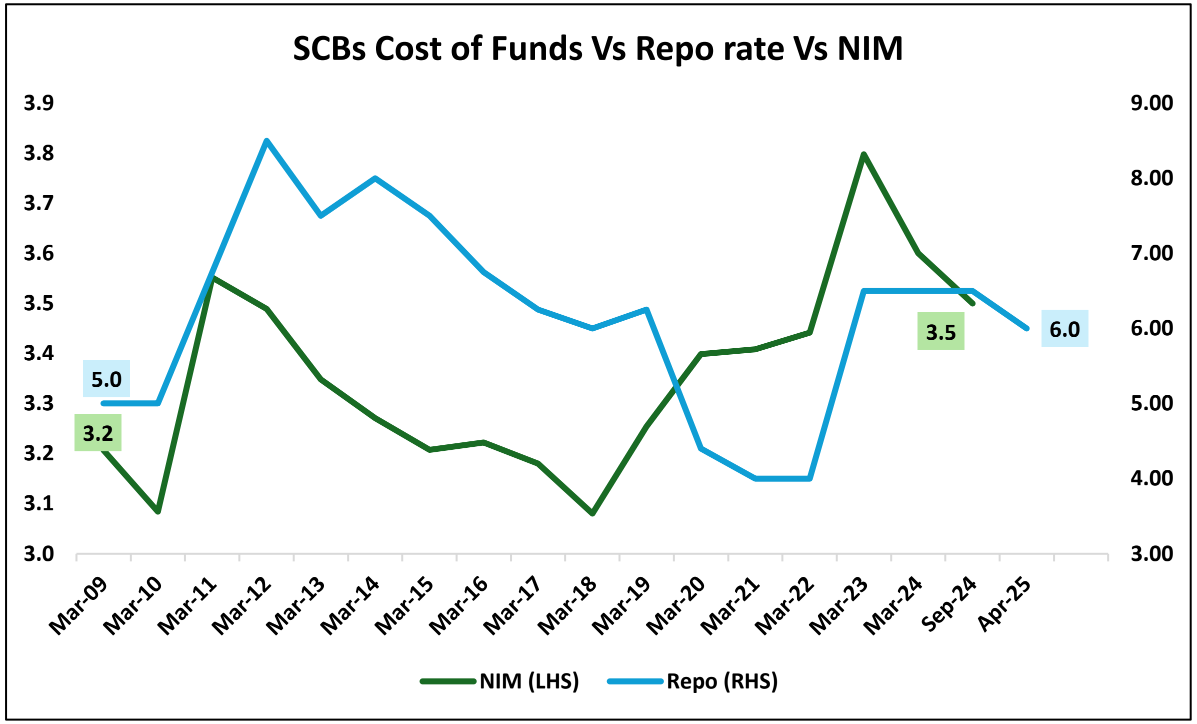
Rs.in Crore	FY23	FY24	FY25
PSBs	**104300**	**42429**	**88381**
Of which: PSB ex-SBI	*100750*	*47979*	*91381*
PVBs	**87333**	**28670**	**81748**
Total	**191633**	**71099**	**170129**



Source: RBI, CCIL, UBI Research

Banks trying best to save NIMs as downward pressure persists in rate cutting cycle

Best of Bank NIMs behind us on shift in deposit profile for banks



- 50 bps rate cut may see a fall of 5 to 10 bps in NIMs for banking system
- However, in current cycle, the behavioral shift in deposits & macro uncertainty makes NIM assessment complicated

Parameter	SCBs (Dec-24)
Credit (% share in assets)	**69.6**
o/w	
*EBLR+ TBLR**	*60.6*
MCLR	*35.9*
Others	*3.5*
Investment (% share in assets)	**25.2**
Deposits (% share in Liabilities)	**90.3**
o/w	
CA	*9.7*
SA	*31.3*
*RTD***	*33.2*
Bulk deposit	*25.8*
Borrowings (% share in liabilities)	**9.7**

For PVBs, even though the EBLR portfolio is ~85%, drop in NIM may be capped by a large fixed rate portfolio of ~30%

***For SCBs, Term Deposits with less than Rs 1 Cr is considered as Retail and for UBI, it is Less than Rs 3 Cr.*

Classification: Internal

Source: RBI, UBI Research

Thank You !

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