moneycontrol

Money market signals | Inter-bank call rate can align with repo rate by Oct-March, say experts

The weighted average call rate has risen from around 3.35 percent in February to 5.28 percent in August, even as the repo rate has risen only 140 basis points during the period

SIDDHI NAYAK

AUGUST 17, 2022 / 03:38 PM IST

The inter-bank call money rates are expected to move closer to the policy repo rate by the second half of this financial year as liquidity surplus dries up and inches closer to neutral levels, bankers and economists told *Moneycontrol* on August 17.
An inter-bank call money market is a short-term money market which allows large financial institutions to borrow and lend money at interbank rates.

The call money rate is the rate at which funds are borrowed and lent by banks overnight. It caters to the day-to-day cash needs of banks, especially to meet cash reserve ratio (CRR) and statutory liquidity ratio (SLR) requirements, and to fulfil sudden demands for funds.

The prevalent liquidity condition in the banking system and the monetary policy influence the call money rate.

Why are call money rates rising?
Rising demand for credit, coupled with dwindling liquidity surplus in the banking system, has increased the need for banks to borrow funds from the call money market to meet their reserve requirements, said bankers.

Call money rates have been inching up on this dwindling liquidity surplus. The weighted average call rate has risen from around 3.35 percent in February 2022 to 5.28 percent in August 2022, even as the repo rate has risen only 140 basis points in the same period.

One bps is one-hundredth of a percentage point. The repo rate currently stands at 5.40 percent.

As long as the weighted average call rate remains near the **Standing Deposit Facility** (SDF), the monetary policy will remain accommodative. Once it moves towards the repo rate, monetary policy will become neutral.
What is SDF?

SDF amount shows the idle funds that banks have. Since it is the floor rate, subscription at the SDF is the true indicator of surplus liquidity, as banks would have exhausted all other avenues to deploy liquidity and would have opted for SDF for the lowest possible return.

The **Reserve Bank of India** (RBI), through the monetary policy framework, aims to set the repo rate based on an assessment of the current and evolving macroeconomic situation, and modulation of liquidity conditions to align the operating target of the weighted average call money rate at or around the repo rate.
"We expect core liquidity surplus to get closer to neutral to marginally negative towards the end of the year, which will shift the weighted average call rates closer to the repo rate on a more sustainable basis," said Upasna Bhardwaj, chief economist at Kotak Mahindra Bank.

According to Jahnavi Prabhakar, an economist at Bank of Baroda, the neutral level of liquidity is around 1-1.5 percent of the net demand and time liabilities (NDTL). This is possible when growth in credit accelerates and this will happen in October-March, she said.

"Call money rate will always be close to repo as it is considered the ceiling. Only if the amount going to SDF is going down, it will lead to a temporary tightening," Prabhakar added.

Narrowing liquidity surplus
According to central bank data, net liquidity absorbed by the RBI, as on August 16, was at Rs 1.29 lakh crore, down from Rs 5.49 lakh crore on May 5 and Rs 7.36 lakh crore on February 27.

This indicates that surplus liquidity has fallen sharply in the past few months. This is largely due to the credit off-take in the economy and the fact that RBI is slowly withdrawing surplus

liquidity from the banking system through variable rate reverse repo (VRRR) operations and the SDF.

"Some banks misjudged the extent of tax outflows last month, and hence had to borrow heavily from the call money market," said a banker with a state-owned bank, requesting anonymity. "We expect banks to continue borrowing from the call money market, especially as credit demand accentuates during the festive season and pace of tax outflows increases."

During its monetary policy meetings, the RBI has indicated that it is not targeting a particular level of liquidity. Instead, it is looking to gradually move the weighted average call rate towards the repo rate.

"There are natural drains of liquidity, such as currency leakage, which tends to pick up in the second half of the financial year," said Gaura Sen Gupta, India economist at IDFC FIRST Bank.

"We expect the RBI to continue using VRRR to guide the weighted average call rate towards the repo rate in the remainder of FY23 and allow liquidity to gradually reduce. At the same time, we don't expect the RBI to conduct OMO (open market operations) purchases as government cash balances remain substantial."

Sen Gupta expects the overnight call money rate to align closer to the repo rate by the December or February policy, as the real repo rate will be "mildly positive" by then and the monetary policy stance will become neutral.

Liquidity absorption to be gradual

The pace of liquidity absorption is, however, likely to be gradual and not hurried, said money-market experts. Apart from that, the RBI has also ensured that it will conduct two-way liquidity fine-tuning operations to ensure liquidity management.

RBI Governor **Shaktikanta Das**, in a post-policy press conference on August 5, **said** the multi-year process to normalise banking system liquidity will spill over into the next financial year.
Das said one important factor to consider is that some of the targeted long-term repo operations that were announced in the first year of the pandemic will mature in 2023. Hence, the process will spill over into the next year as well.

Moreover, the RBI's intervention in the forex and bond markets, along with the pace of foreign inflows, will determine the extent of liquidity surplus, going forward, said economists. That will, in turn, determine when the call rate will align with the repo rate.

"RBI intervention in the forex market will keep liquidity in the system contained," said Rajani Sinha, chief economist at CareEdge. "We need to take into account that, in the last few weeks, there has been an improvement in FII inflows and that will be supportive of liquidity."

Sinha added that with the RBI focused on the withdrawal of accommodation, eventually the call rate should move towards the repo rate.

SIDDHI NAYAK *is correspondent at Moneycontrol.com*

TAGS: #call rate #liquidity #repo rate #Reserve Bank of India #SDF #Shaktikanta Das

FIRST PUBLISHED: AUG 17, 2022 03:38 PM