Data Focus

Issue of certificate of deposits plunges on poor credit demand, excess liquidity

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Market for CDs has been dormant due to lack of funding requirement

The total outstanding certificate of deposits (CDs) issued by scheduled commercial banks (SCBs) have plunged to one-fourth in the last two years as the conundrum of weak credit demand and excess liquidity removed the need for banks to raise funds through this short-term money market instrument.

According to the latest Reserve Bank of India (RBI) data, the combined outstanding CDs of SCBs at the end of July 2021 stood at ₹64,304 crore, falling from ₹80,622 crore as of end March 2021. For a perspective, CDs outstanding as of March 2020 stood at ₹1,72,996 crore and as high as ₹2,72,260 crore at the end of March 2019.

"The market for CDs has been dormant because of the lack of requirement for funding. Typically, CD issuances go up when there is a boom in credit demand and bank deposits are not growing at the same rate," said Madan Sabnavis, Chief Economist at CARE Ratings.

"Even though the CD rates have come down if you compare it with the rates of regular deposits such as CASA, demand deposits, the weighted average cost of deposits for banks have been very low so going for CDs doesn't make any sense when there is no demand for credit," he added.

Short-term instrument

Much similar to the fixed deposits in features, CDs are fixed-income financial instruments governed under the RBI and issued in a dematerialised form. CDs are issued by SCBs and All-India Financial Institutions for a minimum deposit size of ₹1 lakh for a term period anywhere between 3 months and one year. Banks typically use CDs to bridge the funding mismatch between credit and deposits.

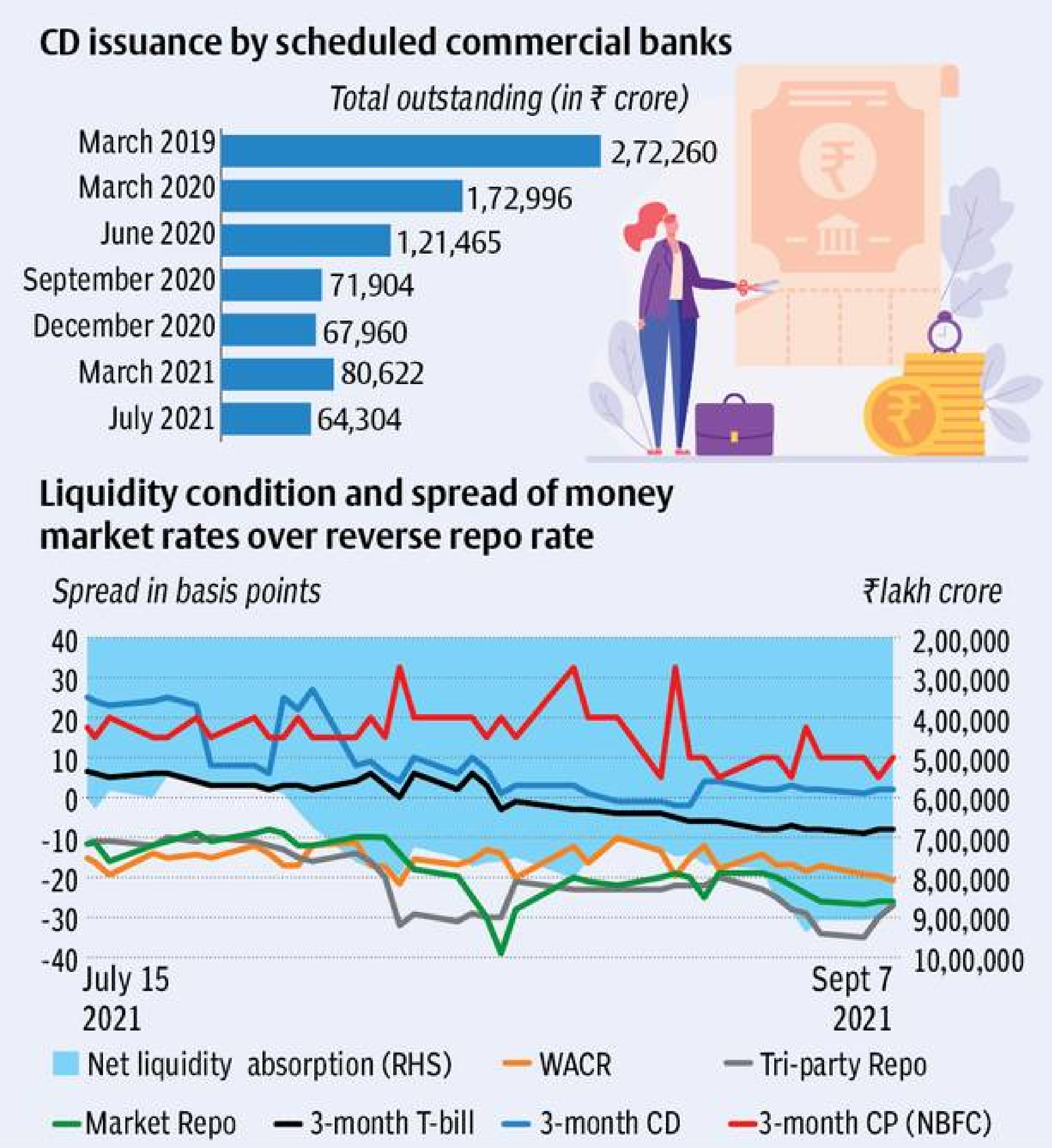
Declining trend

CD outstanding has been on a declining trend since the onset of the Covid-19 pandemic. From ₹1,80,891 crore as of April 2020, CDs outstanding constantly declined to ₹1,21,465 crore as of June 2020, to ₹71,904 crore in September 2020 and to ₹67,960 crore as of December 2020.

"The period till March 2019 was within the ambit of normal economic and banking activity. The following couple of quarters was when the Indian economy witnessed a technical recession due to the lockdown to curb infections. The banking sector witnessed a surge in liquidity from large deposit accretions as people had little avenues to spend the money during the lockdown. On the other hand, businesses did not need significant funds from the banking sector as demand was weak," Indranil Pan, Chief Economist at YES Bank, said.

"Just to give a sense of the liquidity build up within the banking system, the total deposit accretion starting from April 2020 to the end of August 2021 is at ₹19,49,500 crore while the off take of bank credit was only ₹5,26,600 crore. Armed with this huge liquidity from the deposit side, banks found it a good opportunity to reduce other sources of funding – such as the CD route," he added.

According to the RBI's latest bulletin, year-on-year credit growth of SCBs fell from over 13 per cent during April 2019 to 6.7 per cent as of August 2021 while aggregate deposits SCBs — the largest constituent of money supply — witnessed a y-o-y growth of 9.5 percent against 10.8 per cent a year ago.



Sources: RBI, Bloomberg

Published on September 23, 2021