

Surplus Liquidity from FCNR(B) Inflows to Cut Bank Funding Costs by 50 Bps

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Indian banks are poised for a significant reduction in funding costs, potentially up to 50 basis points, driven by a robust surge in liquidity from Foreign Currency Non-Resident (Bank) (FCNR(B)) flows, which will also lessen their reliance on expensive certificates of deposit.



Illustration: Uttam Ghosh

Key Points

Indian banks expect their cost of funds to decrease by up to 50 basis points due to a significant influx of Foreign Currency Non-Resident (Bank) (FCNR(B)) deposits.

The surplus liquidity is projected to reduce banks' dependence on higher-cost certificates of deposit (CDs), with CD issuances sharply declining in August.

CD rates have fallen significantly since the RBI announced the FCNR(B) swap facility on June 8, with the three-month rate dropping 130 bps by September 3.

This liquidity surge is expected to support credit expansion, particularly for short-term lending, and improve banks' liquidity coverage ratio (LCR) by up to 1 percentage point.

Jefferies estimates that FCNR(B) deposits could generate an additional annual profit pool of approximately Rs 100 billion-Rs 110 billion for banks.

The cost of funds for banks is expected to reduce by 50 basis points (bps) owing to surplus liquidity on account of robust Foreign Currency Non-Resident (Bank), or FCNR (B), flows, lowering their dependence on higher-cost certificates of deposit (CDs), according to senior banking officials.

The surplus is expected to support credit expansion, particularly short-term lending, while enabling refinancing agencies to prepay costlier loans. Banks' liquidity coverage ratio (LCR) may improve by up to 1 percentage point, they added.

Impact on Certificate of Deposit Market

The impact is visible in the CD market, with issuances falling sharply in August as banks face less pressure to raise short-term funds.

According to Prime Database, banks in August raised Rs Rs 68,130 crore through CDs, making it the lowest since April, when issuances stood at Rs Rs 45,700 crore.

In comparison, they rang up Rs Rs 1.11 trillion in May, Rs Rs 1.80 trillion in June, and Rs Rs 95,945 crore in July.

HDFC Bank, Small Industries Development Bank of India, Bank of Baroda, Canara Bank and Central Bank of India were the top five issuers in August. Together they raised Rs Rs 46,770 crore, or 68.7 per cent of the total, the data showed.

CD rates have also declined sharply since the Reserve Bank of India (RBI) announced the FCNR (B) swap facility on June 8.

The three-month CD rate fell 130 basis points to 5.86 per cent on September 3 from 7.16 per cent on June 8.

The six-month rate declined 99 bps to 6.46 per cent from 7.45 per cent, while the nine-month rate fell 53 bps to 6.94 per cent from 7.47 per cent.

The one-year CD rate declined 50 bps to 7.02 per cent from 7.52 per cent. The one-month rate fell 74 bps to 5.52 per cent from 6.26 per cent.

Future Outlook and Profitability

Jefferies said in a report the three-month CD rate had fallen 90 bps in August alone, while the six-month rate declined 50 bps during the month.

Its data showed the three-month CD rate at 5.9 per cent on September 3, compared with 6.8 per cent on August 4.

CD issuances are expected to fall further as surplus liquidity in the banking system is likely to rise.

Market participants expect it to touch around Rs Rs 13.7 trillion as the impact of the FCNR (B) inflows works through the banking system.

"Most banks, particularly towards the quarter-end, depend on CDs to improve their credit growth or achieve their targets.

"CD rates had gone up to around 7.5 per cent earlier, but have now come below 7 per cent because they are flush with liquidity and do not need to raise CDs," said a senior banking official.

"There will be some rate reduction, and banks can deploy these funds at lower rates.

"The cost of funds may come down by a maximum of around 50 basis points, although the impact will not be significant because this is for a shorter period," the banker said.

Jefferies has estimates that FCNR (B) deposits could create for banks an additional annual profit pool of Rs Rs 100 billion-Rs 110 billion, equivalent to around 2 per cent of their profit before tax.

It expects banks to normalise margins over two to four quarters by reducing their dependence on high-cost wholesale deposits, lowering the share of government securities held towards the LCR and reducing low-margin overseas trade financing.

Credit Expansion and Refinancing Opportunities

The surplus could also support credit expansion, particularly shorter-tenure lending.

"There will be multiplier effects due to surplus liquidity. Public-sector enterprises, which generally take short-term loans of 30, 60 or 90 days at lower rates, will also benefit.

"They will be able to get funds at a lower price and may prepay older loans that are at higher rates.

"This will reduce their burden and help them save on interest costs," said a senior official at a state-owned bank.

Banks could either deploy the funds in fresh loans, use them to refinance older high-cost borrowings, or park them with the Reserve Bank of India under the Standing Deposit Facility.

Among large lenders, Kotak Mahindra Bank had an LCR of around 144 per cent at the end of the June quarter, followed by State Bank of India at about 125 per cent, ICICI Bank at around 122 per cent, Axis Bank at about 119 per cent, Bank of Baroda at around 116 per cent, and HDFC Bank at around 115 per cent.

Banks mobilised \$127.23 billion through FCNR (B) deposits by August 31, while overseas foreign currency borrowing contributed \$5.26 billion and external commercial borrowing \$3.89 billion, taking the total to \$136.38 billion.

Jefferies said the scale of the inflows was significant, with the \$136 billion equivalent to around 5 per cent of bank deposits and 6 per cent of bank credit.

This compares with 3.2 per cent of deposits and 4.1 per cent of credit under the 2013 FCNR (B) scheme.

The RBI allowed banks to mobilise fresh FCNR (B) deposits, including renewals, with maturities of three to five years under the special swap facility until August 31.

The facility provided banks rupee liquidity against eligible foreign currency deposits, giving them a sizeable funding cushion even after the mobilisation window closed.