

System liquidity surges to four-year high of Rs 7.7 lakh crore

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Inflows to help banks replace costly deposits, CDs; funding costs set to ease



Banking System Liquidity Hits 4-Year High of ₹7.7 Lakh Crore as FCNR(B) Inflows Surge

[Banking](#) system liquidity surged to a four-year high of Rs 7.7 lakh crore on Tuesday, driven largely by foreign currency inflows through FCNR(B) deposits, prompting the [Reserve Bank of India](#) (RBI) to step up liquidity absorption operations.

System liquidity averaged Rs 3.67 lakh crore in August, more than three times the Rs 1.07 lakh crore recorded in July, according to RBI data. The sharp rise in surplus liquidity is expected to help banks replace high-cost deposits and certificates of deposit (CDs), lowering their cost of funds and potentially supporting net interest margins.

The RBI has already intensified liquidity absorption. Over the past two days, the central bank conducted variable rate reverse repo (VRRR) auctions aggregating Rs 15 lakh crore and received bids worth Rs 8.34 lakh crore.

On Wednesday, the [RBI](#) conducted an overnight VRRR auction and received bids worth Rs 4.6 lakh crore against the notified amount of Rs 5 lakh crore.

“After accounting for tax-related outflows, system liquidity could reach around Rs 5 lakh crore by September. However, liquidity is likely to remain abundant over the next three-four months,” said Alok Singh, head of treasury at CSB Bank.

Singh said a large part of the surplus could remain parked with the RBI, which may continue to manage it through instruments such as VRRR auctions. The central bank could also unwind some of the forward positions it had built earlier to support liquidity.

The abundance of funds has already pulled down overnight rates. The weighted average call rate (WACR) eased to 5.02% on Wednesday from 5.16% on Tuesday, significantly below the repo rate of 5.25%. The RBI seeks to keep the WACR closely aligned with the policy repo rate.

“System liquidity is above Rs 7 lakh crore, pushing core liquidity close to Rs 9 lakh crore. Core liquidity will exceed Rs 10 lakh crore in September, primarily due to FCNR(B) inflows,” said Gaura Sengupta, chief economist at [IDFC First Bank](#).

Market participants expect the RBI to deploy additional instruments to absorb the excess liquidity and keep overnight rates anchored around the policy rate.

According to Sengupta, the RBI is unlikely to impose an incremental cash reserve ratio (CRR), as such a move could hurt market sentiment. Instead, it could issue short-term Treasury bills under the Market Stabilisation Scheme (MSS) or conduct sell-buy swaps to drain liquidity.

“That said, core liquidity could stay above 2% of NDTL till March. This could influence whether RBI decides to use temporary or durable tools to withdraw liquidity,” Sengupta said.

For banks, the liquidity is also likely to intensify competition on lending rates. “I do expect banks to start lending a little bit more aggressively. Credit offtake has been reasonably strong as of now. But will excess liquidity have an overhang on interest rates? The answer is yes,” a senior official at a private sector bank said. “There will definitely be a little bit of a price war. I do see that happening.”

Banks are already using the liquidity generated by FCNR(B) inflows to reduce their reliance on expensive sources of funding, particularly bulk deposits and CDs. This is expected to lower overall funding costs, ease pressure on margins and potentially support an improvement in net interest margins. Banks may also temporarily deploy some of the surplus in government securities.

“The liquidity currently parked with the RBI will gradually flow into credit. Banks will also replace high-cost deposits and certificates of deposit. As a result, Rs 2-3 lakh crore of liquidity could be absorbed within the next one to two months,” Singh said.

Signs of reduced dependence on short-term wholesale funding are already visible. Banks raised Rs 68,130 crore through CDs in August, the lowest in four months, according to Prime Database. Short-term funding costs have also fallen sharply, with three-month CD rates declining 127 basis

points over the past three months to 6.05%.

“We primarily used the FCNR(B) deposits to reduce our reliance on certificates of deposit and bulk deposits. Earlier, one-year CD rates exceeded 7%, while bulk deposit rates ranged from 7.25% to 7.50%. Given the amount raised, we expect savings of 20-25 basis points,” said a banker at a large state-owned bank.

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