

# Deposit Rate Rise Leads to Spread Compression, Fresh Rates Volatile

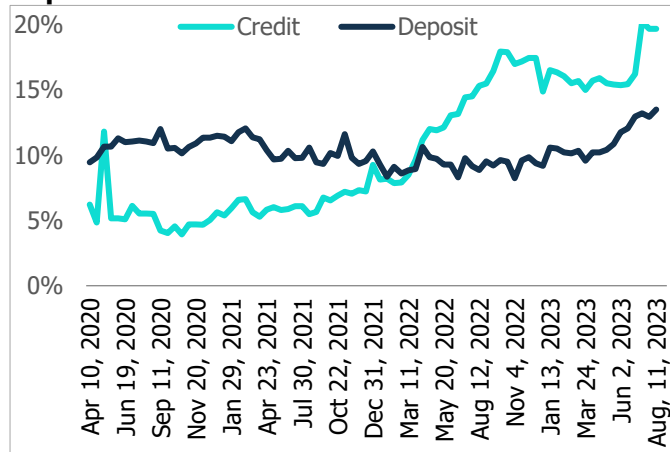
September 07, 2023 | BFSI Research

## Overview

- In July 2023, outstanding deposit rates increased while outstanding lending rates remained flat. Meanwhile, rates on fresh business climbed.
  - The weighted average lending rate (WALR) on fresh rupee loans of scheduled commercial banks (SCBs) increased sequentially by 24 basis points (bps) to 9.44% in July 2023 from 9.19% in June 2023, while the WALR on outstanding rupee loans remained flat sequentially.
  - The weighted average domestic term deposit rate (WADTDR) on fresh rupee term deposits of SCBs increased marginally by 1 bps from 6.34% in June 2023 to 6.35% in July 2023. Meanwhile, WADTDR on outstanding rupee term deposits increased by 8 bps from 6.47% in June 2023 to 6.55% in July 2023.
  - One-year median Marginal Cost of Fund-based Lending Rate (MCLR) of SCBs decreased from 8.63% in July 2023 to 8.60% in August 2023.
  - The spread of SCBs between WALR and WADTDR (the net interest rate spread) stood at 3.09% and 3.27% for Fresh and Outstanding rates, respectively, in July 2023.

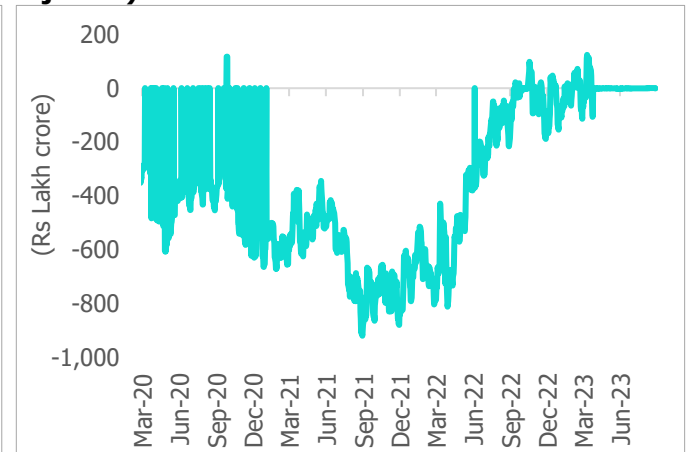
## Continued Large Credit and Deposit Growth Gap Coupled with Lower Liquidity Levels

**Figure 1: Growth in Credit Continues to Outpace Deposit**



Source: CMIE, RBI; Note: Data post HDFC Merger

**Figure 2: Bank System Liquidity (Net Liquidity Injected)**



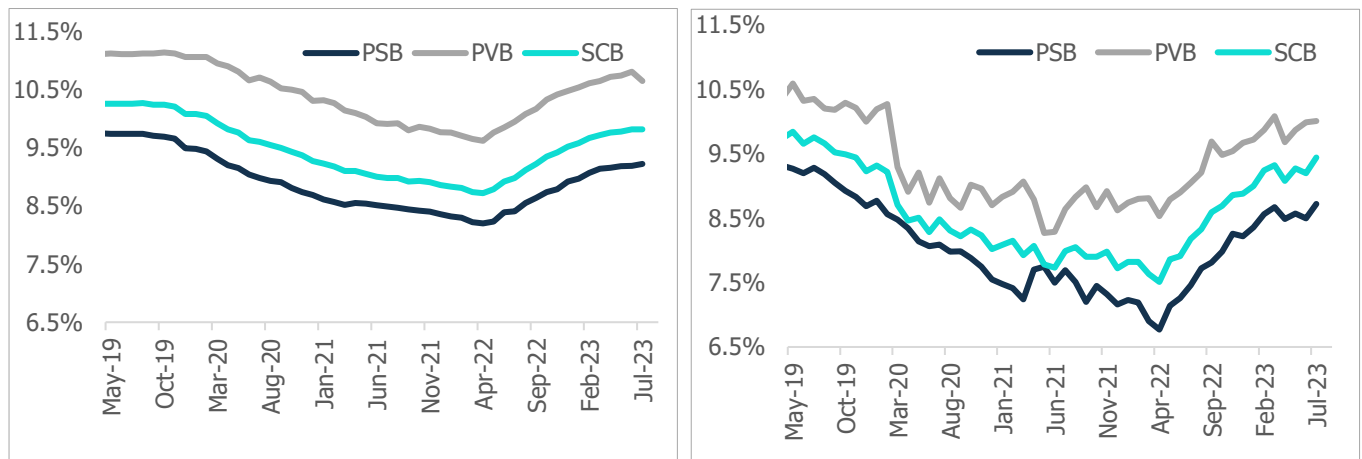
Source: RBI, CEIC

- Credit off-take continued to exhibit robust growth, showing a sequential increase of 19.7% year on year (y-o-y) over two consecutive fortnights, culminating in a total of Rs. 148.8 lakh crore for the fortnight ending August 11, 2023. This notable surge remains primarily attributable to the merger of HDFC with HDFC Bank, alongside the steady expansion of personal loans and NBFCs. However, when excluding the merger impact, credit growth registered a comparatively lower rate of 14.8% y-o-y compared to the previous year.

- In parallel, deposits also demonstrated healthy growth, recording a 13.5% y-o-y increase for the same fortnight, incorporating the effects of the merger. It's worth noting that deposit growth has not kept pace with credit growth, as a substantial portion of HDFC's liabilities comprised borrowings rather than deposits. Despite this distinction, deposit growth reached a six-year high in the current fortnight.
- Notably, the RBI has introduced a temporary provision for incremental cash reserve ratio (I-CRR) for SCBs in the ongoing fortnight to mitigate the accumulation of excess liquidity within the financial system. Under the I-CRR framework, SCBs are required to park additional cash reserves with the RBI, equivalent to 10% of the increase in their net demand and time liabilities (NDTL) during the period from May 19, 2023, to July 28, 2023. This measure has effectively absorbed surplus liquidity from the system. The RBI has scheduled a review of this new provision on September 8, 2023.

**Lending Rates: Fresh Rates Rise, whereas O/s Rates Remain Flat –**

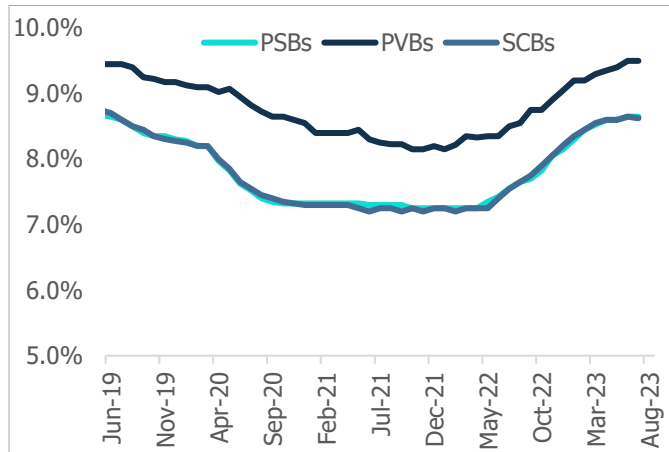
**Figure 3: Evolution of WALR O/s (Lending) Loans    Figure 4: Evolution of WALR Fresh Loans**



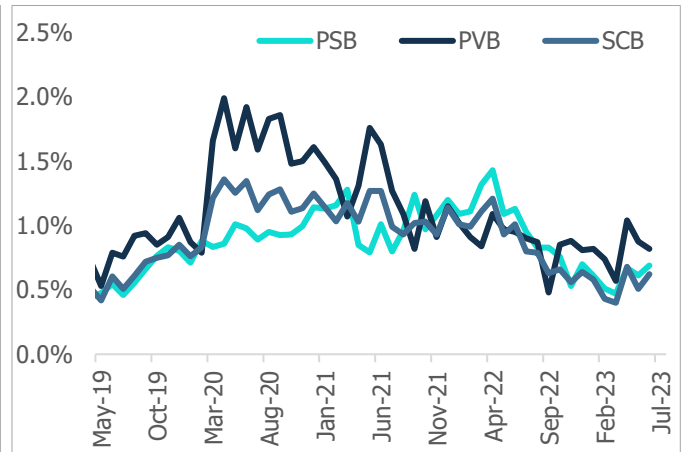
Source: RBI

- WALR on outstanding loans saw a mixed trend across segments and remained flat on m-o-m at 9.82%, PSBs increased by 3 bps, whereas PVBs & FBs fell 16 bps and 5 bps respectively.
- Although Fresh Rates stand above pre-pandemic times, o/s rates have been moving below pre-pandemic times for last few months.
- WALR on fresh loans on m-o-m basis saw an aggregate increase by 24 bps for SCBs; PVBs and FBs increased 22 bps and 36 bps respectively However PSBs saw a marginal rise of 2 bps.
- In contrast to PSBs, PVBs exhibit a notably higher proportion of External Benchmark Lending Rate (EBLR), with EBLR shares as of March 2023 standing at 73.1% for PVBs and 36.2% for PSBs. As a result, the transmission of lending rates is significantly swifter in PVBs compared to PSBs. Following May 2022, the WALR for PVBs experienced a substantial increase of 277 basis points, while PSBs saw a comparatively lower growth of 158 basis points.

**Figure 5: Movement in 1-Year MCLR (Median)**



**Figure 6: WALR o/s vs WALR Fresh**



Source: RBI

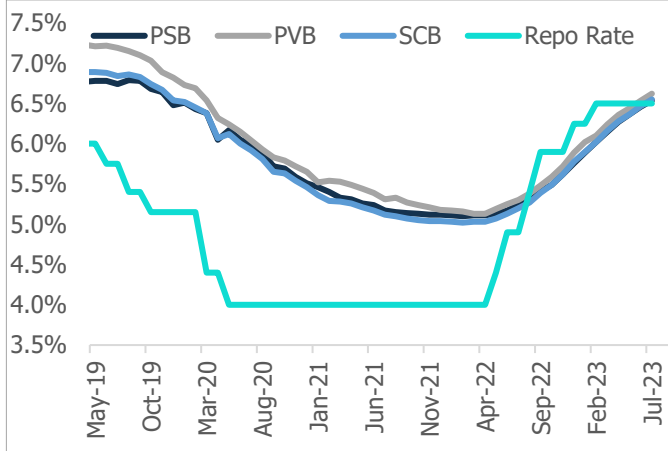
- On a m-o-m basis, 1-Year median MCLR of SCBs declined by 2.5 bps to 8.60% in August 2023 as the majority of the PSBs and PVBs held steady, while the FBs reported mixed numbers causing a marginal fall in SCBs median. Despite a pause by the MPC, banks have continued to raise rates on their outstanding portfolio.
- Meanwhile when we compare pre-pandemic levels, MCLR median for SCBs is above 60 bps, whereas o/s WALR is just above 10 bps. This is mainly driven in recent months whereas MCLR median rates has been increasing whereas o/s WALR has been volatile.

**Figure 7: MCLR Rates (in %)**

Banks	08/22	09/22	10/22	11/22	12/22	01/23	02/23	03/23	04/23	05/23	06/23	07/23	08/23	YoY
<b>Public Sector Banks</b>														
BoB	7.70	7.80	7.95	8.05	8.30	8.50	8.55	8.55	8.60	8.60	8.65	8.65	8.65	0.95
BoI	7.60	7.70	7.80	7.95	8.15	8.30	8.40	8.50	8.60	8.60	8.65	8.65	8.70	1.10
BoM	7.60	7.60	7.80	7.90	7.90	8.20	8.40	8.40	8.50	8.50	8.50	8.50	8.60	1.00
Canara	7.65	7.75	7.90	8.10	8.15	8.35	8.50	8.60	8.65	8.65	8.65	8.65	8.70	1.05
CBI	7.50	7.55	7.60	7.65	7.90	8.15	8.15	8.45	8.45	8.45	8.60	8.60	8.60	1.10
Indian	7.65	7.75	7.85	8.10	8.20	8.30	8.45	8.55	8.60	8.60	8.65	8.65	8.65	1.00
IOB	7.65	7.75	7.90	8.05	8.25	8.30	8.45	8.60	8.60	8.65	8.65	8.65	8.70	1.05
PSB	7.65	7.70	7.80	8.00	8.15	8.30	8.50	8.60	8.65	8.65	8.65	8.70	8.90	1.25
PNB	7.65	7.70	7.75	8.05	8.10	8.30	8.40	8.50	8.50	8.50	8.60	8.60	8.60	0.95
SBI	7.70	7.70	7.95	8.05	8.30	8.40	8.50	8.50	8.50	8.50	8.50	8.55	8.55	0.85
UCO	7.65	7.65	7.70	7.95	8.10	8.25	8.35	8.50	8.60	8.60	8.65	8.65	8.65	1.00
UBI	7.70	7.75	7.90	8.20	8.25	8.40	8.65	8.65	8.65	8.65	8.65	8.65	8.65	0.95
<b>Private Sector Banks</b>														
HDFC	8.10	8.20	8.20	8.55	8.60	8.85	8.90	8.95	8.95	9.05	9.05	9.05	9.10	1.00
ICICI	7.90	8.00	8.10	8.30	8.40	8.65	8.65	8.75	8.75	8.75	8.85	8.85	8.90	1.00
Axis	8.05	8.10	8.35	8.45	8.75	8.80	8.90	8.95	8.95	9.10	9.10	9.10	9.15	1.10
Indusind	9.30	9.40	9.55	9.80	9.95	9.95	10.05	10.15	10.20	10.20	10.20	10.25	10.25	0.95
Kotak	8.10	8.20	8.45	8.55	8.65	8.95	9.00	9.05	9.10	9.20	9.20	9.25	9.3	1.20
Yes.	9.05	9.20	9.60	9.70	9.75	9.85	9.90	0.10	10.15	0.00	10.05	10.15	10.15	1.10

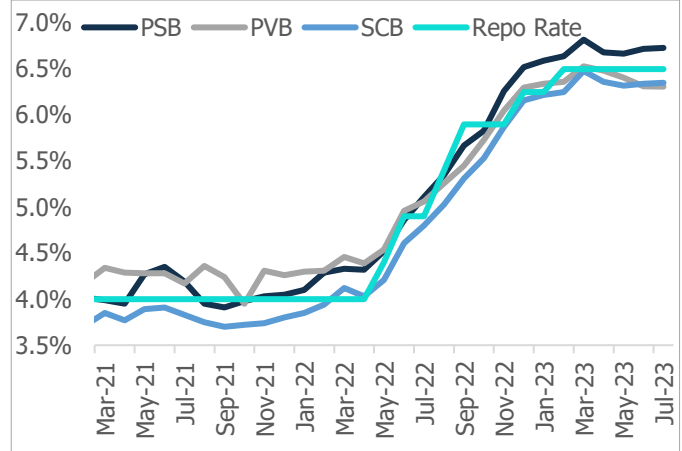
**Deposit Rates: Rates Continue Upward March**

**Figure 8: Evolution of WADTDR O/s Deposits**



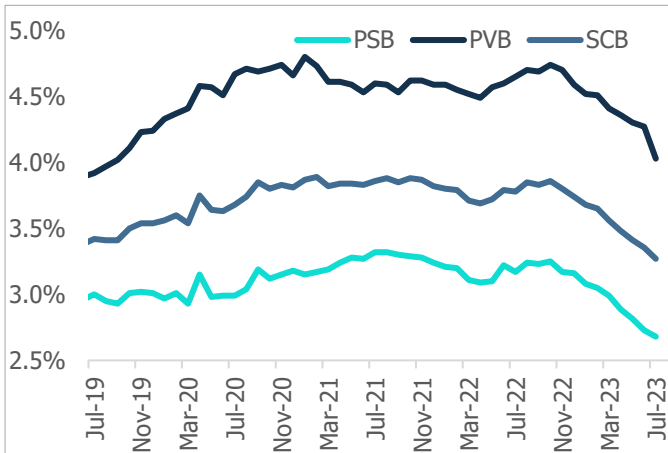
Source: RBI

**Figure 9: Evolution of WADTDR Fresh Deposits**



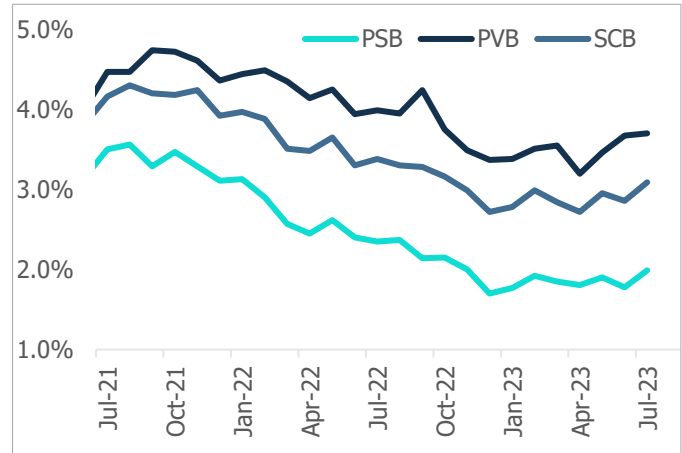
Outstanding deposit rates for SCBs and PSBs saw an uptick m-o-m by 8 bps each, and PVBs increased by 9 bps, o/s WADTDR continue to remain above their pre-pandemic levels (as of March 2020). On the other hand, fresh deposit rates for PSBs and SCBs saw a marginal uptick m-o-m by 1 bps, in July 2023, while PVBs saw remained flat.

**Figure 10: Evolution of Spreads (O/s)**



Source: RBI

**Figure 11: Evolution of Spreads (Fresh)**



- The spread of SCBs between WALR and WADTDR (the net interest rate spread) stood at 3.09% and 3.27% for Fresh and Outstanding rates respectively, in July 2023.
- The spread broadly narrowed in July 2023 compared to June 2022 by 51 bps as fresh lending rates dropped along with fresh deposit rates which declined 29 bps, while sequentially o/s deposit rates rose faster than o/s lending rates. Since June 2023, the spreads of both PSBs and PVBs have fallen below the pre-pandemic levels.
- The spread between Fresh WALR and WADTDR continues to be lower than the spread between Outstanding WALR and WADTDR. PVBs continue to maintain a higher spread given that they charge more as compared to PSBs.

## **Conclusion**

In July 2023, there was an uptick in fresh lending activity, coinciding with a decrease in fresh deposit rates. Conversely, interest rates pertaining to outstanding business loans continued their upward trajectory. It's noteworthy that spreads between the Outstanding Weighted Average Lending Rate and Weighted Average Domestic Term Deposit Rate have dipped below pre-pandemic levels since June 2023. Moreover, the spread between Fresh WALR and WADTDR remains narrower compared to the spread between Outstanding WALR and WADTDR. Banks' profit margins reached their peak in the fiscal year 2023. However, it is anticipated that Net Interest Margins will contract during the current fiscal year, primarily due to the escalation in deposit rates. Despite the Monetary Policy Committee hitting pause, banks have continued to raise interest rates on their existing loan portfolios. A reduced level of systemic liquidity is expected to exert upward pressure on money market rates, contributing to the containment of inflationary pressures. Nonetheless, it is important to note that despite the additional cash reserve requirement imposed under I-CRR, systemic liquidity is projected to remain in a surplus state.

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