

Flush with deposits, banks lend to RBI under reverse repo, invest in G-Secs

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As core lending biz remains sluggish, lenders make use of excess funds to boost income

Date	Fixed Reverse Repo	Variable Rate Reverse Repo
Nov 3	4,530	18,941
Nov 4	3,564	21,570
Nov 8	4,067	10,610
Nov 12	28,057	
Nov 13	57,620	
Nov 14	36,411	
Reverse Repo shifts to variable window		
Nov 22	7,213	93,274
Nov 23	8,486	114,376
Nov 24	8,696	153,396



BL Research Bureau:

The Centre's demonetisation move has left banks flush with deposits. With credit offtake remaining sluggish, where are banks deploying this sudden bounty?

According to data put out by the RBI, banks have been lending excess funds to the RBI through the reverse repo option. Also, data from the Clearing Corporation of India (CCIL) show that PSU banks have bought (net) around ₹ 24,600 crore of government securities in the week ended November 18. They had bought around ₹ 20,000 crore of G-Secs in the entire month of October.

Reverse repo to the rescue

Banks can essentially borrow money for the short term under the liquidity adjustment facility (LAF). Currently, banks can borrow up to 0.25 per cent of their deposits under the fixed repo window and 0.75 per cent under the term repo (variable) window. Alternatively, banks can also lend their excess funds to the RBI and earn interest on them through the reverse repo option. Following the announcement of the demonetisation scheme by the Centre on November 8, there has been a sharp jump in the funds that banks have been lending to the RBI under the reverse repo option — a chunk under the variable window.

The fixed reverse repo activity, after clocking a daily average of about ₹ 4,000-6,000 crore in the past couple of months, suddenly spiked to ₹ 30,000-50,000 crore in the two to three days following demonetisation.

Activity subsequently shifted to the variable reverse repo window, where essentially the price is determined through auctions. Over the past two weeks, banks have been lending funds from around ₹ 60,000 crore to over ₹ 1,50,000 crore under the variable reverse repo window across various tenures.

Good spread

Banks have earned good interest on these funds too. While the fixed reverse repo rate is at 5.75 per cent, the cut-off rate at the reverse repo auctions have been around the 6.2 per cent mark. This is not altogether surprising given that the RBI wants to ensure that the key policy rate is the operational rate. Since the April policy, the system has moved from deficit to a neutral liquidity regime.

In the current scenario, as liquidity is more than ample and banks are rushing to lend rather than borrow funds from the RBI, the reverse repo is bound to be close to the repo rate. For banks, lending money for the short-term to the RBI at an attractive rate of 6.2 per cent, no doubt brings good tidings. With rates on short-term deposits cut aggressively, banks can make a good 2-3 per cent spread on such deposits, albeit for a short period.

To be fair, the massive inflows of old notes have put a strain on banks' daily operations and they have been incurring costs on logistics and cash management in the past two weeks.

Nonetheless, given that for most PSU banks, lending activity has been slack for a long while now, the spread on these excess deposits even for a short period can boost their income.

Treasury gains

PSU banks have also been deploying some of these funds to buy safe government securities. In the week ended November 18, PSU banks have been net buyers in government securities to the tune of about ₹ 24,600 crore. This is higher than the amount of bonds they bought (net) in recent months.

PSU banks have been buying aggressively in the last couple of months. In the September quarter, they were net buyers to the tune of about ₹ 36,000 crore, far higher than the ₹ 18,000-odd crore of net purchase they made in the June quarter.

As core lending business remains muted, PSU banks have been stocking up on government securities instead.

With the yield on government bonds falling from 7.7 per cent levels in the beginning of this year to 6.2 per cent levels now, banks are likely to gain from higher treasury gains.

Private sector banks, on the other hand, had turned net sellers in the September quarter. They sold about ₹ 24,000 crore worth of bonds after a net purchase of ₹ 5,300 crore in the June quarter.

In the week ending November 18, they made a net purchase of about ₹ 4,800 crore in government securities.

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