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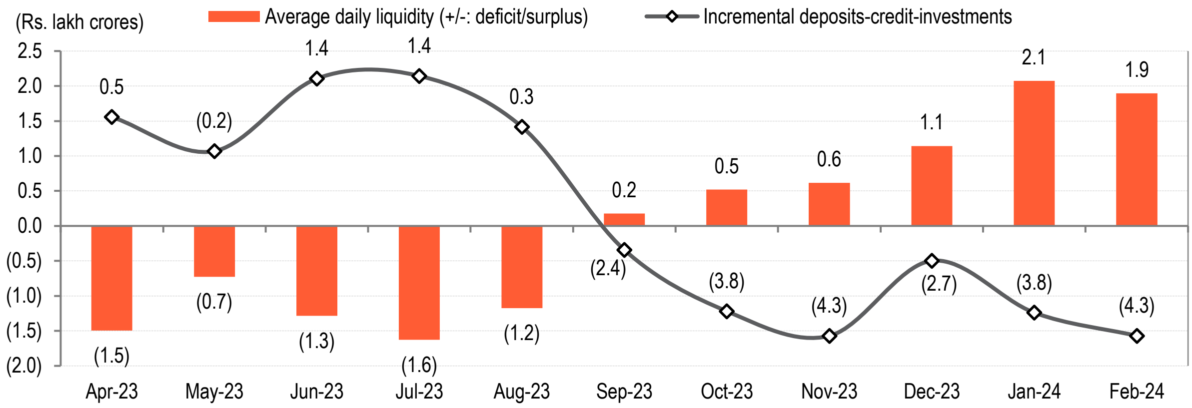
Analysis of the liquidity deficit

Liquidity deficit in the system has been increasing since Sep'23, to reach a record high of Rs. 3.5 lakh crores on 24 Jan 2024. A key factor which has been impacting the banking system liquidity is the uneven growth in credit and deposits. While credit growth has been growing at a robust pace, deposit growth has been lagging in relative terms. Apart from this, government spending was heavily curtailed in Q3FY24. The deficit was further exacerbated by quarter end GST and tax outflows. However, the situation is expected to stabilize in the coming days as government spending picks up. This has also been seen in March when the system turned into a surplus. Deposit growth too has been inching up which should further ease liquidity pressure.

Situation so far:

Figure 1 gives the average daily liquidity in the system in FYTD24. As can be seen, that average liquidity remained in a surplus till Aug'23, after which there was a turnaround. Since Sep'23, when the liquidity deficit stood at just Rs. 0.2 lakh crores, the deficit has swelled and reached a peak of R. 2.07 lakh crores in Jan'24. The situation has somewhat improved in Feb'24, with the liquidity deficit moderating to Rs. 1.86 lakh crores in Feb'24. There has been some improvement in Mar'24, with daily liquidity turning surplus on 4 March 2024. This is the first time since Dec'23 that daily liquidity is in surplus.

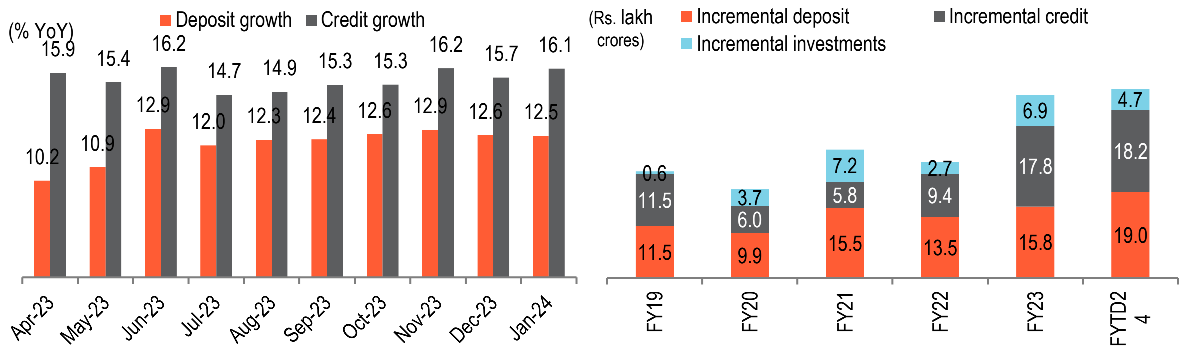
Figure 1: Liquidity position in FYTD24



Source: CEIC, Bank of Baroda Research

One major factor influencing the liquidity situation is the disproportionate growth in credit and deposits. As of Jan'24, while credit growth increased by 16.1%, deposit growth registered an increase of only 12.5% on a YoY basis. On the other hand, investments by banks have grown at a rate of 13.2%. In FYTD24, credit growth is tracking at 13.3%, deposit growth at 10.5% and investments at 8.6%. To put this in perspective, incremental credit and investments stand at Rs. 22.8 lakh crores in FYTD24 (upto 26 Jan 2024), while the deposit accretion has been only Rs. 9 lakh crores, which translates into a deficit of Rs. 3.82 lakh crores. Interestingly, this phenomenon started only after Sep'23, when the difference between incremental deposits was lower than incremental credit and investments by Rs. 2.8 lakh crores. Since then, the gap widened to a peak of Rs. 4.3 lakh crores in Nov'23. Till Jan'24, the deficit stood at Rs. 3.8 lakh crores, as there has been some pickup in deposit growth. Key risk may emerge from a deceleration in deposits growth as individuals rebalance their savings portfolios, ahead of the end of the financial year

Figure 2: Liquidity position in FYTD24



Source: CEIC, Bank of Baroda Research | Note: Based on fortnightly data as of 26 Jan 2024

<u>Outlook for Mar'24:</u>

In order to assess the likely liquidity situation in the coming days, it is imperative to account for all the factors which are likely to affect it. The key factors to watch are growth in credit, deposit and investments. Investment growth is assumed to remain at current levels since the central government borrowing program is over for the current financial year. However, banks will continue to participate in the SDL auctions. Apart from this, there might be some portfolio balancing undertaken by banks towards the end of the financial year. We are assuming a 10% growth in investments for FY24.

For credit and deposit growth, we are assuming three scenarios, baseline, low and optimistic. In the baseline scenario, we are assuming a pickup in deposit growth to 13%, led by an increase in deposit rates. On the other hand, credit growth is expected to moderate to 15.5%. This translates into a deficit of Rs. 3.2 lakh crores, which is lower than the current levels (Rs. 3.8 lakh crores as of 26 Jan 2024). In a more optimistic scenario, we assume deposit growth to inch up by 13.5%, while credit growth maintains its momentum and increases by 16%. In this case, the liquidity deficit with banks is estimated at Rs. 2.9 lakh crores. In the low scenario, both credit and deposit growth are projected to be weaker at 12% and 15% respectively, resulting in a gap of Rs. 3.4 lakh crores.

<u>Table 1: Scenario analysis</u>

Credit/Deposit (↓ / →)	Low (12%)	Baseline (13%)	Optimistic (13.5%)
Low (15%)	-3.4	-2.5	-1.6
Baseline (15.5%)	-4.1	-3.2	-2.3
Optimistic (16%)	-4.7	-3.8	-2.9

Source: Bank of Baroda Research

Another major factor affecting the liquidity in the system is government's action on the Budget. While advance tax outflows will lead to increased pressure on liquidity, pickup in government spending is likely to mitigate it to some extent. As of Jan'24, government has spent only 74.7% of its Budgeted expenditure for FY24. This suggests that close to 25% or Rs. 11.4 lakh crores is likely to be spent in Feb-Mar'2024. Historically, an average of 12% of government's total spending happens in Mar'24 alone, which will help ease the liquidity situation. With government spending picking up, liquidity deficit in the system been moderating in the last few days. In fact, at Rs. 0.4 lakh crores, liquidity deficit is at its lowest since Dec'23.

On the outflows side, advance tax outflows typically pick up towards the end of each quarter. As of Jan'24, corporate tax collections were ~82% of the budgeted amount, which implies that around 18% of the taxes will be paid in Feb-Mar'24. Apart from this, GST collections too have been only 70% of the target till Jan'24, and are likely to pick up in the coming days. Hence, we may see higher outflows towards the end of Mar'24, which will put pressure on liquidity.

However, given that government's spending momentum has picked up pace, some of the impact is likely to be absorbed.

Conclusion:

- Liquidity situation in the coming days is likely to be influenced by a number of factors such as momentum in credit/deposit growth as well as government's year-end fiscal program.
- Higher tax outflows, particularly towards the end of March as well as currency leakages ahead of the elections, can put some pressure on the liquidity deficit towards the end of Mar'24.
- However, we believe that a combination of pickup in deposit growth, along with higher spending by the government will ease the liquidity pressure to a large extent.
- Adding to this, maturity of US$ 5bn swap is due on 11 March 2024, which is likely to add Rs. 40,000 additional liquidity in the system.

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