**PRESS RELEASE**

**August 29, 2024**

# Declining liquidity coverage ratios to slow down credit growth for banks: ICRA

- *Proposed changes in liquidity coverage ratio framework to further moderate the reported liquidity coverage ratio (LCR) and constrain the credit growth for banks*
- *Lending rates may need to rise by 10 bps, while deposit rates would remain elevated, even if rate cuts commence*
- *Negative impact foreseen on Return on Asset (RoA) and Return on Equity (RoE) of 6-7 basis points (bps) and 70-90 bps, respectively*

In its recent report, ICRA highlighted that the share of deposits from retail customers and small businesses declined by almost 4.8% since its peak in June 2021 to 59.5% of total deposits by March 2024. This reflects a relatively higher growth in wholesale deposits for banks, when compared to retail deposits. Since such wholesale deposits have higher run-off factors, a larger share of such deposits adversely impacts the reported liquidity coverage ratio (LCR) for banks. A decline in LCR would need banks to place a higher share of their incremental deposits towards high quality liquid assets (HQLA) instead of deploying these deposits for credit growth.

Additionally, the proposed changes by the Reserve Bank of India (RBI) in its draft circular dated July 25, 2024 to review the LCR guidelines will reduce the system-wide reported LCR by 14-17%, i.e., from 130% reported during Q4 FY2024 to 113-116%, on account of the higher run-off factors for certain deposits and haircuts on the HQLA. Banks would then need to rework their strategy on credit and deposit growth, especially where the LCR declines to a level closer to the regulatory requirement of 100%. To recoup the LCR loss, banks may focus more on retail deposits, reducing the share of wholesale deposits, moderating credit growth and deploying a higher share of deposits to the HQLA.

**Sachin Sachdeva, Vice President & Sector Head – Financial Sector Ratings, ICRA** said*: "With the declining share of retail and small business deposits of banks, ICRA expects the interest rate on retail deposits to remain elevated even if the credit growth slows down. The peak deposit rates for banks, hence, may stay elevated despite expected rate cuts in H2 FY2025, implying delayed transmission. In such a scenario, the banks may cut down low-yielding wholesale exposures, who will then have to shift to the debt capital markets or external commercial borrowings."*

As per ICRA's assessment, the recent regulatory actions like urging banks to reduce their credit-to-deposit (CD) ratio, increasing risk weights towards high growing loan segments, and the proposal to review the LCR framework, all point to the need to align credit growth with deposit growth while focusing on growing retail deposits. ICRA expects the non-food bank credit (NFBC) growth to slow down to Rs. 19.0-20.5 trillion (11.6-12.5% YoY) in FY2025[1] from Rs. 22.3 trillion (16.3% YoY) in FY2024[1]. Incremental deposit growth is expected to moderate to Rs. 19.4-20.0 trillion (9.5-9.8% YoY) in FY2025[1] from Rs. 23.2 trillion (12.9% YoY) in FY2024[1].

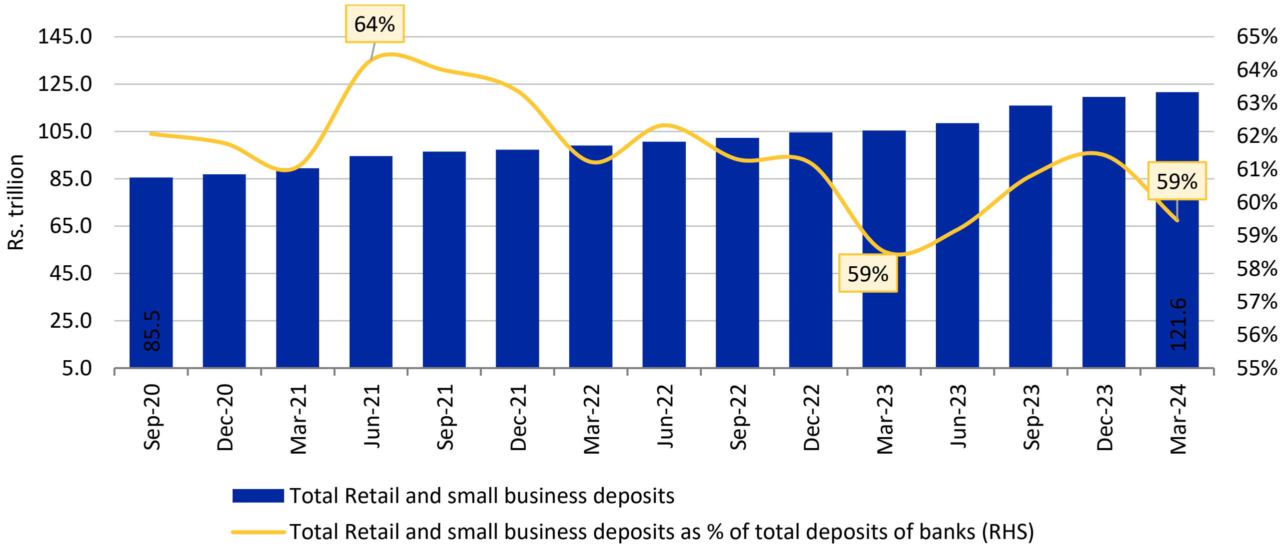
With credit growth outpacing deposit growth, the CD ratio reached an all-time high of 78.0% (80.2% including impact of HDFC merger) as of March 2024 in the last five years. Thereafter, following the regulatory nudge to banks to moderate their CD ratio, there has been a slight dip to 77.1% as of June 2024 with incremental CD ratio declining to 60% in Q1 FY2025.

[1] *Growth rate for FY2024 excludes impact of the HDFC merger; growth rate for FY2025 is calculated by including the impact of the HDFC merger in FY2024*

Overall, ICRA anticipates that banks will moderate their credit growth targets in the run-up to the proposed implementation of revised LCR norms w.e.f. April 01, 2025, resulting in an improvement (i.e., decline) in the CD ratio and increase in liquidity buffers. ICRA views these as positive developments from the banks' risk perspective, however, at the same time the negative impact on Return on Asset (RoA) and Return on Equity (RoE) can be 6-7 basis points (bps) and 70-90 bps, respectively.

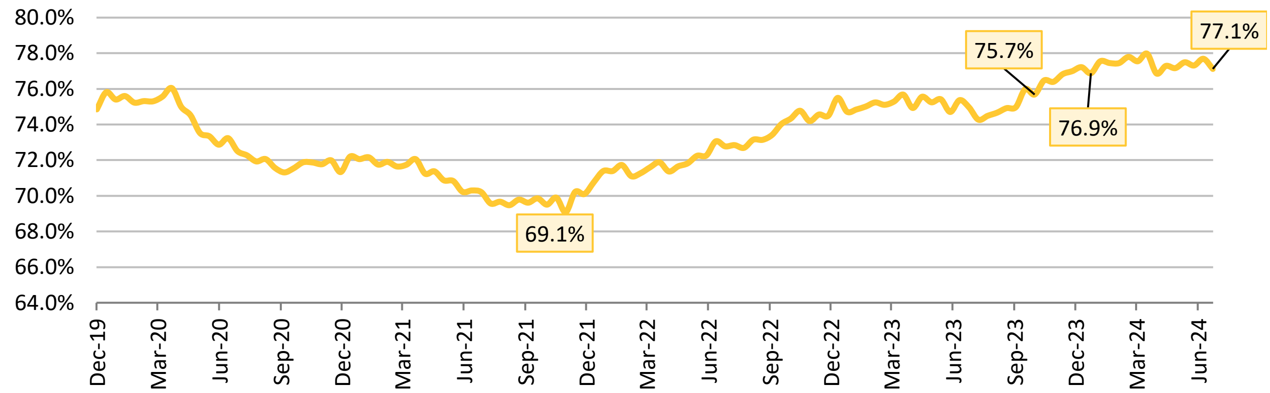
*"With lower growth aspirations, banks can be selective with the lending segments they choose to grow, for improved pricing power. To neutralise the impact on profitability because of the proposed LCR guidelines, banks will need to hike their lending rates by 10 bps. This could mean a higher cost for the borrowers,"* **Sachdeva** added.

**Exhibit 1: Share of retail and small business deposits in total deposits**



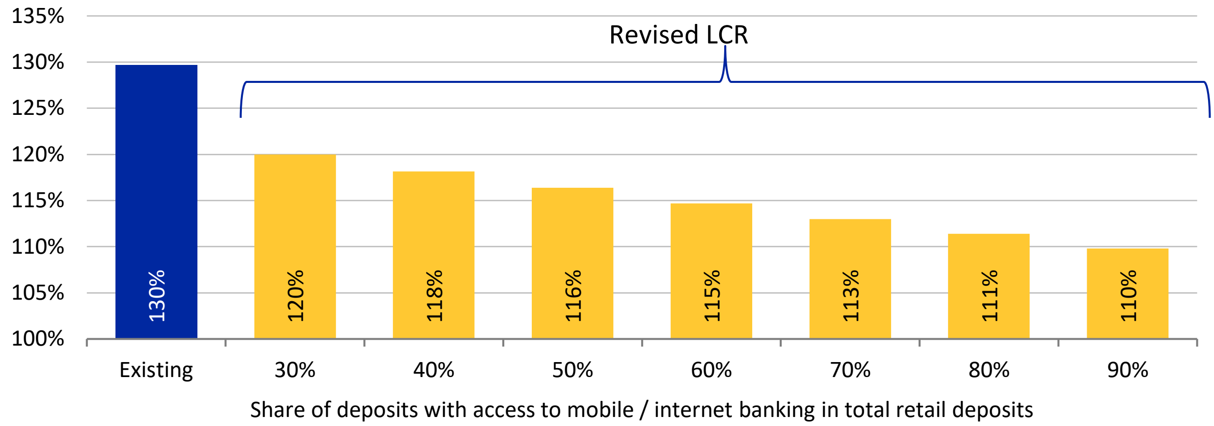

*Source: Banks (13 PSBs including IDBI and 19 large private banks), ICRA Research*

**Exhibit 2: Credit-to-deposit ratio touches all-time high in recent past**




*Source: RBI, ICRA Research; excludes impact of merger of HDFC*

**Exhibit 3: Recent proposal to review LCR framework to pose further challenges to credit growth**




*Source: Aggregate for 13 PSBs (including IDBI) and 19 large private banks for Q4 FY2024, ICRA Research*

**Click here to access our previous press releases on the sector.**

**For further information, please contact:**


| **Media Contacts:** | |
|---|---|
| **Naznin Prodhani**<br>Group - Head Media & Communications<br>ICRA Ltd<br>Tel: + (91 124) 4545300,<br>Dir - 4545860<br>Email:<br>naznin.prodhani@icraindia.com | **Saheb Singh Chadda**<br>Deputy Manager - Media & Communications<br>ICRA Ltd<br>Mob: +91- 9833669052<br>Email:<br>saheb.chadda@icraindia.com |




**About ICRA Limited:**

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

Click on the icon to visit our social media profiles.