

Rs 2,000 note withdrawal impact: CD, CP yield falls on expectation of improvement in bank deposits

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The yield on certificates of deposit (CD) has fallen 15-20 basis points (Bps) since last week on expectations of an improvement in banking system liquidity after the Reserve Bank of India (RBI) announced the withdrawal of Rs 2,000 banknotes last week. Also, last week's liquidity injection by the central bank through a repo auction also contributed to the fall, dealers said.

Similarly, the yield on the commercial papers fell 10-15 bps during this period. One basis point is one hundredth of a percentage point.

"Yields in money market papers like CP and CD have improved a lot with expectations of an improvement in bank deposits and last week's RBI efforts to inject liquidity via the term repo window. There was a large redemption of G-sec as well that happened," said Ajay Manglunia, Managing Director, JM Financial.

The central bank had on May 19 conducted a 14-day repo auction and injected Rs 46,790 crore, which was aimed at addressing liquidity concerns of some banks and institutions.

On May 19, the RBI announced the withdrawal of Rs 2,000 bank notes as part of its clean note policy. The RBI has given time till September 30 for the public to deposit or withdraw these notes.

CPs issued by non-banking finance companies (NBFC) maturing in three months fell to 7.05-7.10 percent, from 7.25-7.35 percent on May 17, according to money market dealers.

Similarly, manufacturing company CPs declined to 6.90-7.00 percent, from 7.10-7.20 percent on May 17.

CPs and CDs are short-term debt instruments issued by companies and banks to raise funds generally for a period up to one year.

Date	NBFC CP	Manufacturing companies CP	CD
May 17, 2023	7.25-7.35%	7.10-7.20%	7.00-7.20%
May 24, 2023	7.05-7.10%	6.90-7.00%	6.80-6.95%

Source: Market dealers

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Liquidity factor

The withdrawal of banknotes of Rs 2,000 denomination from circulation is likely to increase the liquidity in the banking system.

"The withdrawal will bring at least Rs 1.5 lakh crore of currency back into the banking system, which will bring back liquidity," said Umesh Kumar Tulsyan, managing director of Sovereign Global Markets, a New Delhi-based fund house.

While announcing the decision, the RBI had said that as on March 31, 2023, the total value of Rs 2,000 notes in circulation had declined to Rs 3.62 lakh crore, and accounted for only 10.8 percent of the notes in circulation. At its peak, the value was Rs 6.73 lakh crore, as on March 31, 2018.

About 89 percent of the Rs 2,000 notes were issued before March 2017 and were at the end of their estimated life-span of four to five years, the banking regulator said.

Further, on May 22, RBI Governor Shaktikanta Das said the central bank expects most of the Rs 2,000 notes to return to the banking system by September 30.

Earlier today, the central bank governor said the denomination was not in much use and noted that high-denomination notes could lead to collateral issues. "Therefore, we took this decision," Das said at the CII Annual Session - 2023.

Outlook

Money market dealers are of the view that rates on these short-term debt instruments will fall a further 10 bps.

"Yields may come down further, by around 10-15 bps, in the coming days," said Tulsyan.

Manglunia noted that post the monetary policy meeting in the first week of June, as the market expects no rate action, rates may keep improving, though there is no cut expected any time soon this year.