

Down the liquidity rabbit hole: 2.5-3% of NDTL is 'trapped'

The above-normal CD-OIS spreads January to March, which pushed up lending rates, were ascribed to heavy issuance of CDs. This is an incomplete explanation: the right question is why CD demand did not respond adequately to higher rates. We believe policy has not adjusted adequately to two major shifts in the financial system that make 2-3% of system liquidity effectively unavailable for lending: i) government cash balances are 1% of NDTL higher and 0.5% of NDTL more volatile post-2020; ii) across debt and equity MFs, TREPS balances are 1-2% of NDTL: these are not deposits, and banks cannot build assets with them. We explore some options for policymakers.

21 Apr 2026

Cost of deposits

Banking liquidity and money markets

Exhibit 1: What explains the sharp rise and the rapid fall in the CD-OIS spread?



Source: Bloomberg, Axis Bank Research

Much higher than usual CD-OIS spreads Jan-Mar: where is liquidity trapped?

CD-OIS spreads are back to 'normal' levels in April, in line with seasonality (Fig 6, 7), but the spike in 3M and 12M CD-OIS spreads Jan to March was well above seasonal and began much earlier than usual (Fig 2-3). Many ascribe this to heavy CD issuance in Nov-25 and Feb-26 (Fig 4, 5), with gross CD issuance hitting an all-time high. That said, this is unlikely to be the dominant factor, with rates having normalised (Fig 6, 7). The deeper questions are – why CD demand did not respond to prices, and where liquidity is trapped.

TREPS liquidity is 'trapped'; Govt. cash balances higher and more volatile too

With corporates' share of incremental deposits rising (Fig 24, 25) and current account ratios flat, additional savings flow to banks either directly via non-retail term deposits (NRTD), or indirectly as CDs via debt mutual funds, which hold 87% of CDs. Debt MF AUMs (funds mostly from corporates/HNIs) are now 5.5% of NDTL, vs. 3.3% in 2018. As CDs also affect NRTD (8% of NDTL vs. 3% in 2018) rates, their impact on rate transmission has risen.

The share of CDs in debt MFs has risen to a 10Y high 26% (Fig 11: vs. 10-15% levels pre-Covid). For liquidity, Money Market funds (70% of debt MF AUM, Fig 10) keep 35-40% of AUM in TREPS and T-bills. Across debt and equity MFs, TREPS balances are 1-2% of NDTL (Fig 22). They don't show up as deposits and have limited utility for banks in building assets.

In addition, government cash balances are now 1% of NDTL (Fig 17-19), and much more volatile (Fig 20-21). 2-3% of system liquidity is thus effectively unavailable for lending.

Possible solutions: above 'normal' liquidity; more T-bills; MF discount window?

We believe policy has not adequately adjusted to this new plumbing. To handle volatility in government cash balances, Fed researcher (Note, Paper) suggests: i) ample reserves; and ii) active trading of securities (incl. T-bills). With net liquidity below 0.4% of NDTL on 40% of days (Fig 14-15), there is a case for ample reserves. More T-bills in deficit financing plans can help too, and a discount window for MFs can also reduce flow into TREPS.

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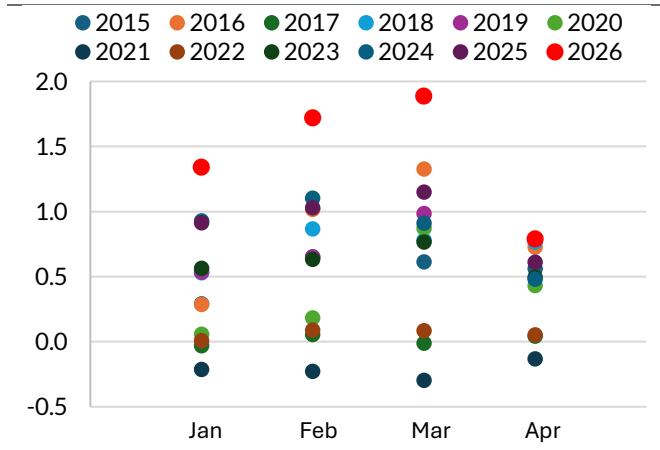
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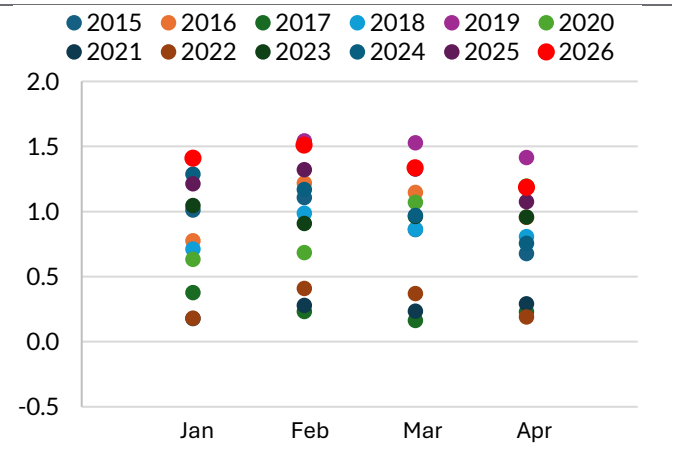
Story in Charts

Exhibit 2: 3M CD-OIS spread widened to record levels in Jan, Feb and Mar; 'normal' now in Apr (upper bound of the range)



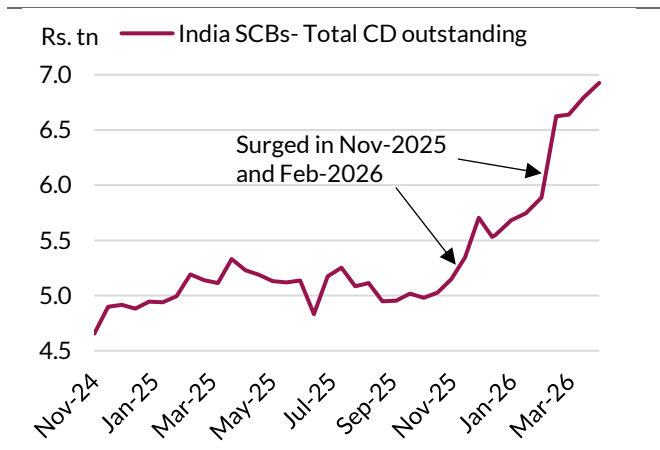
Source: Bloomberg, Axis Bank Research

Exhibit 3: 12M CD-OIS spread widened to record levels in Jan and Feb; 'normal' now in April



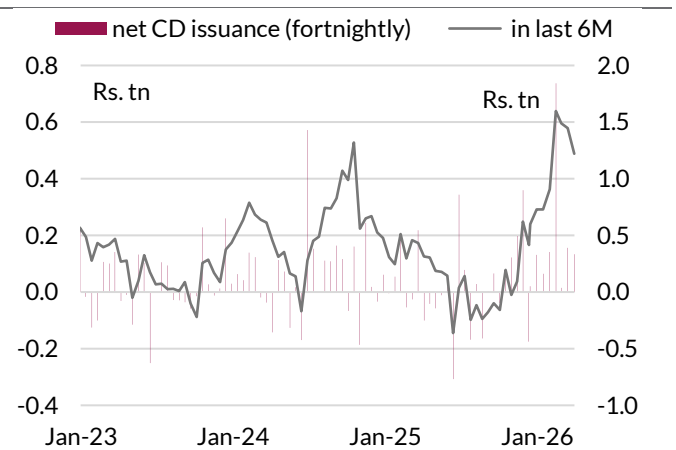
Source: Bloomberg, Axis Bank Research

Exhibit 4: Total CD outstanding spiked in Nov-25 & Feb-26



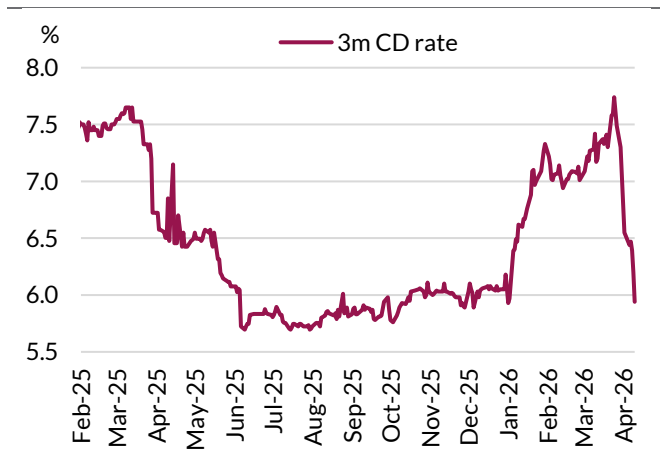
Source: RBI, Axis Bank Research

Exhibit 5: 6M net issuances at an all-time high by mid Feb-26



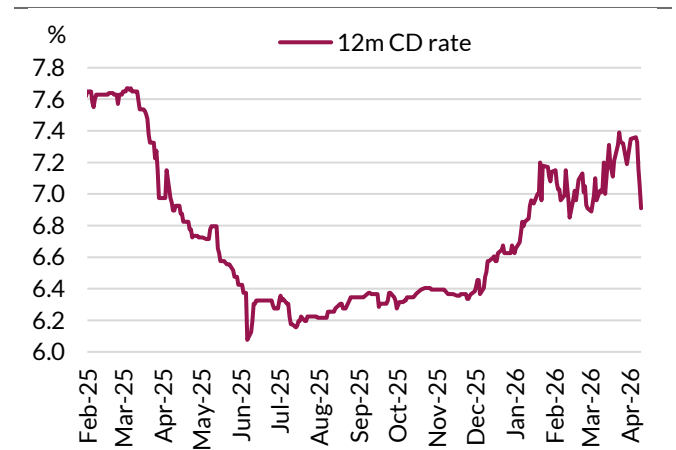
Source: RBI, Axis Bank Research

Exhibit 6: This led to a sharp rise in CD rates, but surprisingly the move up was 'totally' reversed in Apr (3M CD rate)...

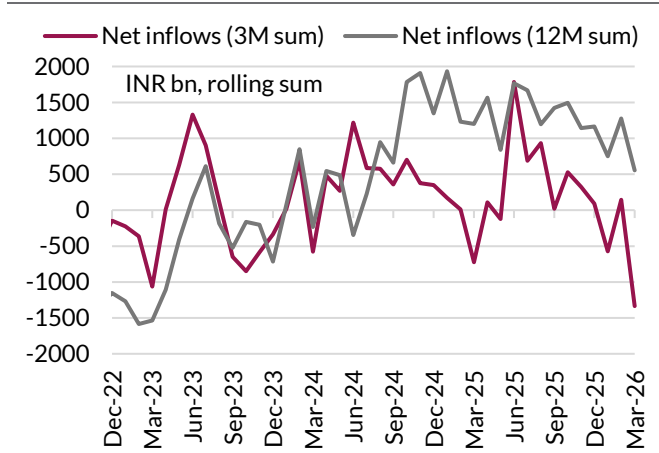


Source: Bloomberg, World Bank, Axis Bank Research

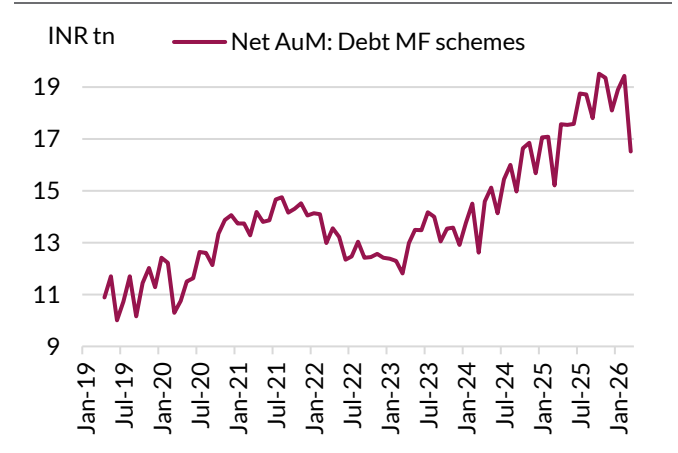
Exhibit 7: ...as well as in the 12M tenor; this suggests that issuance pressure was not the only explanatory variable



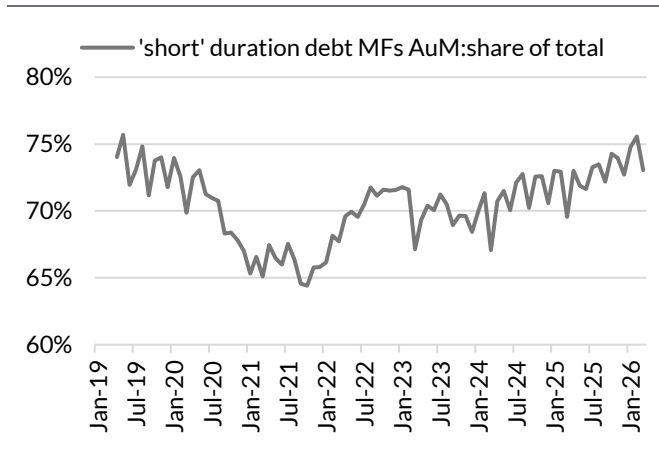
Source: Bloomberg, Axis Bank Research

Exhibit 8: 3-month net outflows in debt MFs in Jan-26 were as bad as in Mar-25; 12M net flows in Jan-26 were weak too


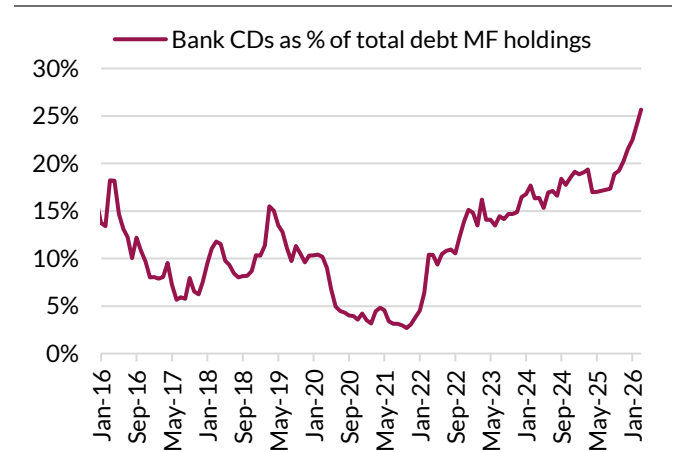
Source: SEBI, AMFI, Axis Bank Research

Exhibit 9: Weak net inflows → 'stagnant' debt MF AuM (assets under management)


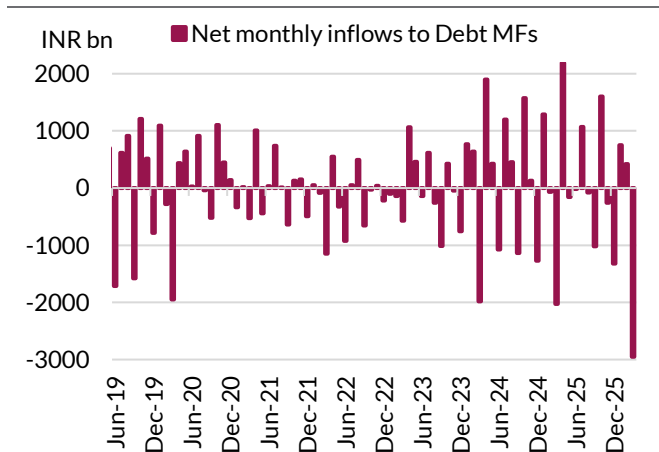
Source: CEIC, Axis Bank Research; Note: valuation affects AuM as well

Exhibit 10 – Funds that mostly buy CDs are 'low' duration funds; they account for ~75% of Debt MFs' AuM


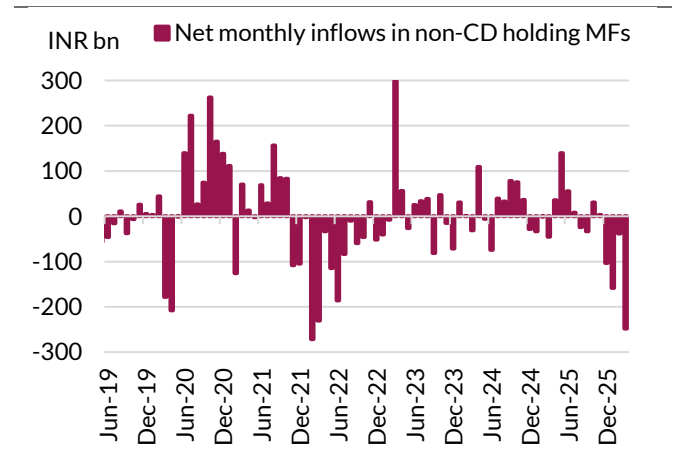
Source: Bloomberg, Axis Bank Research

Exhibit 11 – Share of CD holdings of Debt MFs rose from 20% in Nov-2025 to 24% in Feb-2026


Source: Bloomberg, Axis Bank Research

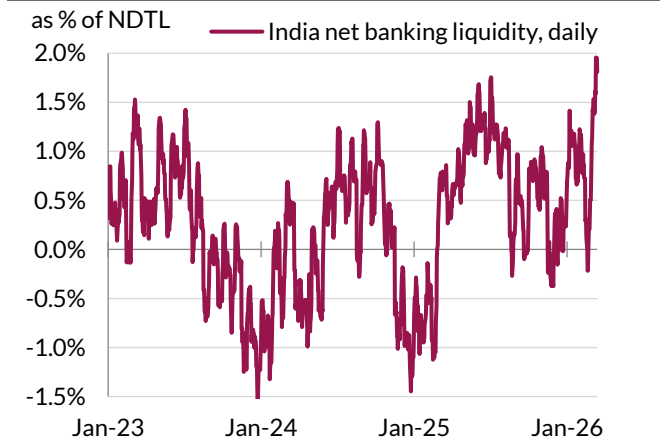
Exhibit 12 – Sharp quarter-end outflows and the subsequent month's rebound in inflows a persistent feature of debt MFs


Source: Bloomberg, Axis Bank Research

Exhibit 13 – Driven by the MFs that invest in CDs (~75% of Debt MFs AuM); removing those gives a different picture


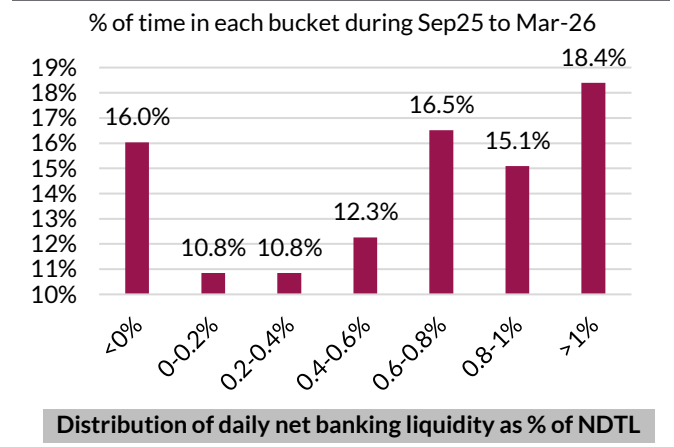
Source: Bloomberg, Axis Bank Research

Exhibit 14 – Net banking liquidity has been too volatile and below 1% of NDTL most of the time



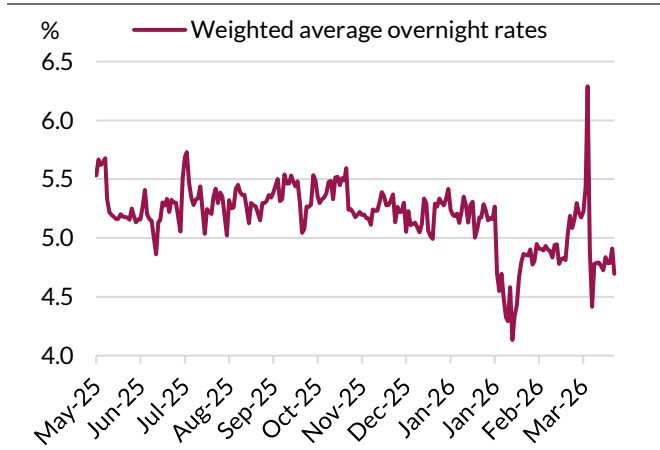
Source: Polymarket, Axis Bank Research

Exhibit 15 – Net liquidity was below 0.6% of NDTL for 50% of the time from Sep-25 to Mar-26; deficit for 16% of the days



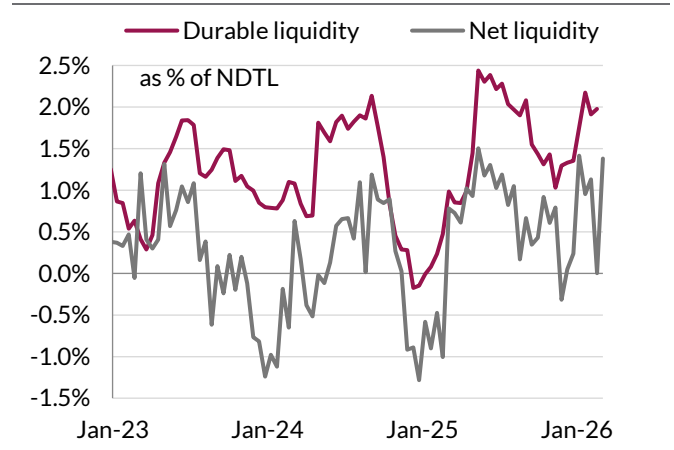
Source: Bloomberg, Axis Bank Research

Exhibit 16 – As a result, overnight rates are too volatile



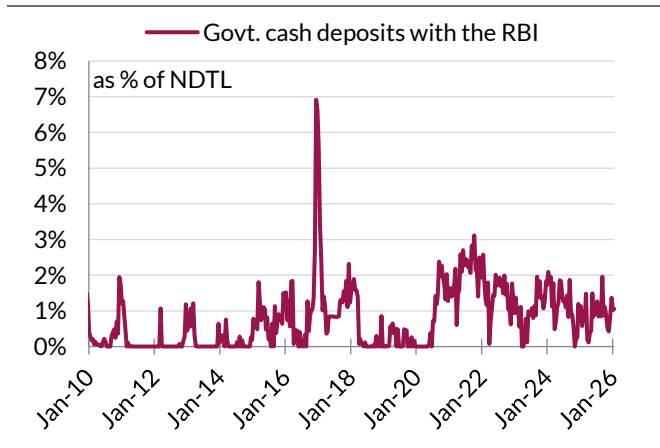
Source: Bloomberg, Axis Bank Research

Exhibit 17 – Volatile govt. cash balances another problem



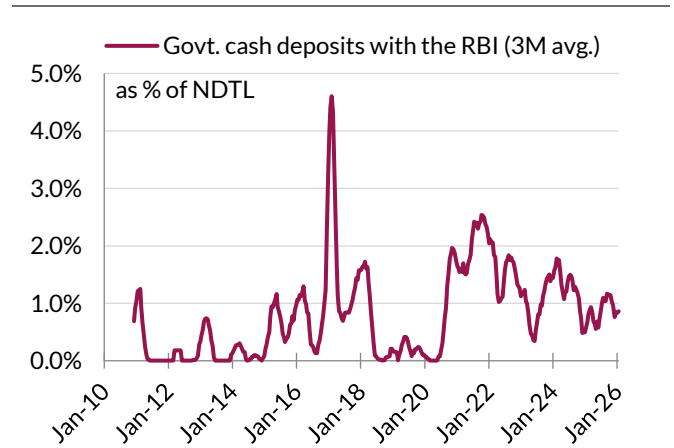
Source: Bloomberg, Axis Bank Research

Exhibit 18 – Govt. cash deposits with the RBI now avg. 1% of NDTL vs. 0.5% of NDTL averaged during 2010-2020



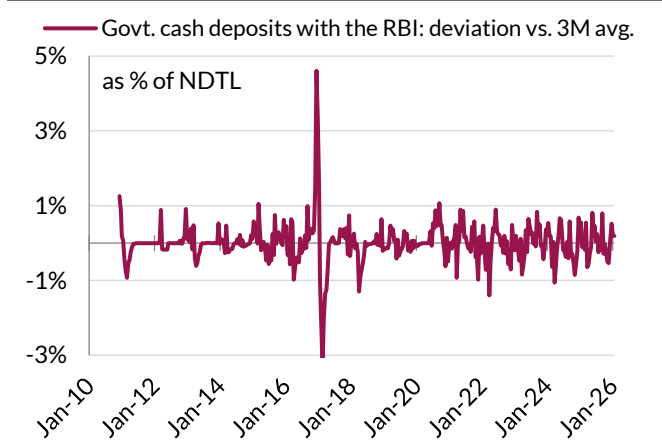
Source: RBI, Axis Bank Research

Exhibit 19 – The distinction (regime-shift) becomes clearer when we look at rolling 3M average (CY17 an exception)



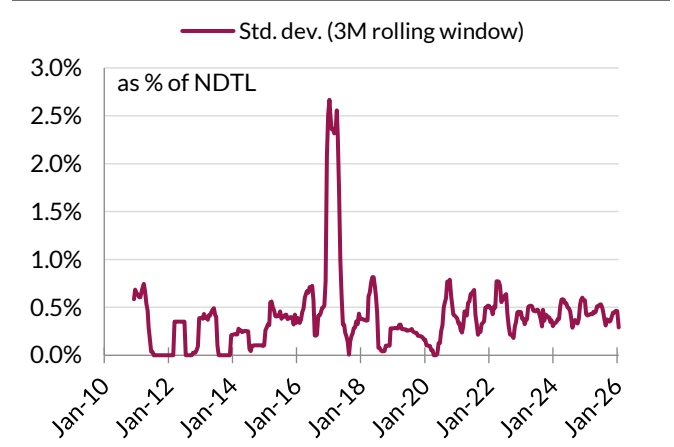
Source: India Data Hub, Axis Bank Research

Exhibit 20: In addition, the deviations vs. 3M average are now more regular making the shocks more persistent



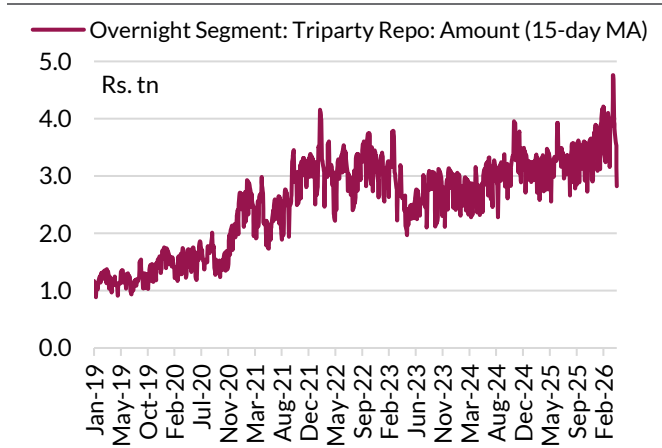
Source: Energy Institute, World Bank, Axis Bank Research

Exhibit 21: The rolling 3M standard deviation of govt. cash balances with the RBI is at ~0.5% (higher vs. pre-COVID avg.)



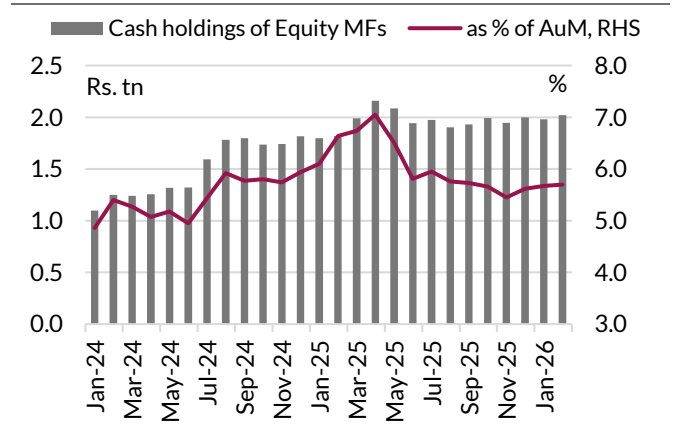
Source: FRED, Axis Bank Research

Exhibit 22: TREPs quantum (and volatility) affects bank deposits: Peaked in Mar-26, now lower



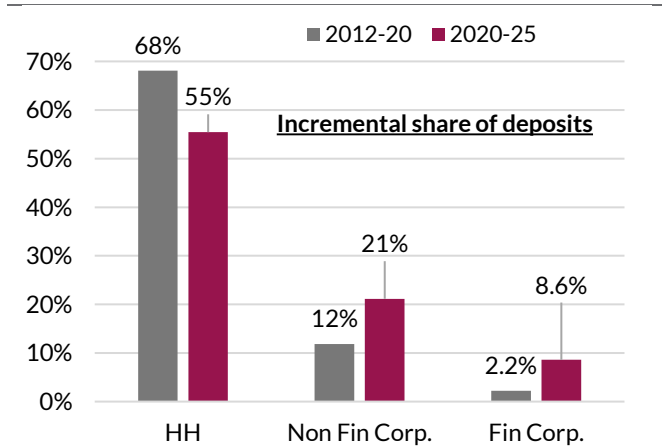
Source: CEIC, World Bank, Axis Bank Research

Exhibit 23: The volatility mostly arises due to a Debt MFs flow patterns as cash holdings of equity MFs largely stable



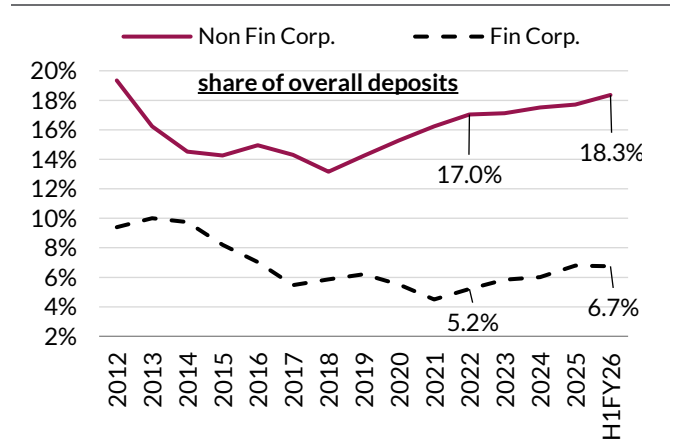
Source: AMFI, Axis Bank Research

Exhibit 24: Deposit share shift (from HHs to corporates) makes deposits costlier



Source: RBI, Axis Bank Research

Exhibit 25: Rising corporate share of deposits → higher pressure on funding costs



Source: RBI, Axis Bank Research

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