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THE CURIOUS CASE OF HIGH DEPOSITS DESPITE LOW RATES

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

At a time when interest rates on bank deposits have steadily declined following successive policy rate cuts, bank deposits have actually increased. Deposit rates are now as low as 3% at major banks. Mint explains the dichotomy of rising deposits amid falling rates.

Why have deposit rates fallen so much?

Deposit rates depend on multiple factors, one of which is the repo rate set by the central bank's Monetary Policy Committee (MPC). The moderation in inflation has resulted in very high real interest rates as we witnessed a growth slowdown from September 2018 onwards. Since then, the MPC has prioritized growth and has decided to slash interest rates to stimulate growth. Successive cuts in repo rates and a reduction in the small savings rates have allowed banks to reduce deposit rates, which will help them in reducing their lending rates, thereby reducing the cost of borrowing for the private sector.

But why are deposits rising despite this?

It is generally argued that lower rate of interest on deposits should discourage people from saving. Moreover, there are other assets such as mutual funds and stocks that offer a higher rate of return and therefore, people may prefer them over bank deposits. However, in the present context, with a major part of the economy under lockdown, people could not spend on discretionary consumption. This could have led to an increase in the deposits. Additionally, risk-averse individuals may respond to lower level of interests by higher deposits to maintain a stable level of interest income.

Does a rise in savings mean there's no income stress?

It's difficult to state so. The rise in bank deposits could be due to precautionary reasons, suggesting a bleak outlook of future income by households. Anecdotal evidence in the form of layoffs and wage cuts suggests some income stress. Wage cuts and layoffs represent a permanent income loss which could translate into an aggregate demand problem.

What about sluggish credit growth?

Even though banks sanctioned loans, disbursals have been low and the credit growth has been sluggish. While the government's credit guarantee scheme has partly addressed banks' risk-aversion, there remains a problem of low demand for credit. Borrowers are sceptical of debt as they are uncertain about the future economic outlook. Moreover, with covid-19 cases gradually increasing, there is a sense of fear which is disrupting economic activity despite relaxations of lockdown restrictions.

What does this mean for growth recovery?

Growth recovery is likely to be prolonged over the second half of the financial year as economic activity stabilizes and the fear of the pandemic subsides. Revival of discretionary consumption and credit growth would be essential for a recovery. A lot will also depend on foreign investments that can be attracted. The recovery to pre-covid levels of growth rate (4-5%) should be swift. However, going back to our potential of around 7% will remain a challenge.

Karan Bhasin is a Delhi-based policy researcher.

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