

The concept of “real rates” has garnered much attention in recent research. The RBI in its July Bulletin published a paper asserting that the real rate required to maintain savings-investment equilibrium in the fast growing Indian economy has seen an uptick to 1.4-1.9% vs 0.8-1.0% using earlier study conducted during covid period (Fig.1). In our view, the need for higher real rates is a combination of higher potential growth along with rise in (perceived) inflation. The latter has led the households to “hunt for yield” and allocate a large part of savings away from bank deposits to asset classes - equity, real estate and gold - all clocking much higher returns in recent years vis-à-vis long-term average. This has driven structural slowdown in low-cost CASA deposits and raising cost of funds for the banking system. This has led to fight for deposits by banks witnessing credit-deposit growth wedge during high growth phase with C-D ratio at record highs and incremental C-D ratio at close to 100%. HDFC merger effect exacerbating the impact duly acknowledged by RBI as well in the Financial Stability Report.

The interesting part is that the share of physical savings in total household savings at 70% is similar to taper tantrum period which also saw a loud call for higher real rates (Fig.2). In our view, the RBI is required to maintain high real rates and stay considerate about the “silent depositor” (a phrase used by the RBI Governor in recent CNBC interview) even as the government is focused on lowering cost of capital via lower market borrowings. The latter must be complemented on giving due credence to this issue in the Budget hiking taxes to impede flow into real estate and equity.

On balance, till this financial (in)stability is addressed, the RBI is required to keep rates on hold in our view. Hence, we take out our rate cut call for this fiscal year vis-à-vis our earlier call of 50bps rate cut starting October with a risk of later rather than sooner. The adequate liquidity available at attractive rates driving asset classes higher during the MPC’s “withdrawal of accommodation” phase needs to be addressed on an urgent basis.

Fig.1: RBI estimates a rise in natural rate of interest on pick up in potential growth post Covid

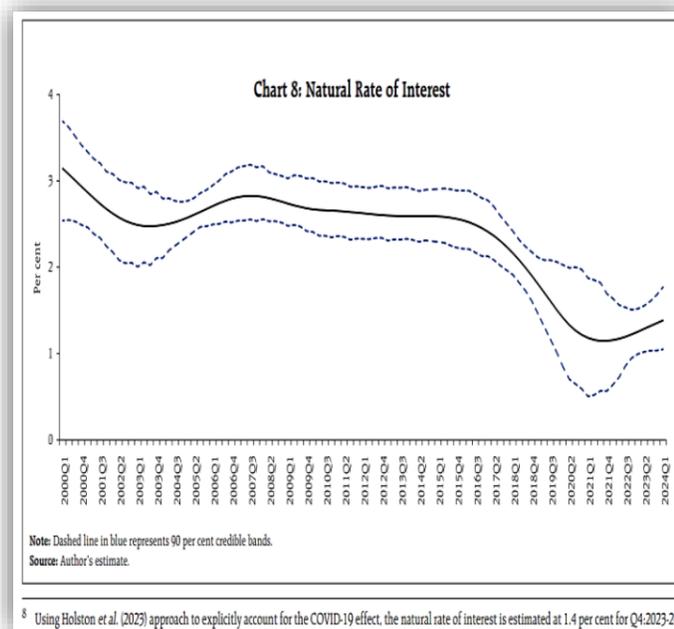
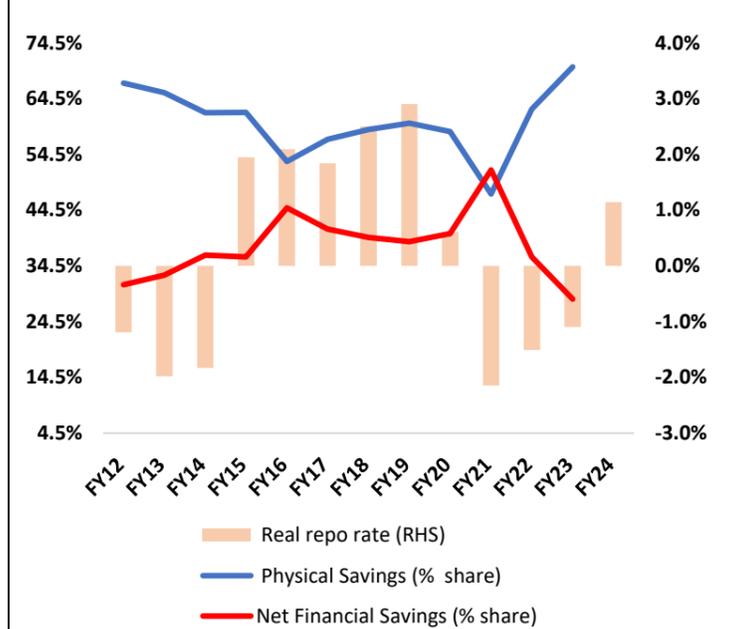


Fig.2: Low real rates driving the share of Households' physical savings to worst levels since taper tantrum



Source: RBI paper (Updating Estimates of the Natural Rate of Interest for India with Post-Pandemic Evidence), CEIC, UBI Research

Savings rate picked up in FY24 as per our estimate:

- The Current Account Balance (CAB) can be expressed as the difference between National Savings (S) and Investment (I). Using (S-I=CAB) identity which implies that the gap between domestic savings and capex is balanced by flows for abroad (or a C/A deficit), we estimate that national savings grew from 30.2% in FY23 to 33.2% of GDP as current account balance decreased from -2.0% in FY23 to -0.7% of GDP in FY24 (Fig.3). These national savings are reflected in positive government balance (Credit of Rs.1.72 Lakh Crore as on 31st Mar-24), Corporate cash surplus (Positive operating Cash flow of c.Rs.10 lakh crore) and Household savings.
- In FY23, Household Savings were 18.4% of GDP, which must grow at 20.2% in FY24 to hold above equation true. This is in line with our expectations of pick up in savings rate as the rising C-D ratio created scarcity of deposits pursuing Banks to raise retail term deposit rates. It is the perception of real rates that determines the flow of savings into financial assets.

Households hunt for high yielding assets on low (perceived) real rates:

- Households with c.61% share in overall deposits have seen a drop-in savings rate to 18.4% of GDP in FY23 (latest data available) vs 22.7% in FY21 (covid year).
- A switch in households savings mix to physical (real estate, gold etc.) with 70% share in FY23 vs 47.4% in FY21. Meanwhile, gross financial savings have stayed broadly unchanged at 11% of GDP in last 5 years. Within financial savings of households, there has been a switch away from deposits (FY23 savings share at 37% vs 57% in FY13) into higher yielding assets like equity/MFs, insurance, small savings etc. (MF SIP flows were -Rs 20,000 cr in the month of Apr

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'24). While the money flow into high yielding assets is expected to return into the banking system, there has been a time lag, in our view.

- On balance, we believe that the shift in household savings-investment behavior in recent years with “hunt for yield” exacerbated by easy availability of cheap liquidity, has led to above average returns across asset classes like equities, real estate and gold as against traditional deposits (Fig.4).
- During the past 2 years, gold and equity along with real estate have given above average returns c.21% making them an attractive alternative to the traditional term deposits. Retail participation in capital markets is a cause of concern which is being highlighted by both RBI & SEBI.
- More importantly, RBI in its July bulletin paper “Updating Estimates of the Natural Rate of Interest for India with Post-Pandemic Evidence” asserted that estimate of the natural rate for Q4:2023-24 is at 1.4-1.9 per cent as compared with our earlier estimate of 0.8-1.0 per cent for Q3:2021-22. RBI acknowledged that the factors which reduce savings or increase investment raise the natural rate of interest. Hence, in order to sustain the economic growth and savings-investment balance, high real rates are required.

Despite savings rate pickup, deposit growth is lagging that for credit:

- FY24 clocked bank credit and deposit growth at 19.1% and 13.4% respectively with C-D ratio at 79.6% (Fig.6), highest on record.
- Deposit growth lagging credit growth thereby leading to a race for deposits within banking system. In FY24, deposit growth clocked 12.7% (without HDFC merger effect) and 13.4% (with HDFC merger effect) (Fig. 10).
- Historically, deposit growth has been better aligned with nominal GDP vis-à-vis credit growth. However, in FY24, it was way above the 9.6% nominal GDP growth at 12.6% (without merger effect) as banks sharply raised deposit rates.
- Fight for deposits which has been exacerbated by the HDFC merger effect continues. Major banks have intensified efforts to garner retail deposits through special plans that offer savers at least 25-30 basis points more than current commitments of comparable tenures, signaling policy interest rates will remain elevated. This has led to narrower margins and also led to credit mispricing within banking system thereby causing financial (in)stability.

Low cost CASA deposits facing structural slowdown; fight for deposits by banks in ‘real’:

- Interestingly, given the sharp spike in deposit rates in recent months, total deposit accretion from Households in FY24 was Rs. 14 Lakh Cr from close to Rs 10 Lakh Cr in FY23 (Fig.8), though primarily in Term Deposits and not in CASA deposits. We expect the same trend to continue as the household investments in other avenues may come to the Banking System with a time lag and as high-cost deposit by institutions.
- As per RBI, there is complete transmission of 250 bps hike in Repo rate in fresh rupee term deposits and 188 bps transmission is done in outstanding rupee deposits. In Mar-23 the share of deposits in 7-8% interest rate bucket was 30.3% which has jumped to 59% in Mar-24, showing fight for deposits expected to get messier in FY25.
- Due to the lower pace of deposits growth, banks may tighten their lending decision also to reduce the credit growth rate. However, pent up demand of Credit may keep C-D ratio elevated in FY25 and this kind of financial (in)stability warrants attention from the regulator.
- These kinds of wide C-D ratio is not new for the Indian economy. The close the average growth gap between Credit & Deposit, it took 22 to 43 months in the past (Fig.9). The present C-D wedge has already passed 23 months as of Jun-24, hence is at the cusp of a turnaround towards closing the wedge, which requires a greater downfall in Credit growth vis-a-vis deposit growth.

Rate may stay on hold for longer; protecting the “silent depositor”:

- The households hunt for yield in low real rate scenario accompanied with cheap liquidity & low mortgage rates are in contrast with the “real” fight for deposits by banking making “marginal” FD rates spike thereby driving credit mispricing. This is not in consonance with the “withdrawal of accommodation” stance of the RBI and needs attention from the regulator.
- We must complement the RBI Governor for being vocal on these issues though giving a different economic lens. In a recent interview, when asked about timing of rate “cuts”, the RBI Governor alluded to ‘silent depositor’. We agree with the Governor and in our view there are bigger macro and financial (in)stability issues to address before the MPC may shift in stance and initiate rate cut cycle.
- ***We take out our rate cut call for this fiscal year vis-à-vis our earlier call of 50bps rate cut starting October with a risk of later rather than sooner.***

Fiscal prudence along with Tax rationalization may fix:

- The Final Budget of FY25 tried to address the trinity of growth, prudence and investment. The capital market measures of rationalization of capital gains tax & withdrawal of indexation benefit from property and gold thereby expect the flows to reverse from physical assets. Also, the government’s intention to have a withdrawal of Rs.1.40 lakh crore and lowered T-bills borrowing by Rs.1.0 lakh crore gives opportunity in the lower end of the curve, along with fiscal consolidation and JPM bond index inclusion flows supporting the 10year benchmark.

Fig.3: Using (S-I=CAB) identity, we estimate that national savings grew from 30.2% in FY23 to 33.2% of GDP

Particulars	National Savings (S)	Investment (I)	Current Account Balance (CAB)
FY 2022-23	30.2%	32.2%	-2.0%
FY 2023-24	33.2% (Estimated)	32.5%	-0.7%

Fig.4: Share of bank deposits in Household financial savings on a downtrend as of FY23

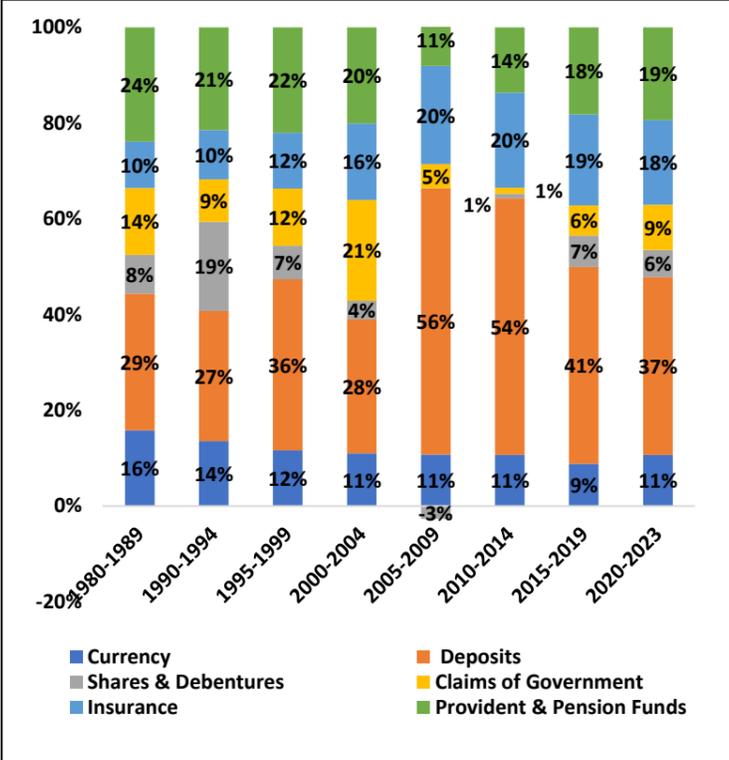


Fig.5: Mutual Funds saw record high SIP flows in FY24

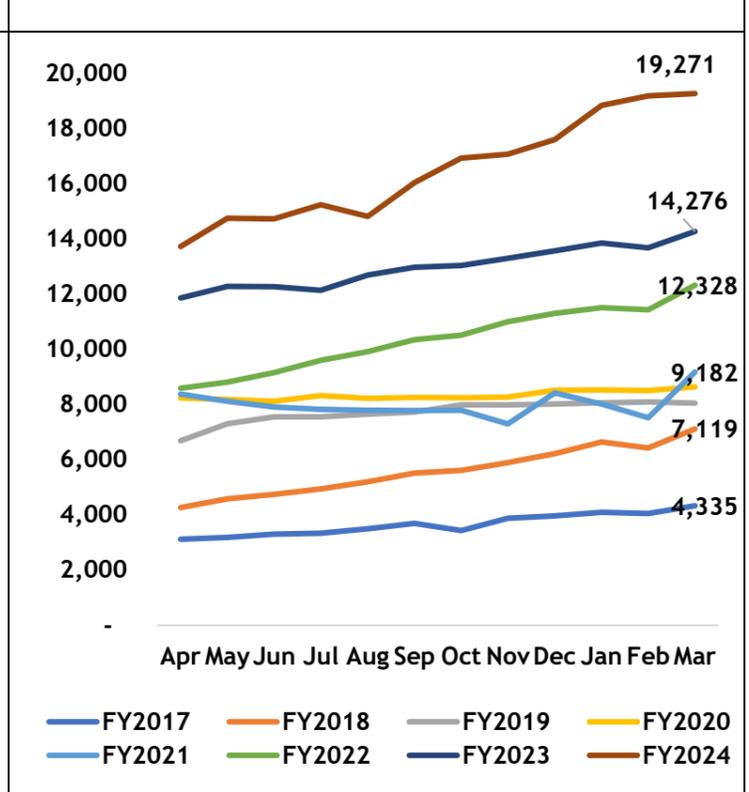


Fig.6: Outstanding C D Ratio on continued uptrend

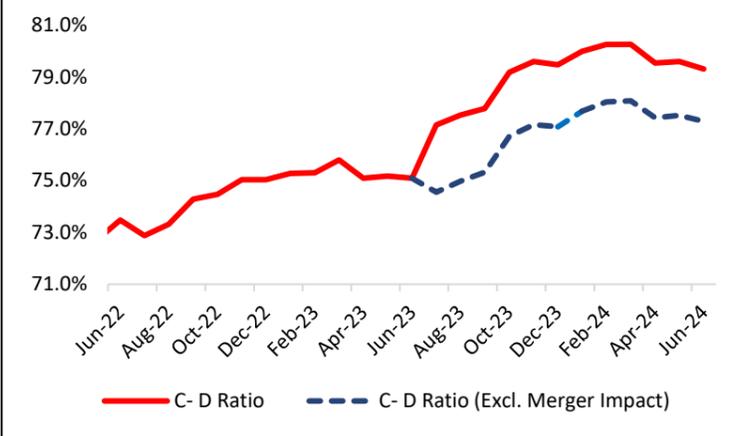


Fig.7: Incremental C D Ratio hovering near 100%

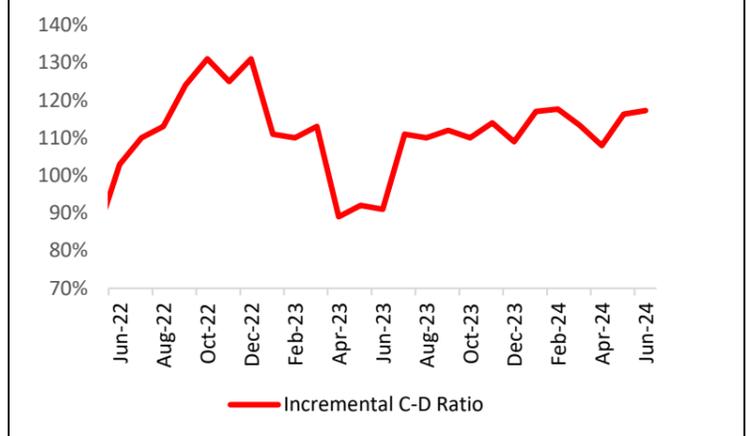


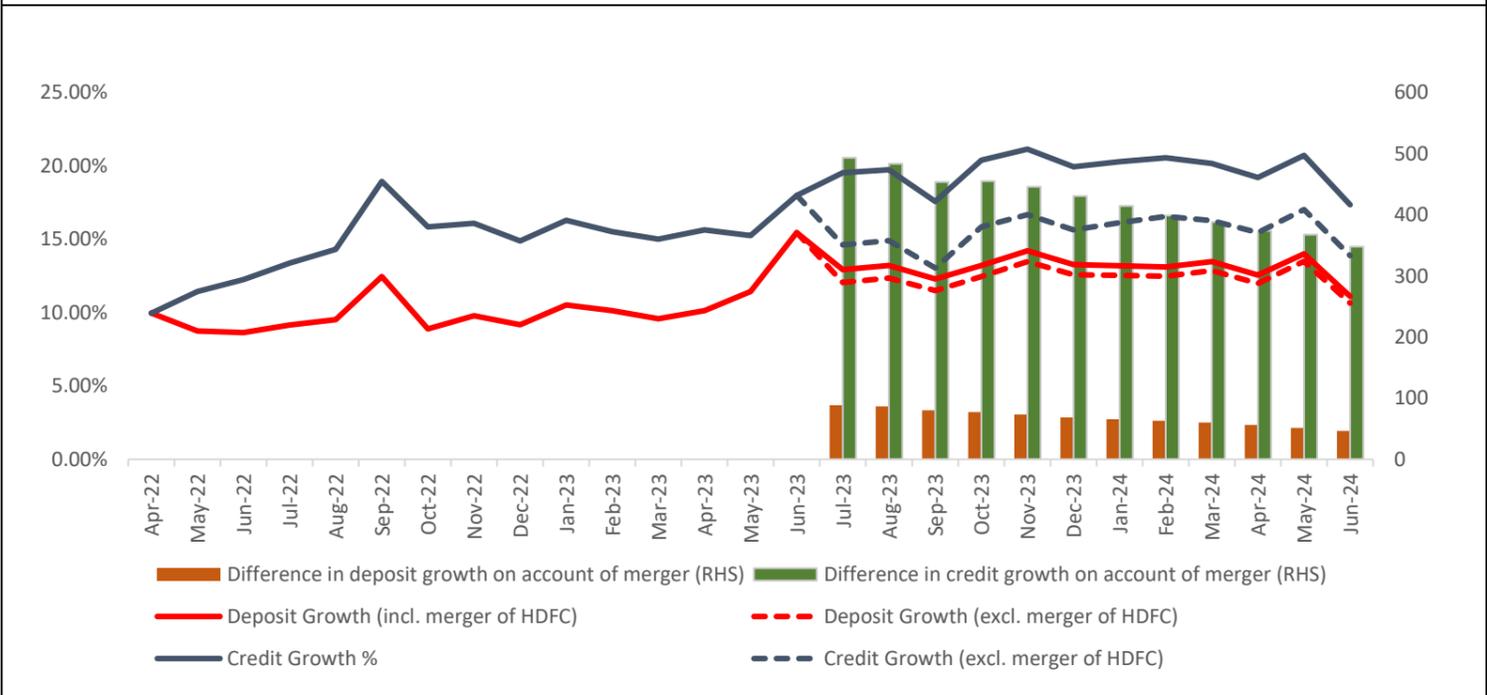
Fig.8: Slower SCB deposit growth led by households, the segment with highest share in total deposits

Ownership of deposit by segment							
	% share	% y/y			Incremental deposit		
					(Rs lakh cr)		
		FY22	FY23	FY24	FY22	FY23	FY24
Households	61.1	7.5%	9.0%	12.0%	7.6	9.7	14.1
Corporates	23.5	18.1%	13.8%	16.3%	5.9	5.3	7.1
Government	9.3	15.4%	10.4%	17.5%	2.1	1.6	3.0
Rest of world (NRIs)	6.1	2.0%	9.1%	13.5%	0.2	1.0	1.6
Total	100.0	10.0%	10.2%	13.5%	15.7	17.6	25.8

Fig.9: Credit and deposit – Divergence and Convergence

Identifying Period				Credit Growth			Deposit Growth		
Start Month	End Month	Number of Months	Average Growth Gap: Credit Deposit (bps)	Peak of Credit Growth during that period (y-o-y; per cent)	Credit Growth after 12 months after end month (y-o-y; per cent)	Change in Credit Growth (bps)	Deposit Growth in the month when credit growth peaked (y-o-y; per cent)	Deposit Growth after 12 months after end month (y-o-y; per cent)	Change in Deposit Growth (bps)
Apr-04	Jun-07	39	1071	36	26	-961	20	22	232
Apr-10	Oct-13	43	332	24	11	-1382	17	11	-555
Nov-17	Aug-19	22	432	15	6	-958	9	11	173
Apr-22	May-24	26	408	17			13		

Fig.10: Credit and Deposits wedge further exacerbated due to HDFC merger



Sources: RBI, CEIC, AMFI, MoSPI, UBI Research

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