Ecowrap

RS 14 LAKH CRORE BANK DEPOSITS OF SENIOR CITIZENS AND EXTERNAL BENCHMARKING

'Be the Bank of Choice for a Transforming India'

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With the introduction of external benchmark linked lending rates, the stage is now set for an instantaneous transmission of a change in repo rate to lending rates. Thus, if the repo rates changes by 25 bps in either direction, lending rates will change in exact equivalent amount in either direction. The spread over such external benchmark will only change once in every 3 years and this could impart a degree of stability in interest rate structure only if prices are stable and does not deviate significantly from RBI inflation mandate.

While such an external benchmarking is most welcome, some points deserves special mention. **First,** our estimate suggests that there are around 41 million senior citizens term deposits accounts in the country with total deposit of Rs 14 lakh crores / 7% of India's GDP. The average deposits size per account is around Rs 3.3 lakh and interest income from such deposits forms 5.5% of Private Final Consumption Expenditure in FY19. Given the declining interest rate scenario, this might go down and will impact PFCE also.

The Government has an excellent scheme for senior citizens. Under Senior Citizens Savings Scheme (SCSS), a senior citizen can deposit Rs 15 lakh and the current interest rate is 8.6%. However, the interest on such SCSS is fully taxable **The Mar'18 outstanding under SCSS was Rs 38,662 crore**. **It will be fair if such amount is given full tax rebate as the revenue foregone by the Government could be only Rs 3092 crores, that will have the minimal 2 bps impact on Government fiscal deficit.**

Second, the RBI should also now mandate that the liability of the banks also move in tandem with lending rates. Possibly, the only solution is that the regulator strictly enforces that all incremental bulk deposits have to be repo linked or otherwise. Rough estimate indicates that a 100 bps decline in deposit rates (bulk and savings bank) translates into around 45-50 bps decline in lending rates. Interestingly, bank NIM in India are currently higher than only Japan!

Meanwhile, we expect RBI could still cut rates in excess of 25 bps in the forthcoming monetary policy, but future rate cuts could be on hold given the recent Government measures . **We still believe that fiscal deficit estimates for Centre in current fiscal should be still close to 3.5%**. We are surprised that the market has missed out that only 58% of the Rs 1.45 lakh crores fiscal bonanza will be revenue loss for the Centre / Rs 84,100 crores. Even this estimate could be on the higher side, given that nominal GDP numbers for FY20 could still be much lower than 12%. Our revised fiscal deficit estimate shows that Government will be largely able to recoup Rs 1.95 lakh crores of receipts shortfall through Rs 1.53 lakh crore expenditure adjustment, subsidy rollover and extra dividends. The states however, could face pressures given GST challenges and will continue to cut capital expenditures that will be growth negative !

We strongly believe that deficit targets in India are not in consonance with growth projections. Additionally, fiscal policy rules have been continuously set as an apriori condition in the last few years for subsequent monetary policy actions. We must remember, policies work in tandem, not as substitutes!

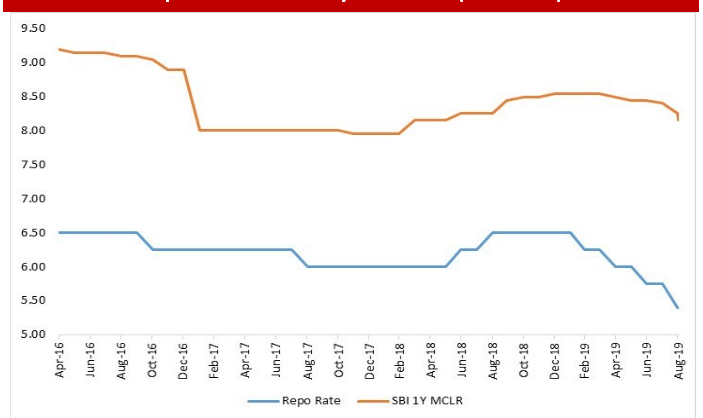
EXTERNAL BENCHMARK BASED LENDING BY BANKS VS TRANSMISSION OF POLICY REPO RATE

- On 04 Sep'19, RBI made it mandatory for all the banks to link all new floating rate retail loans and of Micro and Small Enterprises to an external benchmark effective from 01 Oct'19. Bank need to choose their external benchmark, out of the following: GoI 3-months/6-months T-bill yield published by FBIL and RBI Repo Rate.
- As repo rate is stable and does not change frequently, most of the banks are benchmarking their floating rate loans to the RBI policy repo rate. The new 'Effecting Rate would be as: {Repo Rate + (Negative Carry on CRR + Operating Cost)} + Credit Risk Premium. The new lending rate would start from 01 Oct'19 and would be reset on the 1st day of every calendar quarter.
- RBI has stipulated that 'Banks are free to decide the spread over the external benchmark'. However, credit risk premium may undergo change only when borrower's credit assessment undergoes a substantial change, as agreed upon in the loan contract. Further, other components of spread including operating cost could be altered once in 3-years.
- Earlier, the SBI had introduced floating rate home loans from July 1,2019. A few modifications have now been made effective Oct 1, 2019 to comply with the latest regulatory guidelines. With this new rate, the lending rate will move with the policy repo rate movement.

HOUSEHOLD LEVERAGE IS INCREASING

- In the last four years, India's household leverage (i.e. household debt as % of GDP) has increased from 9.0% (Mar'15) to 11.7% (Mar'19). Still India's household debt is lowest among the developed and developing economies (China 53%, Brazil 28% and Russia 17%) due to the culture of thrift (as against consumerism in West). One of the reasons for such increase in leverage is may be due to the declining interest rates.
- Against such a background, rate cuts might not work, unless it works in tandem with countercyclical policy measures.

Repo rate and SBI 1 year MCLR (% of GDP)



Source: SBI Research

India's Household Debt (% of GDP)

Source: SBI Research

TERM DEPOSITS WITH SENIOR CITIZENS

- Since data for size wise term deposits of senior citizens is not available, we estimated the number of senior citizens term deposits accounts and amount. Our estimate suggests that there are around 41 million senior citizens term deposits accounts in the country with total deposit of Rs 14 lakh crores. Out of such 41 million accounts, almost 38 million accounts are in the size of Rs 25,000 to Rs 15 lakh.
- The average deposits size per account is around Rs 3.3 lakh. Assuming 7% per annum interest rate, the interest amount comes out to be Rs 24,000 per annum (or Rs 2,000 per month only).
- In the backdrop of low level of social security in India and declining interest rate situation, this is a pertinent question that how we can protect the interest of such citizens.
- Government has an excellent scheme for senior citizens. Under Senior Citizens Savings Scheme (SCSS), a senior citizen can deposit Rs 15 lakh and the current interest rate is 8.6%. However, the interest on SCSS is fully taxable which is a major drawback of this scheme (the interest amount for Rs 1 lakh deposit for 5 years is around Rs 51,000 which is taxable). **The Mar'18 outstanding under SCSS was Rs 38,662 crore. It will be fair if such amount is given full tax rebate as the revenue foregone by the Government could be only Rs 3092 crores, that will have the minimal 2 bps impact on Government fiscal deficit.**

INTEREST ON SUCH DEPOSITS (% OF PFCE) ARE DECLINING

- The interest on deposits (as % of private final consumption expenditure) is exhibiting declining trend which is a serious concern. From 8.1% in FY13 the share has declined to merely 5.5% in FY19. Given the declining interest rate scenario, this will further go down and will impact PFCE also.

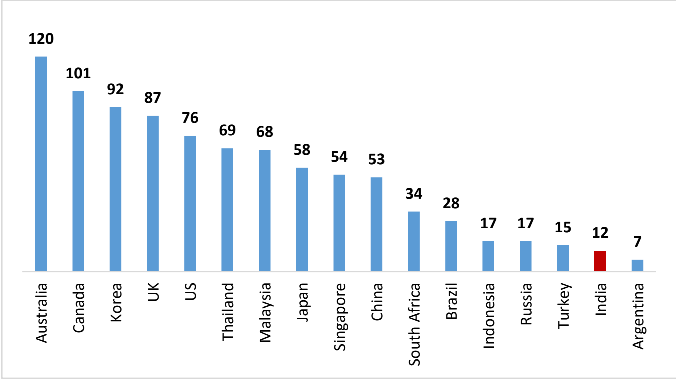
MONETARY TRANSMISSION: MANDATING BULK DEPOSITS TO BE FLOATING

- One of the reasons why transmission is not happening is that any bank which would take the lead, of deposits being market determined, would probably lose meaningful quantum of business as bulk customers would have better bargaining power or would easily switch bank. However, retail customers can't really negotiate terms - and so it is easy to implement and let them forego. Hence, banks cannot separately link retail savings only to be linked to repo on liability side of balance sheet of bank.
- **Possibly, the only solution is that the regulator strictly enforces that all incremental bulk deposits have to be repo linked.** This could protect interest of retail savers and also help system achieve quicker transmission. We believe banks would be comfortable if bulk deposits are floating rate and be more willing to pass on as well by having repo linked loans (as their spreads get locked with more stability in NIMs). **Since no bank can do it alone and sail through, it needs to be an RBI decision for implementation to happen.**
- **Rough estimate indicates that a 100 bps decline in deposit rates translates into around 45-50 bps decline in lending rates.**

CORPORATE TAX

- Fiscal policy in India has often been painted as the mother of all villains (populist dole outs like loan waivers has not helped either) and the obsession of the markets with a 3% deficit has kept the debt market in India enamored to unrealistic, unjustified and irrational exuberance! This has not been helped by setting deficit targets that are not in consonance with growth projections and also making fiscal policy rules an apriori condition for monetary policy! We must remember, policies work in tandem, not as substitutes!

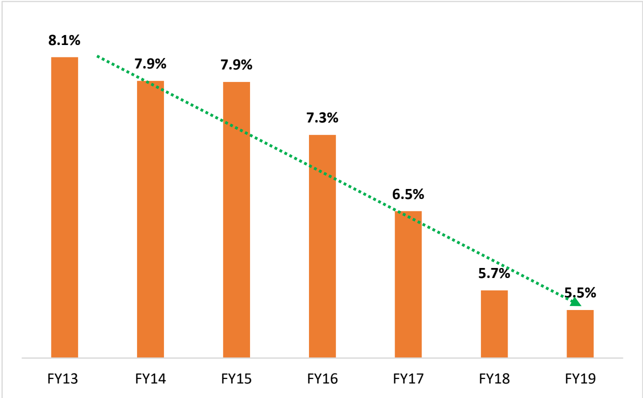
Household Leverage Ratio (% of GDP)



Source: SBI Research

Estimated Term Deposits with Senior Citizens			
Size of Term Deposits	Number of Accounts (in Million)	Amount (in Rs Billion)	Average Amount per Account (in Rs)
Less than 25,000	2	34	18916
25,000 to 1 Lakh	10	638	62088
1 Lakh to 15 Lakh	28	9153	3.3 lakhs
15 Lakh to 1 Crore	1	3495	29.5 lakhs
1 Crore and above	0.03	405	154.20 lakhs
Total	**41**	**13724**	**334243**

Interest on Deposits (% of PFCE)



Source: SBI Research

Fiscal Arithmetic (Rs Crore)	
1. Revenue Shortfall	1,10,000
2. Revenue foregone from today's measures	85,000
3. RBI Surplus (over BE) + Economic Surplus	58,000
4. Revenue Surplus from PM-KISAN & Others	35,000
5. Expenditure rationalisation (pro-rata Expenditure Adjustment and Subsidy Postponement)	50,000
6. Extra Dividend from PSEs	10,000
7. Total Shortfall (1+2)	1,95,000
8. Total Surplus (3+4+5+6)	1,53,000
9. Impact on Fiscal Deficit (7-8)	42,000 (0.20% of GDP)

Source: SBI Research; FY20 nominal GDP growth projected at 9% (i.e. Rs 207 lakh crore) against 12.0% assumed in Budget

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