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Rise in income, not interest rates, key to deposit growth: RBI research

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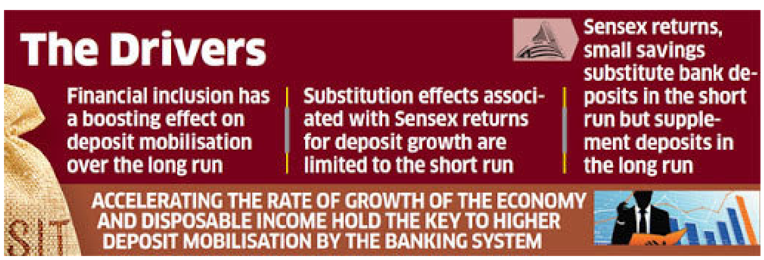
What's causing deposit growth rates to slow? Mutual funds? Gold? Property? None of these, says a central bank research paper. Rather, deposits quicken when incomes rise fast — and the latter is often aided by a robust economy.

Household savings data show that there is a shift from bank deposits to stocks & mutual fund schemes, where comparative returns have been more lucrative in the recent past.

That apparent shift prompted Reserve Bank of India (RBI) researchers to study the dynamics of savings deposit behaviour in the country.

The study says that income is the most important determinant of deposit growth, both in the short and long runs. Moreover, the correlation between interest rates and deposit mobilisation seems rather weak. "Empirical evidence underscores (that) income (is) its most important determinant," the study said. Economists and market experts have been debating the slowdown in bank deposit growth, especially because of revival in credit demand.



Outstanding bank deposits at Rs 125 lakh crore, as on March 31, 2019, accounted for 128.7% of outstanding bank credit (lower than 132.5% per a year ago), reflecting low deposit growth. The widening gap between credit and deposit growth is also triggering concerns of a structural liquidity gap in the system. Interestingly, the study finds that financial inclusion boosts deposit mobilisation over the long run, suggesting expansion of bank branches in unbanked areas.

Also, substitution effects associated with Sensex returns for deposit growth are limited to the short run, warranting a careful appraisal of regulatory reforms and tax arbitrage.

The study also finds that like Sensex returns, small savings substitute bank deposits in the short run but supplement deposits in the long run.

So, the study seems to suggest that limits on income tax exemption eventually even out substitution effects and allow income to be the key determinant of both in the long run. Hence, accelerating the rate of growth in the economy and disposable income is crucial to higher deposit mobilisation in the banking system.