Why SBI cutting rate on savings deposit is bad news

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Other banks could also follow suit and cut their savings deposit rate. Depositors may be stuck with lower rates for long

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Depositors who have been feeling the heat of the recent steep cuts in deposit rates can find themselves in a stickier spot. In a bid to cushion its margins from the blow of adopting an external benchmark — repo rate — to price its floating-rate MSME, housing and retail loans, SBI has trimmed the interest rate on its savings deposits (of up to ₹1 lakh) to 3.25 per cent from 3.5 per cent, effective November 1, 2019.

Also read: SBI cuts rate on Savings Bank deposits below Rs 1 lakh to 3.25 per cent

With the country's leading bank making the first move on savings deposit rate, others are likely to follow suit, which will pinch depositors more in the near term.

Why the move

Banks that have been reducing lending rates this year have been facing pressure on their spreads (yield on advances, less cost of funds). While the weighted average lending rate on fresh loans has fallen by 29 basis points, weighted average deposit rates have fallen by a lower 4 basis points. Some banks have cut deposit rates steeply in certain buckets to safeguard their spreads or margins. But, overall, most banks have been facing margin pressure.

The pressure will only get accentuated in the coming months, with the RBI's mandate to banks to link their new floating-rate personal, retail and MSMEs loans to an external benchmark, effective October 1. Since loans get re-priced faster than deposits, banks' margins would come under further pressure.

In a bid to ease the pain, SBI has cut its savings deposit rate and also slashed the interest rates of its retail term deposits and bulk term deposits by 10 bps and 30 bps, respectively, in the one- to two-year tenure effective October 10. While all banks have been cutting rates on their fixed/term deposits — more aggressively over the past two months — SBI's move to tinker with savings deposit rate is an added burden for depositors.

Others to follow

Banks have almost always moved in tandem on savings deposit rates. The interest on savings accounts was deregulated from October 2011. But only a few banks — YES Bank, Kotak Bank, IndusInd Bank and Lakshmi Vilas Bank — chose to offer higher rates (5-7 per cent) to their depositors. Other banks, including SBI, offered a uniform 4 per cent for a very long time, even in rising-rate cycles.

Two years ago, SBI was the first bank to cut savings deposit rate by 50 basis points to 3.5 per cent. Other banks were quick to follow suit, and there was a spate of similar cuts across banks. Most banks currently offer 3.5 per cent for their low-value savings deposit (for deposits of up to ₹25-50 lakh).

SBI's move to trim rates on its low-value savings deposits to 3.25 per cent is likely to trigger another spate of cuts across banks, given the imminent pressure on their margins owing to repo-linked loans. For large banks such as SBI, savings deposits form 25-35 per cent of their deposits. Reducing rates on such deposits can help cushion the blow from faster revision (cut) of lending rates.

Stuck with low rates

Hence, depositors across the board could feel the pinch as banks trim their savings deposit rates. But the bigger issue is that once banks cut rates on savings deposits, they may not hike them again, even in a rising-rate scenario, going by past trends. Hence, depositors may be stuck with these lower rates for a long while.

When two years ago, SBI cut savings deposit rate, it did so to reduce the pressure on its margins, owing to the then steep reduction in lending rates and the benefits of surplus inflows ebbing after demonetisation. But in 2018, when banks started to increase fixed-deposit rates aggressively, none of them raised their savings deposit rate. This is because, with savings deposits forming over a fourth of many banks' total deposits, a 50 bps hike could eat into their margins — possibly a 15-20 bps impact. The rate of low-value savings deposit rate remained stock-still at 3.5 per cent.

This time around, too, if most banks reduce savings deposit rates further to 3.25 per cent, in line with SBI's move, depositors may get stuck with this lower rate for a long period of time.

Some relief

Effective May this year, SBI set the interest rate on its savings bank deposits for balances above ₹1 lakh at 2.75 per cent below the repo rate. At the current repo rate of 5.15 per cent, this would have meant a meagre 2.4 per cent on such savings deposits. But in a bid to ease the pain for depositors (and possible flight of deposits), in August, SBI decided to retain a minimum 3 per cent rate on such deposits (capping the downside).

While this has been a relief to depositors in a falling-rate cycle, it has led to uncertainty on what may happen in a rising-rate scenario. Since such savings deposits are linked to the repo rate, depositors can gain when the RBI starts to hike the repo rate. Will SBI cap the upside, too, for depositors, when the repo rate increases sharply?

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