Sudden rise in deposits due to higher govt borrowing: Ind-Ra report

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No surge in savings, the report points out; adds asymmetric accretion of deposits creating challenges for smaller banks.

During January to May 2020, aggregate deposits in the banking system grew by Rs 7.05 lakh crore.

The sudden surge in bank deposits is due to a rise in overall borrowings of both the central and state governments, rather than increased savings, India Ratings and Research said in a report on Thursday.

While deposit growth at banks has been strong, there has been a concentration of deposits in favour of large banks and away from new-age private banks, regional banks and small finance banks (SFBs), the report added.

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"As against the common myth, Ind-Ra believes that this growth in deposits has not been on account of a surge in savings. Not only the lockdown has caused a significant decline in the overall purchases, it has also eroded the income and wealth of producers and sellers; therefore, there is almost not much impact on aggregate savings," the report said.

Moreover, even in the normal course, spending happens through the transfer of money between various modes in the banking system, without affecting aggregate deposits (barring a portion of sustained cash-based transactions).Therefore, spending in an economy (other than imports and cash transactions) has almost zero-sum impact on its aggregate banking deposit, India Ratings said.

Instead, the deposit surge could have been led by a process known as endogenous money creation, where incremental credit creates fresh deposits in the banking system, according to the ratings firm.

"During January to May 2020, incremental credit in banking system remained tepid, but the centre and various states borrowed significantly. It was also observed that the support from the RBI to the central and state governments has increased substantially through ways and means advances to address short-term funding gap for the respective governments, along with open market operations to ensure the system liquidity is at ease," the report said.

While deposit accretion has been strong, a shift in the profile of the banks accruing them has been noticed, with depositors focusing on quality and safety to differentiate between banks. “AAA rated banks in Ind-Ra’s coverage have witnessed an increase in the deposit accretion rate, both on q-o-q and y-o-y bases in Q4FY20, whereas new-age private banks, regional banks and small finance banks (SFBs) have mostly slowed down. This has created a divide in the banking segment deposit rates,” the rating agency said.

Though almost all banks have reduced their deposits rates, the slide is much sharper in the public sector and large private sector banks, creating a wider spread between the top banks and others. The deposit rate differential is also reflected in the large spread in the marginal cost of funds-based lending rates (MCLRs) of these banks and this should help in acquiring better credits while protecting their margins once credit demand picks up, India Ratings said. “Lesser flexibility in terms of attracting deposits at lower rates implies that small and low rated banks will either face the challenge of sacrificing margins to compete with large banks or have to on-board low rated customers which will increase their risk profile,” the report added.

During January to May 2020, aggregate deposits in the banking system grew by Rs 7.05 lakh crore, compared with Rs 4.65 lakh crore during the same period last year. Credit grew by only Rs 2.2 lakh crore during January to May 2020 against Rs 2.84 lakh crore during January to May 2019.