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Opinion | Are negative interest rates on the horizon?

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The interest rate on PPF has been hiked to 8% while Senior Citizen Savings Scheme will fetch 8.7%. Photo: Mint

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Negative interest rates could have an adverse effect of depositors not being ready and willing to deposit their money with financial institutions

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The pandemic has brought in its wake [illegible]m of lowered consumption levels and deepened cash conservation. It has resulted in an increasing trend in unemployment levels, massive job layoffs and demand disruption. The virus had brought economies to a halt abruptly in its trajectory of economic growth leading to a contractionary performance in Q1 FY21 for all countries worldwide. With the Unlock, the Indian economy did initially witness signs of green shoots but localised lockdowns proved to be the dampener. The grim picture being painted on the wall has ensured that people are refraining from discretionary spending and indulging only in purchase of essentials. The foremost thought in the minds of one and all is to engage in the precautionary motive of money and conserve cash.

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To provide a relief from the onslaught of the pandemic, the central government and RBI did announce a slew of fiscal and monetary measures. The continuous effort on the part of the regulatory authorities has been to strike a balance between financial stability, preserve the financial and economic value of businesses and protect depositors simultaneously. However, a micro level investigation of bank deposit and credit growth numbers show that the difference between deposit and credit growth numbers for India has widened even more during the pandemic. Even with RBI infusing ample liquidity in the financial system of the economy through its monetary policy stimulus, bank credit growth which on March 27, was at 6.3% saw a declining trend to 5.4% as on September 11. On the other hand, deposit growth numbers y-o-y have shown a steady upswing. Growth in time deposits has seen an increasing trend from 8.2% y-o-y as on March 27 to 11.4% y-o-y as on September 11.

Taking into account, fixed deposit interest rate in India and inflation numbers, even with real interest rates close to zero are depositors in these unprecedented times more keen to focus on the precautionary motive of money? With SBI interest rates ranging from 3.30% - 6.50% for 7 days to 10-year period and CPI inflation well above the 4-6% bracket at 6.69% in August, real interest rates are close to zero and bordering around the negative territory. The relevant point being that positive interest rates are generally the enabler for depositors to gravitate towards banks and engage in higher savings. However, the virus has resulted in a paradoxical situation of depositors saving more money even in the face of negative real interest rates.

Additionally, one must be conscious of the point that as on September 11, the credit deposit ratio of banks in India has fallen to a low of 71.8% from 76.4% as on March 27. Is this indicative of the fact that corporates are flush with funds and have adequate surplus liquidity available with them and thus do not need to rely for their borrowings on the banking system? Or, are they misusing the facility of loan moratorium extended by RBI as a stimulus measure from April-August?

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Banking stalwarts such as the then SBI chairman Rajnish Kumar and HDFC chairman Deepak Parekh in the end July had opined that the RBI should not extend the loan moratorium beyond August. This could be attributed to the fact that even corporate units with comfortable loan servicing capacity were perhaps avoiding fresh loan demands now that moratorium facility could be availed. Alternatively, the declining trend in borrowings could also be an outcome of inter-corporate or inter-unit fund support which is a case for an in-depth study.

Rather, the subsequent monetary measure of one-time loan restructuring under the K V Kamath-led Committee report clearly identifies only 26 specific sectors based on financial ratios for resolution plan for borrowers under loan restructuringand does not recommend that banks be allowed for loan restructuring for all Corporates. It identifies sectors such as power, steel, real estate, cement, construction, travel and tourism, retail and wholesale trade, roads, textiles etc which have been hardest hit due to the pandemic for loan restructuring and does not recommend the measure for all sectors ie one size fits all. Thus, the question here is: Did undue misuse of loan

thereby seeing a declining trend, the important question in the minds of economists and analysts should be: Is India heading towards a realm of negative interest rates? Is India, an emerging economy moving in the direction of a borrower being paid with interest for borrowing money and depositors paying the bank a parking fee for safekeeping of their money?

The business of banking is to earn profits through acceptance of deposits at lower interest rates and thereafter lending the same money at a higher interest rate. They make money and earn margins on interest charged on corporate borrowings, mortgages, personal loans etc. Given a supportive monetary policy environment both deposit and credit disbursal play a crucial role in that direction. The global financial crisis of 2008 resulted in expansionary monetary policies and quantitative easing being espoused by central banks worldwide. This led to low and negative interest rates being adopted in advanced economies. The European Central Bank had implemented the unconventional negative interest rate policy ie banks were required to pay interest for depositing their surplus funds with it – an effort to penalise them and rather lend more to kickstart the economy. Is India too moving in a direction of savings and deposits losing value and borrowers being paid to take a loan?

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Negative interest rates could have an adverse effect of depositors not being ready and willing to deposit their money with financial institutions. Rather, many financial institutions worldwide are hesitant to charge for deposits and thus strategise for lowering of borrowing costs i.e. squeeze the margins or spread between what they pay for deposits and what they earn by lending money to borrowers. The downside of this could result in the policy backfiring and banks becoming less hesitant to lend. This

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Considering that India is an emerging economy and is capital scarce is this advisable? It is pertinent to bear in mind that financial institutions play a role in creating of credit, which in turn leads to increased production, higher employment levels and increased consumer spending thereby fuelling the economic growth.

Thus, in these unprecedented times, it is prudent that India be cautious. Different economies' dependence on its interest rate structure varies. In a scenario of negative interest rates, would India be in a position to attract foreign investments? Would negative interest rates not create an unstable financial environment? Banks could find it difficult to attract money for further lending. Depositors would be more keen to hold on to cash and start scouting for alternative safe non-bank deposits. While in India negative interest rate seem to be implausible, negative real interest rate is certainly not unthinkable and the RBI and policymakers need to sit up, take notice and plan accordingly.

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