Lower Savings Pose Structural Impediment To Aggressive Rate Cuts

Net financial savings (NFS) of Indian households increased to a four-year high at 7.7% of gross domestic product (GDP) in FY15. However, it was primarily driven by the collapse in financial liabilities rather than gross financial savings (GFS). The latter, in fact, fell to a 25-year low last year, which is attributed to a 25% decline in incremental deposits. Households, however, increased their exposure to risky assets in FY15. A look at leading indicators reveals that GFS fell further in FY16. Unless domestic savings pick up, investments are unlikely to witness a significant turnaround. As the former is affected by interest rates, lower savings, we believe, act as a structural impediment to aggressive rate cuts in the medium term. Accordingly, the repo rate is unlikely to fall below 6.5% by March 2017.

NFS increased in FY15...: According to the Reserve Bank of India (RBI) data, NFS of Indian households increased from 7.4% of GDP in FY14 to 7.7% last year. Although it is the highest level in the past four years, it remains way below the average of ~10% in the post-liberalisation period.

...but GFS fell to its lowest level in 25 years: The increase in NFS was primarily driven by the collapse in financial liabilities, as GFS fell to 9.8% of GDP, marking its lowest level in the past 25 years. A detailed look at GFS shows that households increased their exposure to risky assets (up 76% YoY) and long-term safe assets (up 25%), while their savings in deposits (on incremental basis) declined 25% in FY15. As risky assets account for only 4% of GFS, increased exposure to shares and debentures failed of offset the negative impact of deposits (which account for ~50%), as a result of which GFS fell last year.

Household savings likely to have fallen further in FY16: While NFS was up in FY15, the collapse in financial liabilities indicates lower physical savings, which forms a larger portion of total household savings. Consequently, the latter may have been lower in FY15. Not only this, a look at leading indicators reveals that GFS may have declined further in FY16.Incremental bank deposits are down ~22% YoY in the first five months of FY16, while currency holdings slipped by ~25%. Moreover, addition to assets under management of mutual funds was also down ~8% YoY in April-August 2015. Overall, households’ (gross) financial savings are most likely to have declined further this year.

Lower savings pose structural impediment to aggressive interest rate cuts: A fall in household savings, we believe, represents a structural constraint to domestic investments in India. As explained earlier, investments could either be financed by domestic savings or current account deficit (foreign borrowings). As the scope to increase the latter, over the medium term, is limited, the turnaround in the investment cycle has to be supported by higher domestic savings, which are closely related to interest rates. Whether or not the RBI will cut interest rates at its policy next week (we are against it), lower domestic savings will act as a structural impediment to aggressive rate cuts over the medium term. Accordingly, we maintain that repo rate is unlikely to fall below 6.5% by March 2017.

Exhibit 1: GFS fell to its 25-year low in FY15

Exhibit 2: Lower financial liabilities indicate reduced physical savings
Disclaimer

Stock Ratings Absolute Returns

BUY > 15%
ACCUMULATE -5% to 15%
SELL < -5%

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