**Key argument: Bank 1 year retail FD rate has been the biggest determinant of Indian equities decoupling from the rest of the World.**

India's “retail” bank deposit rate had been at a remarkably low level. This is perhaps the single most important factor that has led to decoupling of Indian market over the last few quarters. **Why this is likely to change?**  
1) Gap between India and US sovereign rates is at record low levels.  
2) Gap between SBI 1 year deposit rate and Indian Central Govt 1 year Gsec yield is at near all-time low.  
3) Gap between %yoy growth of Banks credit and deposit rate is at 8.3% as of Oct 7th 2022. This gap is very wide in historical context. CD ratio has widened as a result. **What's driving this Gap between banks' credit and deposit growth?**

A) Current account deficit (CAD). Rise in CAD often leads to higher CD ratio. When CAD is wide and BoP is negative then it means there is leakage of domestic savings. What is leading to higher CAD. It's a chicken and egg situation. Benign domestic liquidity and tough global liquidity environment means domestic demand is strong and global demand is weak. From agent/entity perspective its the households who are to be blamed this time. Within K shaped, households savings had sharply gone up as upper income/organized HH were saving and households liabilities accretion was very low. So in FY21, it went upto 11% of the GDP. By FY23, this would have likely fallen to 7 to 7.5% of the GDP which will be multi year low level. Already by end FY22 it was 8% and its fair to assume some more deterioration in net financial savings. We will revisit this factor again later,  
B) Substitution in favour of bank credit. It's cheaper to borrow in domestic market versus global market. Therefore some substitution of foreign loans is already underway. These are refinancing loans so they are creating assets to the banking system without leafing to higher deposits. Local substitution is happening but from CD ratio perspective its neutral.  
C) Inventory restocking with rising inflation could be partly leading to credit to deposit gap.  
D) other factors may include some comeback of parallel economy, real estate, etc.  
  
**Why deposit accretion may remain challenging?**Income: biggest driver of households savings and deposit accretion is income. Income growth has been good but it will slow as both nominal and real GDP to slow in coming quarters. Net exports to be a drag and rising interest rates will have some deflationary impact with a lag.  
Inflation will be less of a worry.  
Rates will rise but real rates will decline.  
Rate hike will help but since it will be happening in falling growth it will become challenging for deposits unless rate hikes are adequate. Households’ savings investments gap to my mind will be difficult to reverse easily.  
  
What does history tell us about extent of rate hike?  
Last episode was in 2011. We saw meaningful interest rate jump then in next 6 and 12 months.  
  
Isn't it normal for rate hikes to happen in a strong and rising economy?  
Yes, it's a sign of strength but only when overall savings rate is healthy and growth is rising.  
  
Also it's a global reset of cost of capital. If deposit rate hikes take time then CAD may not sufficiently narrow and that would keep INR under pressure. In the past whenever INR had depreciated against $ by 10% we saw some sharp reset in domestic interest rates.  
  
**Why it has taken so long for rates to rise?**Starting point of liquidity matters. Periods like demon and covid led to sharp domestic liquidity accretion. Starting point of CD ratio, liquidity surplus, financial slack matters a lot. For eg in FY05, India had sizeable current account surplus in past year, CD ratio was in mid 50s. So some differences versus that period as well.  
  
Rate normalisation is a process and not an event so no fireworks here but after rising if rates remains sticky then this would have these implications.  
  
Marginal propensity to consume to reduce. *This is straightforward.*  
Marginal propensity to invest on bank FDs. *That straightforward too.*But from market perspective, it's the reduced marginal propensity to put money in stocks which is what is **most important for the change in decoupling argument.**Consider this data. Households financial savings going into equity MFs sharply went up a) versus India’s free float market cap and, b) as % of incremental bank deposits (which includes households and non-households deposits). This is just savings flows into equity MFs. If we know that direct participation and alternatives like PMS, AIF have also gone up then HH flows to equity to incremental bank deposit ratio reached record levels.  
  
Rate nomination therefore will certainly have impact on domestic flows. To what extent is anyone's guess but this would be enough to weaken decoupling argument to my mind. Other way if saying is that global financial conditions. This will matter more from overall market perspective and our market will be part of global risk on/risk off again as retail FD rate reset happens before FY23 end.

Here are some of the charts and tables supporting this whole argument. Simples straightforward.

1. **Credit Deposit Growth Gap and FD Interest rates**

* We take SBI 1-Year FD rates as the representative interest rate for households.
* Credit Growth (YoY%)- Deposit Growth (YoY%) is the credit deposit gap, henceforth referred to as the ‘Gap’. Data taken from 2000 onwards.
* As of 7th Oct 2022, this gap was 8.3%. This is a very large gap from historical perspective.



**2) India 10 (2) Year Yield - US 10 (2) Year Yield**

**3) SBI 1Y FD minus India 2Y Gsec yield (Negative gap is near record with exception of select taper tantrum weeks in 2013)**

**4) India Savings Investment Gap (As % of GDP). Households S-I gap has declined sharply, leading to CAD widening.**

**5)12 Month Rolling MF Flows and Nominal and Real Interest Rates**

**6 Record (adjusting for demonetisation related anomaly in monetary data in FY17) high local flows in equities versus what’s going into bank deposits**