Small savings schemes: Interest cut by govt doesn't signal decline of rates in economy

The reduction of 20 basis points on small savings returns may not have much impact on the overall interest rates in the economy as inflation is inching up, according to experts.

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Written by Sunny Verma | New Delhi | Updated: December 29, 2017 6:39 am

The government has announced rate cut for all schemes except for savings deposit (4 per cent) and for 5-year senior citizen savings scheme that earns an interest of 8.3 per cent to the investor.

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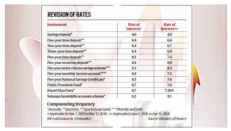
Already concerned about low interest earning on their investments in small savings schemes, debt investor sentiment was further dented on Wednesday as the government announced a 20-basis point cut in the interest rate offered on majority of those schemes. The reduction in rates on small savings schemes that have continued over the past 20 months is in line with the two percentage point cut in repo rate by the Reserve Bank of India over the past three years, and subsequent cut in deposit and lending rates by banks have resulted into a 110-basis point drop in earnings in Public Provident Funds (PPFs) and 180-basis point cut in 1-year time deposits. Experts, however, say that the latest move should not be taken as an indication of a broader reduction in interest rate in the economy as inflation has been on a rise and there has been a rise in global oil price and other commodities.

As a result of the 20-basis point cut, while the interest offering on PPF and National Savings Certificate (NSC) will come down to 7.6 per cent, that on a 5-year and 1-year time deposit will come down to 7.4 per cent and 6.6 per cent, respectively, experts say that a 7.6 per cent return on PPF is a good rate as it is tax-free and pre-tax return for someone in the highest tax bracket comes to 10.86 per cent.

"It's only 20-basis point reduction and I don't think it will have much impact on the overall interest rates in the economy, in terms of bringing them down. The reduction in market interest rates is unlikely now since inflation is inching up. But in terms of signalling, it's a good move in the sense that the administered rates are also being aligned with the market rates," said D K Joshi, chief economist at rating agency Crisil.

The government has announced rate cut for all schemes except for savings deposit (4 per cent) and for 5-year senior citizen savings scheme that earns an interest of 8.3 per cent to the investor. The interest rate on the senior citizens' scheme is paid quarterly. The girl child savings scheme Sukanya Samriddhi Account will offer 8.1 per cent from the existing 8.3 per cent annually, while the five-year recurring deposit is pegged at 6.9 per cent.



REVISION OF RATES

Instrument	Rate w.e. September	Rate w.e. December
Savings deposit*	4.0	4.0
One year time deposit**	6.8	6.6
Two year time deposit**	6.9	6.9
Three year time deposit**	6.9	6.9
Five year time deposit**	7.5	7.4
Five year recurring deposit**	6.4	6.9
Five year senior citizens savings scheme***	8.3	8.3
Five year monthly income account**	6.6	6.6
Five year National Savings Certificate*	7.6	7.6
Public Provident Fund*	7.6	7.6
Kisan Vikas Patra*	7.7	7.694
Sukanya Samriddhi account deposit*	8.3	8.1

Compiled by Sunny Verma
Note: *Quarterly, **Yearly, ***Quarterly payment, ****Monthly and Cumulative
w.e. = applicable for the period 1 July - 30 September 2017, w.e. = applicable for the period 1 October - 31 December 2017
All instruments, 7 instruments
Source: Ministry of Finance

Among the instruments, the PPF will still be attractive for investors in the highest tax bracket. After the reduction in rates of the small saving instruments, the other government scheme could be going for dumps in the sovereign bonds, which are quoting at 6-6.5 per cent in the secondary market – an attractive tax-free yield. The Pradhan Mantri Vaya Vandana Yojana also offers an attractive scheme for senior citizens. So rates in senior citizen savings have been maintained. For other schemes, interest rates have come down. So, investors will have to close between whether they want to move in favour of small savings schemes or debt mutual funds/bank deposits, which offer better liquidity compared to the former – said Vishal Dhawan, founder and chief financial planner at Plan Ahead Wealth Advisors.

According to a finance ministry notification, rates have been reduced across the board for schemes such as NSC, Sukanya Samriddhi Account, Kisan Vikas Patra (KVP) and Public Provident Fund (PPF). The government has been recalibrating the interest rates on all small savings schemes since April 2016 when it announced a sharp cut in interest rates.

While the government had slashed the interest rate payable on 1-year time deposit from 8.4 per cent for the quarter ended March 2016 to 7.1 per cent for the April-to-June quarter, it also cut the interest rate on PPF scheme to 8.1 per cent for the April-to-June 2016 period, from 8.7 per cent for 2015-16. With the latest decision to cut rates, the interest offering on PPF has been slashed by an aggregate of 110 basis points from 8.7 per cent in 2015-16 to 7.6 per cent for the forthcoming January-to-March quarter.

While announcing the quarterly setting of interest rates, the ministry had stated that rates of small savings schemes would be linked to government bond yields. The move could push banks to lower their deposit rates in line with the small savings rate offered by the government. The interest rate on 1-year time deposit has been rationalised by 180 bps in the same period. The interest offering for KVP has come down from 8.7 per cent in March 2016 to 7.3 per cent, down 140 bps and will now mature in 118 months.

At the macro level, the reduction in rates is not expected to improve government finances since the quantum of the rate cut is small, Joshi said. The government finances are under strain with the GST collections falling in the past two months and the finance ministry on Wednesday announcing plans to borrow an extra Rs 50,000 crore in terms of dated securities. Though the government said that its net borrowings will remain the same because of trimming down of Treasury Bills, the increase in issuance of dated securities raises concerns of the Centre breaching the fiscal deficit target of 3.2 per cent of the gross domestic product (GDP) by March-end 2018.

Rating agency ICRA's principal economist Aditi Nayar said that the risk of a fiscal slippage is mainly from the growing likelihood that tax revenues, dividends and inflows from other communication services would undershoot the budgeted level. The GST collections slipped to their lowest levels in November to Rs 80,808 crore, down from Rs 83,346 crore in October and Rs 95,131 crore in September.

Government bond prices slumped and yield on 10-year benchmark security closed higher by as much as 17 bps to 7.39, its highest level since early July 2016. Yields on the benchmark bonds have surged nearly 100 bps since July and analysts expect it to go up further if the government is unable to stick to its fiscal deficit target. India's fiscal deficit for the April-October period has already reached 96.1 per cent of the target for the year to March. The recent rise in international crude oil prices only adds to concerns relating to fiscal deficit.

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