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Investment options you can look at beyond fixed deposits when rates are low

By Dipak Mondal

A five-year fixed deposit (FD) started in April 2016 would have fetched you 7% interest, but now if you want to reinvest the same amount in an FD, the bank would offer you a meagre 5.4% interest.

The gradual fall in FD rates has caused a lot of distress to depositors, especially senior citizens who park a large sum of their retirement corpus in 'safer' FDs to earn monthly income.

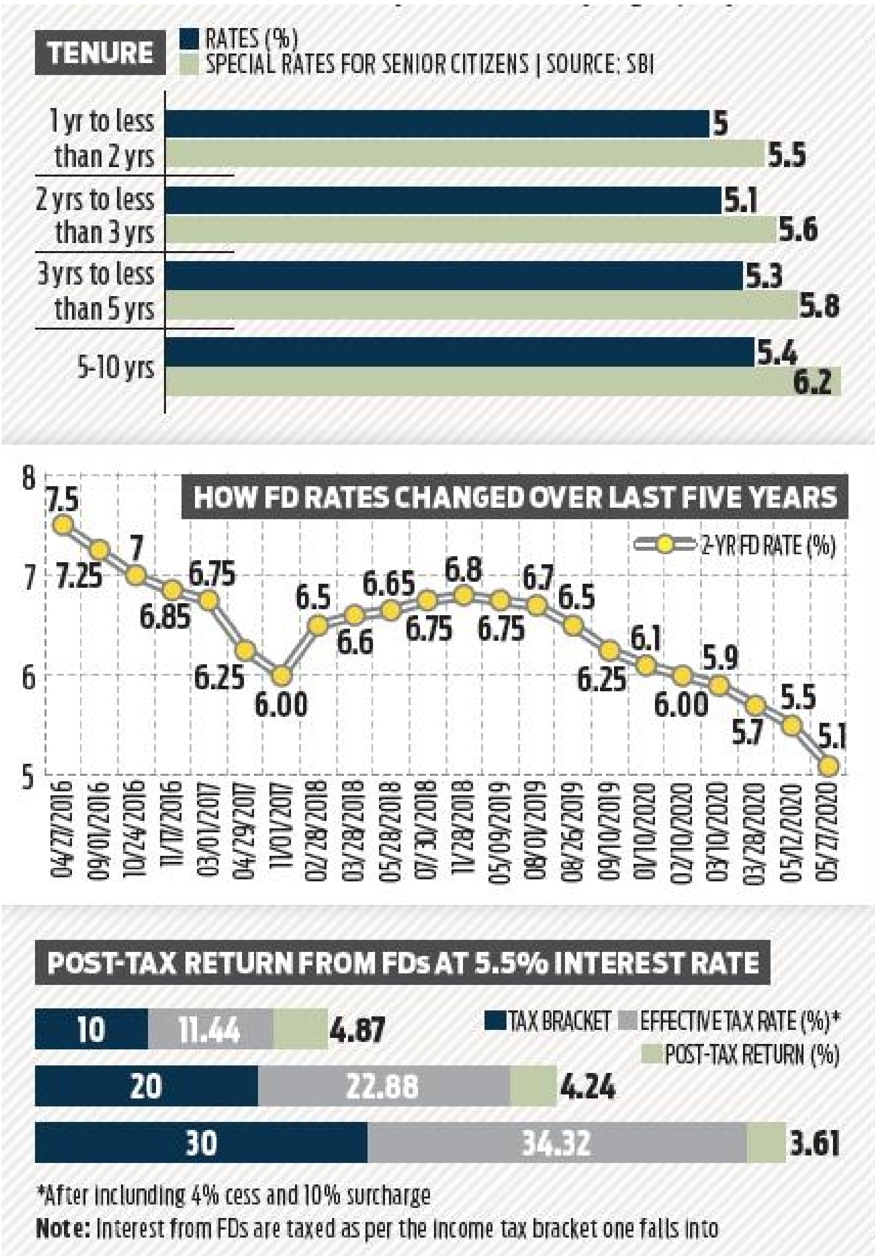
The Reserve Bank of India (RBI) has been lowering interest rates in order to boost growth.

While it has helped borrowers, the relief has come at the cost of depositors.

In the last three years, the RBI has cut the repo rates (the rate at which banks borrow from RBI) by 225 basis points to 4% now, resulting in both lending and deposit rates to fall sharply during this period.

With the economy in the woods and a likely moderate inflation in 2021-22 most debt and money market experts believe that interest rate cycle is unlikely to change soon, and deposit rates would remain in these levels.

Worringly, interest rates from small savings schemes, which continue to offer better returns than FDs, may also fall going forward



Looking for alternatives

What should risk-averse investors, who typically park their money in bank FDs or small savings schemes do to earn better returns without taking undue risks?

The trouble is that the returns from the whole fixed income category have come down sharply, thanks to falling interest rates as well as yields on government bonds, which act as benchmarks for deciding interest rates on small savings schemes like Public Provident Funds (PPF), National Savings Schemes (NSC), etc.

As things are today, it is unlikely that either the interest rates or the bond yields would rise anytime soon.

However, there are still scopes for some manoeuvre for depositors.

Without getting out of their comfort zone as far as their risk-taking ability is concerned, one can shift some of his/her corpus out of FDs to some small savings schemes as per their investment goal.

Small savings schemes are still offering better returns compared to bank FDs.

A five-year deposit under the small savings schemes is offering 6.7% compared to 5.4% offered by banks like SBI.

A monthly Income Scheme (MIS) under small savings schemes offers 6.6%.

Schemes like NSC and Senior Citizen Savings Schemes —both of which have a tenure of five years — are offering 6.8% and 7.4%, respectively.

For senior citizens looking for a regular income, Pradhan Matri Vaya Vandan Yojna (PMVVY) is a good option, says Shalini Dhawan, financial planner and co-founder of Plan Ahead Wealth Advisors. PMVVY is a pension plan which offers 7.4% per annum, payable every month.

It has a 10-year lock-in period.

“While 10-year lock-in may dissuade some people, the fact that the scheme returns the principal amount to beneficiary in the case of the demise of the pensioner, it is a product worth evaluating,” says Shalini Dhawan.

Non-convertible debentures and corporate FDs also offer better interest rates than banks, but investors need to be careful not to get swayed by the higher rates offered by corporates that are rated low by rating agencies.

SMALL SAVINGS SCHEMES RATES FOR Q1 2021-22		
Savings Instruments	Maturity (years)	Interest Rate (%)
Savings deposit	NA	4%
1-yr term deposit	1	5.5
2-yr term deposit	2	5.5
3-yr term deposit	3	5.5
5-yr term deposit	5	6.7
Recurring deposit	5	5.8
Monthly Income Scheme (MIS)	5	6.6
Public Provident Fund (PPF)	15	7.1
Kisan Vikas Patra#	10.33	6.9
National Savings Scheme (NSC)	5	6.8
Senior Citizen Savings Scheme	5	7.4
Sukanya Samriddhi Account Scheme	21	7.6

#Current tenure is 124 months | Source: RBI

Debt funds

Debt funds are not risk-free as many would have us believe, but they are still an option between an FD and an equity.

As Mahendra Jajoo of Mirae Assets says, as long as investors understand the risks in debt funds, and they come forward not with the intention of only preserving their capital, there is money to be made in debt funds.

According to Sankaran Naren, CIO, ICICI Prudential AMC, debt has a major role to play in one’s asset allocation.

DEBT FUND PERFORMANCE	AVERAGE CATEGORY RETURNS (%)			
Category	1-yr	3-yr	5-yr	10-yr
Long duration funds	6.18	10.28	8.77	8.7
Medium duration	7.68	5.49	6.74	7.73
Short duration	6.85	6.69	6.58	7.79
Ultra short duration	3.91	5.57	5.93	7.66
Dynamic bond funds	5.68	8.02	7.33	8.42

"Investors can consider investing in low duration, dynamically-managed duration products or floating rate funds which tend to be relatively immune to interest rate movements," he says.

Dhawan further adds that investors with low-risk appetite can look for schemes which are hold-to-maturity or target date debt funds.

These schemes, she says, have lower volatility, considering that the bonds in these schemes will be bought and then held till maturity.

In the case of debt funds there are tax benefits, too.

While interest earned on FDs and small savings schemes such as SCSSs and NSC are taxed as per an individual's income tax slab, long-term capital gains (gains made after selling the units of such funds after holding them for three or more years) is taxed at an effective rate of 23.2% (20% tax+12% surcharge +4% cess).