RBI urges govt to cut rates on small savings schemes

FinMin To Review Returns On PPF, PO Deposits At Month-End

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New Delhi:

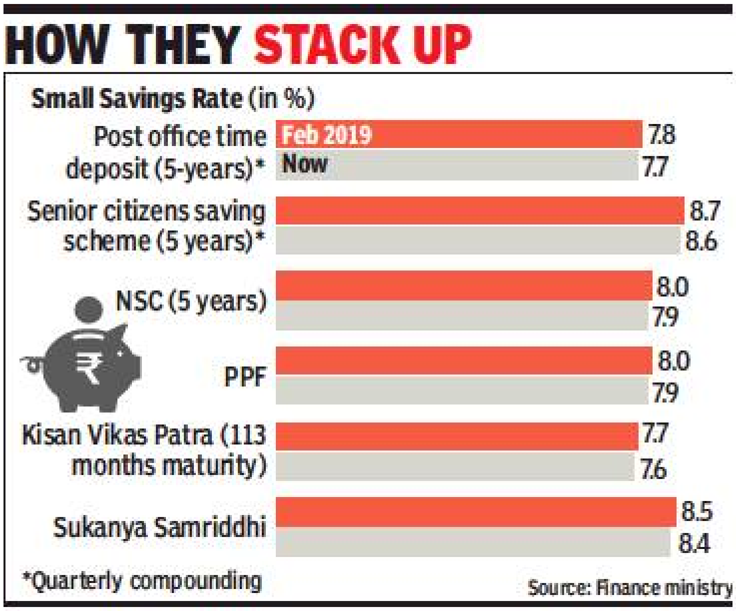
The RBI has urged the government to move forward on reducing interest rates on small savings schemes such as public provident fund (PPF) and post office deposits, to help banks pare rates on deposits and loans and lead to a better transmission of the central bank's rate cuts.

The central bank believes that a reduction in rates on the small savings schemes, which were left unchanged by the government when they were last reviewed at the end of September, will enable banks to cut deposit rates that have been sticky as banks do not want to lose out on deposits. Banks have argued that in absence of a sharp reduction in small savings rates, depositors will move funds from fixed deposits to these schemes, which offer higher returns, any many of them, such as public provident fund, come with tax benefits, making the real returns much higher.

Since February, the RBI has reduced policy rates by 135 basis points (100 basis points equal a percentage point) to lower the cost of funds for borrowers and increase demand for loans. But on an average, banks have reduced deposit rates and the one-year marginal cost of lending rate (MCLR), the benchmark for most loans, by around half-a-percentage point each, prompting the RBI to hold rates steady during the last review in the expectation that the earlier reduction will be passed on by banks. SBI has reduced interest rates on its two-three year fixed deposits by 55 basis points since February and now pays 6.25%.

The government has, however, reduced interest rates on most schemes by a meagre 10 basis points although the rates are linked to market rates. The issue has been raised several times in the past but the governments have been reluctant to move due to a fear of a public backlash.

For the finance ministry, which is under pressure due to weak economic activity, the decision has to be taken at the political level as those with bank deposits, especially senior citizens, are complaining of a fall in their income as they have parked a bulk of their savings in fixed deposits. Besides, higher rates will help the government mobilise more funds and reduce the need to go for additional market borrowings at a time when it is widely expected to miss the fiscal deficit target for the current financial year.


HOW THEY STACK UP
Small Savings Rate (in %)
Feb 2019
Now
Post office time deposit (5-years)*
7.8
7.7
Senior citizens saving scheme (5 years)*
8.7
8.6
NSC (5 years)
8.0
7.9
PPF
8.0
7.9
Kisan Vikas Patra (113 months maturity)
7.7
7.6
Sukanya Samriddhi
8.5
8.4
*Quarterly compounding
Source: Finance ministry