Finance Ministry to review small savings schemes; banks complain of high interest rates

With the government looking to spur demand and boost growth, the finance ministry is planning a review of its small savings schemes later this month, a finance ministry official told ET. Banks have long complained to the government that interest rates on these schemes are too high and need to be lowered to bring about a reduction in the cost of borrowing that will in turn spark credit expansion.

Experts pointed out that the government will need to proceed with caution as stakeholders are bound to protest forcefully at any such move. The government is facing difficulty in taking its reform agenda forward because of political opposition.

The finance ministry official said all options will be considered at the review meeting.

Interest rates on small savings schemes are benchmarked to the yield on government bonds and revised annually. The plans offer depositors interest rates as high as 9.3% while banks give 7.5-8% on a five-year fixed deposit of less than Rs 1 crore.

In their competition for funds, banks are unable to lower rates significantly below those offered by small savings, and this prevents them from pushing down lending costs.

The Indian Banks' Association (IBA) had raised the issue with the finance ministry and specifically pointed out that high interest rates offered under Sukanya Samriddhi Accounts and the Senior Citizens Savings Scheme eat into their deposits.

"If the government can bring down the interest rates, it will have a bigger impact than tweaking done by Reserve Bank in its policy rates, as that affects only 2-3% of the banks' resources," said the chairman of a state-run bank, adding that such a move can possibly bring down the base rate by at least 50-100 basis points. A basis point is 0.01 percentage point.

The base rate is the level below which a bank can't lend. In the past six months, the Reserve Bank of India (RBI) has cut its policy rate by a total of 0.75 percentage point at three times to 7.25% but banks have passed on less than half that reduction. The RBI is scheduled to make its next monetary policy announcement on August 4.

During the finance ministry's review of state-run banks in July, bankers had raised the issue again. Finance minister Arun Jaitley said the government had "heard them." Small savings schemes currently include Savings Deposits of one, two, three and five-year terms; Recurring Deposits; the Senior Citizens Savings Scheme; National Savings Certificates (five and 10 years); Public Provident Fund (PPF); Kisan Vikas Patra and the Sukanya Samriddhi Accounts.

The decision won't be easy as a reduction in rates will make the plans less attractive, which will impact the government's financial inclusion drive and could also increase the allure of gold.

Besides, the government has also budgeted Rs 22,408 crore from small savings to meet its budget deficit. Economists are of the view that interest rates on small savings schemes need to change to reflect the shifts in the economy as inflation slows.

"If the government manages to keep inflation low, investors will continue to get real returns on the money parked in these schemes, even if rates are lowered a bit," said DK Joshi, director and chief economist, Crisil.

ET view

It's good that the finance ministry is lending an ear to banks and doing its bit to lower rates. Lowering artificially induced small savings rates, fixed by the ministry every year, will reduce their attraction vis-a-vis bank deposits. Postal and small savings deposit rates are supposed to be benchmarked to the market rates on government securities. But they should be revised more frequently, say, every quarter. It will help banks which are sitting on a pile of debt due to stalled projects as they need extra provisioning for bad loans. Additional capital, which the government has promised, will also help.

(Economic Times)