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Small savings will continue to be attractive despite Coronavirus outbreak

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Sanjay Kumar Singh **March 23, 2020** Last Updated at 20:34 IST

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Interest rates on small savings schemes may be reduced from the April-June quarter. News reports suggest the government is contemplating this step to facilitate faster transmission of interest rates, thereby assisting an economy that is rapidly approaching stall speed in the wake of lockdowns triggered by the COVID-19 pandemic.

Experts are of the view that a cut in small savings rates has become inevitable. “Thirty-eight central banks have already cut rates, 11 of them twice. The Reserve Bank of India will also follow suit. We are likely to be in a low-rate regime for some time, so small savings rates are also bound to come down,” says Ankur Maheshwari, chief executive officer, Equirus Wealth Management.

While banks have been cutting fixed deposit (FD) rates, small savings rates have not been revised for some time, and that has created an abnormal differential between them.

Investors still have the opportunity to lock into the prevailing rates of several small savings schemes. “In case of Public Provident Fund (PPF) and Sukanya Samriddhi Yojana (SSY), the interest rate changes for existing investors as soon as a rate change is announced. In the other small savings instruments, it remains unchanged for the entire tenure,” says Deepesh Raghaw, founder, PersonalFinancePlan, a Securities and Exchange Board of India-registered investment advisor. Make use of the window of opportunity still available.

OPTIONS YOU MAY CONSIDER

Instrument	Rate of return (%)	Taxation
Senior Citizens Savings Scheme	8.6	Section 80 benefit, interest taxable
Sukanya Samriddhi Yojana	8.4	Section 80 benefit, tax-free at maturity
Public Provident Fund	7.9	Section 80 benefit, tax-free at maturity

*3-year category average

Source: indiapost.gov.in, mutualfundindia.com

Many small savings schemes will remain attractive, compared to other fixed-income instruments, even after a cut. “Instruments targeted at specific groups, like Senior Citizens Savings Scheme, meant to generate a regular income for retirees; SSY targeted at people with a girl child aged below 10; and PPF, which comes with a 15-year tenure and is meant for long-term savers, will remain attractive,” says Arnav Pandya, a Mumbai-based certified financial planner.

PPF and SSY can have a place in the debt portion of long-term portfolios. In the current environment of high uncertainty, small savings schemes will remain attractive due to their sovereign backing.

Once the rate cuts happen, compare the post-tax return on small saving schemes with other fixed-income instruments before making a choice. Pay heed to your liquidity needs as many instruments that offer high rates and attractive tax benefits come with a lock-in.

When interest rates are falling, investors in the higher tax brackets are generally advised to try out debt mutual funds. Currently, experts are still making this suggestion, but with caveats. “If the lockdown continues, many companies’ debt papers could be downgraded. In a worst-case scenario, there could be a wave of defaults. Debt funds have turned riskier than they were a couple of months ago,” says Pandya.

Interest rates may decline, but avoid taking duration risk also at this point as turns in the rate cycle are difficult to predict. “Currently, retail investors should have 80-85 per cent of their investment in debt funds with ‘AAA’ credit quality and duration below two and a half years,” says Maheshwari.

Avoid credit risk funds completely. Only investors with high risk tolerance should hold them, and in limited quantities.

The 7.75 per cent Government of India bond remains attractive. A sovereign-backed instrument, it is completely free of credit risk.

Tax-free bonds from REC and National Highways Authority of India (NHAi) available in the secondary markets are another option. “The yield-to-maturity on them is usually at least 100 basis points higher than the returns on bank FDs,” says Pandya.

Only savvy investors, or those with an investment advisor, should go for them. “REC or NHAI will have a number of bonds with different maturities. Liquidity tends to be low, yields tend to fluctuate, and there is a brokerage charge. Remember these points and buy only if you get a good deal,” says Raghaw.