



# Interest Rates on Small Saving Schemes

## Why in News

Government may reduce interest rates on small saving schemes for the July - September Quarter.

- A cut in small savings rates at this point **would further hurt households amid a surge in inflation**, according to economists.

## Key Points

### ▪ Background:

- Small savings rates **were slashed between 0.5% and 1.4%** on different instruments in **April 2020**, bringing the PPF (Public Provident Funds) rate to 7.1% from 7.9%.
- The government decided to further slash interest rates for the first quarter of 2021-22 (April-June), but withdrew its decision terming it an "oversight".

### ▪ Small Saving Schemes/Instruments:

#### ◦ About:

- They are the **major source of household savings in India and comprises 12 instruments**.
- The **depositors get an assured interest on their money**.
- Collections from all small savings instruments are credited to the [National Small Savings Fund \(NSSF\)](#).
- Small savings have **emerged as a key source of financing the government deficit**, especially after the **Covid-19 pandemic** led to a ballooning of the **government deficit**, necessitating higher need for borrowings.

#### ◦ Classification: Small savings instruments can be classified under three heads:

- **Postal Deposits** (comprising savings account, recurring deposits, time deposits of varying maturities and monthly income scheme).
- **Savings Certificates:** National Small Savings Certificate (NSC) and Kisan Vikas Patra (KVP).
- **Social Security Schemes:** [Sukanya Samriddhi Scheme](#), Public Provident Fund (PPF) and Senior Citizens' Savings Scheme (SCSS).

#### ◦ Determination of Rates:

- Interest rates on small savings schemes are **reset on a quarterly basis, in line with the movement in benchmark government bonds** of similar maturity. The rates are reviewed periodically by **the Ministry of Finance**.
  - For the last one year, yields on benchmark government bonds have ranged between 5.7% and 6.2%. This provides the government the leeway to cut rates on small savings schemes in future.
- The **Shyamala Gopinath panel (2010)** constituted on the Small Saving Scheme had **suggested a market-linked interest rate system** for small savings

schemes.

▪ **Advantage of the Rate Cut:**

- Since the central government uses the small savings fund to finance its deficit, the **lower rates would reduce the cost of deficit financing.**
- A cut in rates would mean that the **government wants people to spend and provide impetus to the economy.**

▪ **Disadvantage:**

- Rate cuts would hurt **investors**, particularly **senior citizens and the middle class.**
  - Moreover, household savings have been shrinking significantly for two quarters in a row even before the [second Covid-19 wave](#).
- This would **lead to further rationalisation of fixed deposit rates** by banks going forward, and would reduce returns further.
- A lower rate **would mean a negative real rate of return** on most debt instruments as **inflation is hovering around 5%.**

### Rate of Return and Inflation

- The **rate of return is the expected or desired amount of money a person receives from an investment** in a savings account, mutual fund or bond.
- The **real rate of return is the return on investment after adjusting for the rate of inflation.** It is calculated by subtracting the inflation rate from the return on investment.
- Inflation has the power to erode a person's annual rate of return. **When the annual inflation rate exceeds the rate of return, the consumer loses money** when they invest it because of the decline in purchasing power.
- **Inflation refers to the rise in the prices of most goods and services** of daily or common use, such as food, clothing, housing, recreation, transport, consumer staples, etc. It is **indicative of the decrease in the purchasing power of a unit of a country's currency.**

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