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Despite recent reduction in small savings rates, banks may not reduce deposit rates

BY [GAYATRI NAYAK](#), ET BUREAU | DEC 30, 2017, 06.29 AM IST

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Banks may not follow the government's move to lower interest rate on [small savings](#) scheme as the liquidity conditions are not conducive according to ratings firm [Icra](#).

"Despite the recent reduction in small [savings](#) rates, we do not expect banks to follow suit and reduce deposit rates, given the recent re-emergence of the liquidity deficit" Icra said in a report. "Moreover, systemic liquidity is expected to remain relatively tight in Q4 FY2018, based on the anticipated pickup in credit offtake on an absolute basis"

In a notification released by the Ministry of Finance on December 27, 2017, the GoI has reduced interest rates on most small savings schemes by 20bps for Q4 FY2018, from the rates prevailing in Q3FY2018. However, the interest rates on savings [deposits](#) and the five-year Senior Citizens Savings Scheme (SCSS) have been left unchanged at 4.0% and 8.3%, respectively.

The cut in interest rates on the other small savings schemes is in contrast to the trend displayed by G-Sec yields of various maturities, during the trailing three-month period. For instance, the G-Sec yields on 2-year, 5-year and 10-year bonds have increased on average by around 3 bps, 10 bps and 24 bps, respectively, in September-November 2017 relative to the previous three month period. This deviation from the announced linkage with G-sec rates, will add to uncertainty regarding the future trajectory of interest rates on small savings schemes, Icra said.

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Small saving schemes are categorised under three broad heads (i) postal deposits, comprising savings account, recurring deposits, time deposits of varying maturities and monthly income scheme (MIS); (ii) savings certificates, including National Small Savings Certificate (NSC) and Kisan Vikas Patra (KVP); and (iii) social security schemes such as public provident fund (PPF) and Senior Citizens' Savings Scheme (SCSS). These schemes provide an alternative avenue to saving in banks, often at interest rates that tend to be higher than bank deposits of a comparable maturity. Therefore, such schemes have at times been highlighted as a factor that hampers transmission of monetary easing to bank deposit and lending rates, particularly during periods of tight liquidity. To reduce the hindrance posed by small savings schemes to the process of monetary transmission, interest rates on such schemes are being recalibrated on a quarterly basis and have been linked to average G-Sec yields of corresponding maturity in the trailing three months, since Q1FY2017.

Over the course of 2017, the interest rates for most small savings schemes have been cut by 40 bps (except savings deposits: no change; five- year SCSS: 20 bps), with a cut of 10 bps each for Q1 FY2018 and Q2 FY2018, in addition to the recent cut of 20 bps. However, the G-Sec yields on 2-year, 5-year and 10-year bonds have declined by a smaller 13 bps, 0 bps and 5 bps, respectively, in September-November 2017 relative to September-November 2016, following the recent uptick in yields.



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The cut in various small savings rates for Q4 FY2018 is similar to the earlier reduction in the repo rate by 25bps on August 4, 2017. Compared to the latter, banks had reduced deposit rates by a smaller extent, which may have been constrained by the unchanged interest rates for small savings schemes for Q3 FY2018.

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