

Why banks don't need to worry about deposits despite ostensibly higher post office small saving rates

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Small savings do not pose a threat to banks

The increase in interest rates in some small savings schemes has expectedly raised the question on whether or not the demand for bank deposits would come down in case banks do not increase their interest rates. The recent hikes in interest rates, which are based on the movements in market rates of GSecs, have ostensibly made such deposits more attractive. In this regard, it is interesting to gauge the importance of this category of savings.

Small savings come in three forms: Deposits with post offices, certificates and PPF. There are different motivations for going to a post office for opening such accounts. Deposits with post offices are similar to those offered by banks and appeal more to the lower income groups. Certificates are virtually discounted bonds which give a fixed return on maturity and are similar to bearer bonds with certain KYC caveats attached. PPF are long-term deposits with tax benefits which have very rigid rules when it comes to withdrawal. It is a niche product as people use it for tax savings where one gets tax benefits on the deposits made as well as on the returns. However, there is an upper limit on such deposits which is Rs 1.5 lakh per annum. Bank deposits, on the other hand, are quite singular in scope but offer a basket of other facilities once an account is opened that are not available with post office deposits.

Presently, the interest rate disparity is significant in some buckets when returns on bank deposits and post office deposits are juxtaposed. A savings account with a post office gives 4% against 3.5% for most banks, while some offer higher rates of 6%. The difference in interest rates between term deposits in the two schemes could be as much as 50 bps for 1 year, 30 bps for 2 years, 50-55 bps for 3 years and 45-50 bps for 5 years (a sample of five leading banks in terms of size has been used here). Hence, broadly, the difference can be in the range of 50 bps.

Interestingly, within commercial banks, too, there is a similar disparity in interest rates which does not cause customers to switch from one bank to another as these rates are dynamic and the differential can change at various points of time. Besides, once a relationship is built with a bank branch, rarely does one change the destination for deposits on this score. This explains why

Outstanding deposits under small savings and banks (₹ lakh cr)			
	Small savings	Bank Deposits	Share of small savings in total
FY12	6.06	59.09	9.3
FY13	6.05	67.50	8.2
FY14	6.21	77.05	7.4
FY15	6.32	85.33	6.9
FY16	6.81	93.27	6.8
FY17	7.31	107.57	6.4

(For Feb 2018, the share went up to 7%)
Source: RBI

customers do not move from one bank to another even when new branches of other banks are opened.

This can also explain why the small savings avenues have never been too attractive for customers even though, on an average basis, the returns have been better here. The attached graphic provides information on outstanding small savings and bank deposits for the last 6 years ending FY17.

The graphic shows that the share of small savings in the deposits pool of the public has been coming down and is in the range of 6.5-7%. Therefore, there does not really appear to be a significant threat to bank deposits per se. This can be due to several factors.

Firstly, post office deposits are always considered to be more distant and hence less accessible. Secondly, these deposits have been more popular amongst the lower income groups where the savings power is limited. The users of small savings hence tend to be quite niche. Thirdly, banks offer other facilities like cards, remittance facilities, loans, transfers, and third party products, etc, which make it a one-stop shop for all financial requirements. This is not possible when it comes to post offices. And lastly, as said earlier, funds do not move from one structure to another merely because of rate differentials. This is because of inertia on the part of the customer as well as the fact that, given the changes in interest rates by banks, it is not possible to keep switching deposits across these alternatives. The most glaring case is of the savings deposit rate offered by some private banks which is substantially more than that given by the rest of the banks. Yet, every bank has its own clientele and there is rarely a diversion of deposits.

Also, within small savings, interestingly, the share of certificates has come down over the years from around 35% to 27% between 2011-12 and 2016-17. The share of all deposits has increased from 59-60% to 64% while PPF has gone up from 5-6% to 9%. Within small savings, the schemes oriented towards senior citizens and girl children have become popular and have contributed to the growth in such savings.

Prima facie, it does not appear that banks have to worry much about interest rates of small savings being increased as it is unlikely to affect the flow except at the margin. The bigger challenge will be the competition from within i.e., the payments bank of India Post. It offers a savings deposit account with all the frills of a normal bank account and pays an interest rate of 4%. This holds for individuals, merchants and postmen. Add to this the availability of the DBT facility and it would directly impact the business of small savings as whole. Savings accounts of post offices will now compete with those offered by India Post Payments Bank and there can be some cannibalisation. Here, there is a possibility of savers moving their accounts over to the new platform.

With digitisation catching on, commercial banks having Jan Dhan accounts firmly entrenched and the India Post possibly becoming a successful payments bank, the concept of small savings may narrow down to those which exclude deposits. This is something which the system must be prepared for and just like how several postal services are less important in the age of mobile phones and [WhatsApp](#), the same would be the case with this avenue of services of post offices. This would be good for the government which, today, has to pay a higher cost of small savings compared to that of regular market borrowings. The future surely will be interesting for this range of small savings schemes.

The author is Chief economist, CARE ratings Views are personal

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