Savings Bonds Scrapped

Why in News

Recently, the Government of India has **discontinued 7.75% savings (taxable) bonds, 2018** for a subscription.

- The move comes in line with the **cut in repo rate** by the **Reserve Bank of India** (RBI) and subsequent **cut in deposit rates by banks and small savings rate** by the government.
    - Since investors were looking for **safer investment rather than high returns,** this led to the **high demand for these bonds** which led the government to **discontinue** this option.

Key Points

- **Applicable:** The government's withdrawal of these bonds means that it is **only ceasing fresh issuance** and not redeeming those already invested.
- **7.75% RBI Bonds 2018:**
    - These were issued with **effect from 10th January 2018** and were available for subscription to **resident citizens/Hindu Undivided Family** (HUF) to invest in a taxable bond.
        - These bonds were **first introduced** in 2003 as **8% GOI Savings (Taxable) Bonds.**
        - The 8% interest rate was **brought down to 7.75%** in **January 2018.**
    - While **one bond was of Rs 1,000 each,** the bonds had **no maximum limit** for investment.
    - The bonds had a **7-year lock-in period** from the date of issue but it **permitted premature encashment** to individuals who were **60 years and above.**
    - Interest on these bonds is **taxable** under the **Income-tax Act, 1961**.

- **Reasons for High Demand:**
    - The bonds are mostly used by the **High Net-worth Individuals** (HNIs) to invest as the bonds offer both **regular and cumulative income options.**
    - These bonds were a good choice for **savers, pensioners and investors** who are not falling under tax liability or who have an exemption under the Income-tax Act as these are **safe and generate adequate returns.**
    - Their demand went up significantly over the last couple of months as **investors turned risk-averse** and invested in them purely for reasons of safety of their capital.
- **Reasons for Cut in Rate:**
    - The **interest rates are declining** after the global growth rate projections have been brought down following the spread of **Covid-19**.
    - The RBI first announced a **75 basis point cut in repo rate to 4.4%** on 27th March 2020 and then again announced a **cut in repo rate by 40 basis points to 4%** on 22nd May 2020.
        - A cut in repo rates not only **reduces the rate at which commercial banks borrow from RBI** but also leads to a **cut in deposit and lending rates** for banks.
    - The RBI's move to cut in repo rate has been **to push credit growth and demand** in the economy for its growth.
- **Impact:**
    - The move comes as a setback to savers and pensioners at a time when their **returns from bank deposits have fallen steeply** following the cut in deposit rates and reduction in the small savings rate.
    - The saving bonds were **guaranteed for repayment by the RBI** but now savers and pensioners are now at the mercy of banks.
    - The scrapping will **deprive investors** of a saving instrument that yielded relatively higher post-tax returns.
        - Investors and savers are **already worried** due to stock markets falling, the Sensex down by around 10,000 points this year and mutual funds giving negative returns.
- **Comparison to Other Options:**
    - After the cut in the small savings rate in April 2020, **Public Provident Funds (PPF)** interest rates were **cut to 7.1%** (7.9% earlier) and **Sukanya Samriddhi Yojana** interest rates were cut to **7.6%** (8.4% earlier).
    - **State Bank of India** (SBI) currently offers an interest rate of 5.3% for a term deposit of **3-5 years** and **5.4%** on term deposits of **5-10 years.**

Source: IE