

Rates of return on govt. savings instruments need to follow the market

Tuesday, Jun 30, 2015

By *Dr. Ahsan H. Mansur*

For the private sector credit to expand significantly in the fiscal year (FY), 2015-16, in line with the 7.0% growth projection, the deposit base of the banking system must expand at a significantly higher rate. The 12% deposit growth recorded in FY15 will not enable banks to expand credit at rates that would be needed to meet the expected rebound in private credit in FY16. For this to happen, the government sector must not divert funds from the banking system as it did in FY15 and non-bank financing of the budget deficit should be strictly limited to the budgeted level of Tk. 150 billion. To realise this limit, the recent reduction in the rates of return should be sufficient to contain net sales of National Savings Scheme (NSS) instruments at a monthly rate of Tk. 12.5 billion.

However, if domestic interest rates come down further, the spread with the NSS rates will once again widen to increase net NSS purchase to unsustainable levels as happened in FY15. Net purchase of NSS instruments have reportedly still remained high at Tk. 25 billion in May 2015, despite the reduction in the interest rate structure. This does not provide any comfort about the appropriateness of the recently lowered rates of return structure on NSS instruments.

Further cuts in NSS rates of return may not be ruled out. Government should monitor closely the developments in market interest rates and in the levels of net purchases. As soon as it becomes clear that net purchases are remaining at levels above the monthly rate of Tk. 12.5 billion, further cuts of rates of return on NSS certificates or instruments would be warranted in FY16. This may happen because of two reasons: First, the recent cuts in the NSS rates may not have diminished the relative attractiveness of NSS instruments given the current interest

rates offered by the banks. Second, interest rates in the banking system may come down further in the coming months leading to further widening of the spread in favour of NSS instruments.

Now the question is whether NSS instruments are the best way to support the fixed income pensioners and low income household savers? A study conducted under the SPEMP project of the Ministry of Finance (MoF) in FY11 showed that only 19% of households with investments, ranging between Tk. 1.0 million (10 lakh) and above, account for 82.5% of the NSS instruments in Taka (value) terms and the remaining 81% of households with investments up to Tk. 0.999 million (9.99 lakh) account for only 17.5% of NSS instruments. This study was based on a sample size of 11,901 NSS instruments randomly picked from Post offices, National Savings Directorates (NSD) Bureaus and Bangladesh Bank and for households, from all parts of Bangladesh.

With this kind of distribution in holding of NSS assets, one can easily guess which type of households are benefitting from the implicit subsidy offered to households through these schemes. We must find better ways to support the poor, widows and pensioners. Interest rates on NSS instruments were never meant to support the poor and vulnerable and must not be used for that purpose.

How can we best support the government pensioners whose pension income level is too low? One of the major concerns raised by former and prospective retirees from the government service is that a large part of the gratuity income received at the time of retirement is invested in NSS instruments at preferential rates. With the decline in the interest rate structure, their interest income from NSS will go down with potential negative impact on their standard of living. They also rightly argue that their pension income is very modest and completely unrelated to what could be considered as the minimum required for modestly decent living. Even a former Secretary level senior staffer receives less than Tk. 10,000 per month as pension. This is certainly not adequate and also disrespectful to such senior level former officials.

Countering this argument however one can legitimately point out that all senior government officials have received housing plots in prime residential areas of Dhaka and Chittagong – at prices well below the market – which more than compensate them for the lower pension

income and thus most former civil servants do not have to live only on their pension income and have other much larger income sources to rely upon.

These considerations notwithstanding, it would be appropriate for the government to review pensions of government servants and increase them to more respectable levels. At the same time, all preferential NSS rates for government retirees and any conceptual linkage of NSS with social safety net considerations must be avoided. Social issues, including adequately supporting government pensioners, should be addressed through budgetary transfer programmes like increasing allocations for social safety net and government pensions in the budget. Introducing distortions in the money market and obstructing the transmission of monetary policy by setting NSS rates at levels out of line would seriously undermine efficient functioning of the money/credit market and private sector investment in the economy.

Bangladesh, in my view, has already outlived the usefulness of outdated financial instruments like NSS. It was introduced during the British Rule of India when Postal Savings Certificates obtained through local Post Offices were the only way to mobilize savings from the rural areas. Today Bangladesh, enjoying the highest density of banks per square kilometre globally-with multiple banks at most townships and small markets all across the country, the NSS-type instruments are really redundant and costly. The only reason that these instruments are popular is because of high rates of return these instruments offer entailing thousands of millions in interest subsidies which mostly go to the pockets of the rich urban class with holdings of Tk. 10 million (1.0 crore) or more. I can guarantee, if the differentials between bank deposit rates and rates of return on NSS certificates are eliminated completely, nobody will bother to go to the National Savings Directorate (NSD) offices and post offices to buy these outdated instruments and collect interest by physically submitting the signed old-fashioned paper-based coupons.

Today banks and non-banking financial institutions (NBFIs) do conduct transactions electronically and interests are automatically deposited to depositors' bank accounts and the principal amounts are automatically rolled over unless instructed otherwise. The only reason NSD operations still continue - and I am sure will continue for a long time - is because of the vested politically connected pressure groups.

The government of Bangladesh should link rates of return on national savings instruments to

market rates. We are currently in a position where it is possible to reduce inflation rate more aggressively, somewhat like the Reserve Bank of India which has set an inflation target of 4.0% for FY17. Bangladesh should also aim to achieve a more aggressive inflation target such as limiting the inflation rate at 4.0%-5.0% and letting the interest on term deposits come down to 5.0%-6.0% range, keeping 1.0% or more real rate of return on savings.

Under this scenario, lending rates would also come down to high single-digit levels and banks in Bangladesh will be more competitive in lending to prime borrowers who have access to the international capital market. In this environment, rates of return on NSD instruments should not be determined administratively in the manner they are set now and the rates also cannot remain where they are now, disregarding future the credit market developments. Rates of return on NSS instruments must follow the market and not undermine the market.