What RBI discontinuing 7.75% saving bonds means to investors

Introduction

- After the cut in deposit rates by the banks and a cut in small savings rate by the government over the last couple of months, the Reserve Bank of India on Wednesday said the Government of India has discontinued 7.75 per cent savings (taxable) bonds, 2018 for subscription with effect from the close of banking business on Thursday.
- The move will deprive investors of another saving instrument that yielded relatively higher post tax returns for investors.

What are 7.75 per cent RBI bonds?

- The 7.75 bonds 2018 were issued with effect from January 10, 2018 and were available for subscription to resident citizens/HUF to invest in a taxable bond.
- 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 encasement to individuals who were 60 years and above.
- Interest on these bonds will be taxable under the Income-tax Act, 1961.

What has happened now?

- The government has withdrawn these bonds with effect from Friday and therefore it will not be available for investors to invest.
- This means it is only ceasing fresh issuance and not redeeming those already invested. Those whose cheque’s got submitted and cleared till yesterday will get 7.75 per cent.

Was it in high demand?

- Investment advisors say that while it was mostly used by HNIs to invest, the demand for RBI bonds went up significantly over the last couple of months as investors turned risk averse.
- Even as the post-tax returns were low as compared to PSU-debt, experts say investors rushed for it as they saw it as the safest investment instrument available.

How did it fare against other options?

- As the 7.75 per cent RBI bonds were taxable instruments, the interest income on it would be taxable at the marginal tax rate.
- For those having income of over Rs 5 crore and having interest income from these bonds, the return would be 4.44 per cent.
- For those falling in the tax bracket of 30 per cent, the return from these bonds would stand at 5.4 per cent, while for those falling in the lowest tax bracket of 10 per cent, the post-tax return would be 6.975 per cent.
- In April 2020, the government announced a cut in the small savings rate.
- While the rates for PPF were cut from 7.9 per cent earlier to 7.1 per cent, that on Sukanya Samridhhi Yojana was brought down to 7.6 per cent from 8.4% earlier.
- In comparison, SBI is currently offering 5.3 per cent for a term deposit of 3-5 years and
5.4 per cent on term despos of 5-10 years.

- The post-tax return for those falling in 30 per cent tax bracket would stand at 3.71 per cent and 3.78 per cent respectively. Experts say that PSU debt papers offer post tax return of around 7 per cent.

**Why the cut in rates?**

- The interest rates have been on a decline since the global growth rate projections have been brought down following the spread of coronavirus Pandemic.
- The Reserve Bank of India first announced a 75 basis point cut in repo rate on March 27, 2020 to 4.4 per cent and then again announced a cut in repo rate by 40 basis points to 4 per cent on May 22.
- 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 RBIs move to cut in repo rate has been to push credit growth and demand in the economy in a bid to augur growth in the economy.