ON A SERIOUS NOTE

To Save or not to Save in Government Bonds

Good return on savings — the very words that drip honey into most people's ears for sure. No matter whether you are working or retired, a service holder or a homemaker, making good savings and then investing them into options that promise good returns is always on most of our minds. And why not, as smart money management does not come easy to most. Yet, as wide the need of people for savings instruments is, equally varied are the options available. Some most common ones are bank deposits, saving schemes, prize bonds, stock market, and then there are the Sanchaypatra-s, or government bonds.

WHAT IS SANCHAYPATRA?

At the moment, the Sanchaypatra, also known as the National Savings Certificate (NSC), comes in a range of durations and types, offering perhaps the highest assured return at about 9 percent minimum. There are various types of NSCs, for the pensioner, for the family, for joint accounts etc. The limit on total investment is also quite generous for each, making it quite a popular choice for investment, especially since private sector banks offer about 6 percent return in comparison. The certificates are so popular in fact, that net sales in the first eleven months of the just concluded fiscal year stood at over Tk 32 crore — twice the government target! The government needs these funds to finance budget deficits.

It is no wonder then that this year's budget announcement caused quite a stir, and also some unsubstantiated panic, with its proposal to cut returns on NSCs.

The panic stems from the fact that in these times of steady inflation, returns on investments are terribly important, and even more so to small and middle class savers, who are at the moment the majority investor in the certificates, says Md Fakhrul Abedin, EVP of IFIC Bank, sharing his insight.

"In Bangladesh, the middle class income group is the main investor in Savings Bonds. Pensioners and housewives also constitute a large investor group for savings bonds. Apart from these investor groups, small enterprises are also a target segment, though, as an investment tool, it is less popular in this group," he said.

Another perk of the NSC is it being risk free (as the government itself is the guarantor) along with the higher rate of return compared to other available investment schemes like FDR, DPS, etc, he added.

Considering outcry from buyers, the impact looks to be the highest on the middle class families who supplement a part of their monthly income with the interest accumulated from the NSCs. To highlight the impact of cutting down interest rates, Abedin outlines the entire economic process involved.

"If the rate of return is decreased from the current level, it will not only impact the middle class families, but also have a ripple effect affecting the major macro-economic indicators."

The first and most detrimental effect will be a reduction of the purchasing power of the middle class, both now and in the future. When the interest rate on Sanchaypatras is lowered, people will have less money earned on their savings, and when the future consumption possibility tends to decrease, people will prefer more consumption in the present instead.

This will create an inflationary pressure on the price of commodities since the money available for present consumption will increase, especially when compared to a relatively static production capacity of goods and goods available for present consumption.

This inflationary effect will further reduce the purchasing power of people. This could also have the entirely opposite effect, where people decide to save more and buy more certificates to match up to their previously calculated returns, in which case the whole economy will suffer from a lowered purchasing capacity, due to money's multiplier effect, and cause a slouch in the market for everything.

If people stop buying NSCs for smaller returns, the government could have a shortage in funds to meet budget deficits. On the other hand, it will also successfully cut down some expenditure in servicing the certificates. As a result, government could have to rely more on financing from banks or increase the tax.

If the government decides to meet the deficiency arising out from lower funds available from Savings Bonds by bank financing then it will curtail the amount for lending to corporates, which will result in an increased lending rate for corporates. This in turn will increase the cost of production, which will be transferred to consumers as an increased selling price. This once again will reduce the purchasing power of consumers.

If the government decides to meet the deficiency arising out from lower funds available from Savings Bond by imposing additional tax, this will reduce the money available for consumption and savings at the individual level, which is another way to cripple the purchasing power.

Ultimately, this sudden change in the rate of return could have quite a detrimental effect on the economy as a whole, as well as small scale investors. The middle class feels that they are now being forced into a corner with their finances.

Here, Abedin offers us some alternatives as well. The stock market, with shares, bonds and other similar instruments is a good investment destination, but there are of course inherent market risks due to the nature of business being cyclical, with periodic booms and slumps. Also, the two stockmarket debacles of 1996 and 2011, likely caused by unscrupulous influences in the stock market, are yet to be dealt with transparently, and the perpetrators yet to be brought to justice.

SO WHAT CAN A LAYMAN DO?

Another relatively good option is the mutual fund. Abedin addresses some measures in this context so that a family which is reliant of savings bonds does not suffer financially.

Mutual funds are a reliable investment vehicle all over the world and in Bangladesh they are quite prosperous. Mutual funds in Bangladesh are managed by experienced investment professionals and have been providing acceptable rates of return while minimising the inherent risks of the stockmarket.

Besides, there are some value stocks and blue chip stocks, which always provide acceptable capital gains and dividend incomes. That being said, education has no alternative when it comes to investing in the capital market. An educated investor often understands the risks involved with investment in a specific stock and is able to limit his/her expectation from a specific investment.

Most brokerage houses provide fundamental training on capital market investment. Besides, DSE and Bangladesh Institute of Capital Market (BICM) provides quality training on investment in this sector, which are also affordable.

Finally, Md Fakhrul Abedin, from his experience in the financial world, provides some tips for a typical middle class household to be smart with their money and savings.

"When it comes to investment and saving money, people need to be specific about their expectation and risk tolerance. Higher yielding investments are also the investments with higher risks. So if you invest to expect a higher return, you have to have the capacity to bear higher risks associated with that investment. If you do not have that capacity to bear the risk, better not invest in that area."

"Secondly, investment and savings should focus on creating additional perpetual income source, not just bursts of short term consumption.

Always save and invest through legally approved and authorised institutions to protect yourself against scams. Do not fall into the trap of higher return with an illegal investment. The associated risk is too high to compensate for even if you have the capability to bear such risk," he says.

Considering the macroeconomic variables involved, it is by no means an easy feat to fully push back the negative impact which will inevitably affect the middle class from cutting down interest rates on Sanchaypatra-s. Yet, there is little risk of a too much fall in the rate of return, as the government has a responsibility to look out for its middle class and pension earners too, especially in the absence of adequate safety net programmes for the entire population.

From the point where the country is standing at the moment, the middle class make up the financial backbone of the nation. There simply cannot be any financial development in the making at the cost of the people. Cutting into a steady supplementary income source will not instantly divert funds to other investment sources, especially for risk averse groups. Unless accountable and responsible investment schemes come up, the middle class will only end up on the negative quadrant.

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Photo: Collected

With special thanks to Md Fakhrul Abedin, a writer and currently an Executive Vice President of IFIC Bank, with more than two decades of banking experience in commercial lending, trade finance and branch management.