Q5

With reference to the Indian economy, what are the advantages of "Inflation-Indexed Bonds (IIBs)"? 1. Government can reduce the coupon rates on its borrowing by way of IIBs. 2. IIBs provide protection to the investors from uncertainty regarding inflation. 3. The interest received as well as capital gains on IIBs are not taxable. Which of the statements given above are correct? (a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3 Official key: A.

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Explanation

(a) Official key

1 and 2 only. IIBs let the sovereign pay a lower real coupon; they protect investors from inflation uncertainty. Interest and capital gains are not tax-free.

(b)

2 and 3 only. Statement 3 is false.

(c)

1 and 3 only. Tax exemption is the miss.

(d)

All three. IIB cash-flows are taxable in the ordinary way.

Summary

Official key is (a) 1 and 2 only. Inflation-indexed bonds shift inflation risk to the issuer, so the coupon can be lower in real terms, and the holder is protected against inflation surprises. They are not a tax-free instrument.

Related possible facts

These can be asked in a future Prelims paper.

IIB

RBI/GoI inflation-indexed G-sec; principal or coupon linked to WPI/CPI as designed.

Capital-indexed bond

Principal scales with inflation; a cousin of IIBs.