The Bond Market Tussle

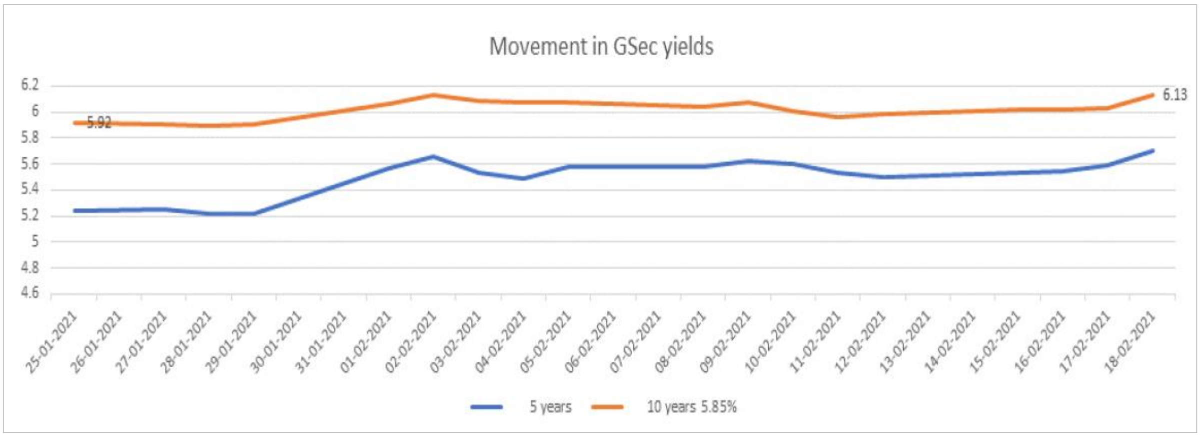
February 22, 2021

Dear Sir/Madam,

There appears to be a distinct tendency towards hardening of GSec yields in the market notwithstanding the RBI's actions of infusing more liquidity into the system through OMOs. The facts are quite straight forward. There is surplus liquidity in the system. The quick indicator of this surplus liquidity is the amount that goes into the daily reverse repo auction (where RBI borrows securities for a day and pays the banks 3.35% interest). This amount has been above Rs 4 lkh crore a day for the entire financial year, going up to Rs 6-7 lkh crore at times. There are also Rs 2 lkh crore invested in the term-reverse repo for 14 days presently. Banks have gone in for the LTROs/TLTROs that were announced last year but have repaid most of the amount and the o/s as of today is around Rs 77,000 cr. Growth in deposits is higher than that in credit and hence there is surplus liquidity in the system.

However, ever since the Budget was announced which spoke of additional borrowing of Rs 80,000 cr this year and another Rs 12 lkh crore in FY22, the markets have been spooked. The 10-year yield has been increasing. The RBI policy did mention that the stance will be accommodative, but the fact that it said that the CRR will revert to the 4% level in two tranches, the message was clear. There would be less of QE in the system even though there was a promise of liquidity. The yields have ben moving up as shown in the diagram below.

The RBI has been aggressive with the OMOs, but that has not helped. In the GSec auctions that have been held since the announcement of the Budget, there have been devolvement sot the PDs which is indicative of the clear different views on market expectations and RBI willingness to pay the price or rather the yield.



Date in Feb	Amount of auction Rs cr	Development Rs cr
5th	31,000	8,810
12th	26,000	6,736
18th	31,000	21,786

Our view earlier that the government borrowing programme for the year would warrant the 10 year to go at around 6.2% but the final outcome would depend on how the RBI deals with the situation. Even in the last 2 weeks, the RBI did bring the yield below 6% in the week ending 12th. Still the market appears to be insistent on higher yields. This situation, we believe will carry on till the borrowing programme for the year is completed. It will hence have an impact on even SDL yields and corporate bond rates especially at the longer end of the curve

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