India Inc borrowing costs rise as corporate bond yields harden

BHASKAR DUTTA
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A rout in domestic bond markets caused by fresh concerns of an extended monetary tightening cycle has resulted in a spike in borrowing costs for corporate entities as yields on bonds issued by private firms have shot up.

The surge in corporate bond yields has largely occurred in line with yields on government bonds, which are the benchmarks for pricing debt raised by the private sector. Bond prices and yields move inversely.

Yields on benchmark three-year corporate bonds have risen 15 basis points (bps) since the Reserve Bank of India's (RBI's) policy statement on February 8 till the end of last week, while those on five-year bonds have climbed 12 bps, Bloomberg data showed. A significant part of corporate fundraising through debt occurs in these maturity brackets. The 10-year corporate bond yield has risen 15 bps.

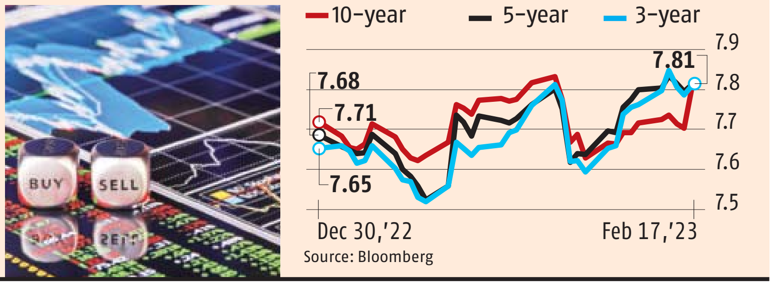
Over the same period, yields on the three-year and five-year government bonds have each jumped 17 bps while that on the 10-year government bond has risen 6 bps. In line with the movement in sovereign bonds, the corporate bond yield has considerably flattened over the past couple of months, even at times experiencing inversions.

This has occurred due to the much sharper rise in short-term bond yields over the past couple of months, a phenomenon that has been driven by the accelerated pace of rate hikes by the RBI and uncertainty over future tightening. Short-term bonds are extremely sensitive to near-term interest rate expectations.

Apart from the concerns over interest rates, seasonal factors that occur towards the end of the financial year, such as increased issuance of certificates of deposits by banks, were also cited by analysts.

"One, of course, is that banks are raising more credit deposits in the market and to that extent liquidity gets diverted to the banks. As such, this is a March phenomenon, you generally see that the cost of funds for borrowing in March is generally higher. There are multiple factors — more companies also borrow at that time which pushes up the borrowing cost," Prakash Agarwal, director and head of financial institutions, India Ratings & Research, said.

TRACKING THE MOVEMENT (BOND YIELD IN %)



Source: Bloomberg

"Another factor that could also be playing out is that for SMEs, now that the Budget says you get the discounts only when you have paid, the outstanding would not be allowed. Corporates may not want to carry that on their balance sheet as well," he said.

Hazy outlook

Among the key triggers for the sharp sell-off in the Indian debt markets were recent rounds of unfavourable cues on interest rates, which caught market participants off-guard.

Firstly, in its latest policy statement on February 8, the RBI did not provide any concrete signs of a pause in its rate hike cycle, disappointing several traders. Just a few days later, data showed an unexpectedly sharp rise in India's consumer prices in January, putting the RBI's inflation forecasts at risk and strengthening the case for more rate hikes.

Adding to the market's worries were data sets in the US, which showed firm jobs additions and higher-than-expected inflation, thus making a stronger case for the Fed to also keep raising interest rates. A consequent surge in US bond yields aggravated the rise in domestic debt yields.

"The market's terminal rate expectations have gone up both for the RBI and the Federal Reserve. There is no demand for issues. The investor interest is there at a higher yield level," a treasury official said.

"There is no appetite for NBFC bonds as well. The short-end is the problem, it's the three-year and five-year point which is the issue. SBI's AT1 bonds which were issued at 7.75 per cent with a five-year call option are now at 8.10-8.15 per cent in the market," he said.

Treasury officials also cited continuing bottlenecks that built up following a transition to an upgraded version of a regulatory reporting platform run by the Ministry of Corporate Affairs.

Reports said that on January 23, the ministry pushed forward the timeline of filing a large number of compliance firms by 15 days in response to glitches in reporting faced by several companies. Non-submission of forms would imply violation of rules.

However, senior market sources said ripples from the technical problems continued to have an impact on market activity.

"Issuers could not issue in January because they could not utilise the money. They said it would be shut only from January 18 to 22. Actually the effect lingered on far longer," a source said.

"In these cases, the easiest solution is to run two parallel modules and shut down the old one once the new module proves that it is working," the source said.