

OIS curve signals 20-bp cut in repo rate by February

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The one-year overnight indexed swap (OIS) rate, the most closely watched gauge of near-term interest-rate expectations, is now pricing in a 20 basis-point cut in the repo rate by February, market participants said.

Overnight swap rates have declined across the curve this week.

The one-year OIS rate fell six basis points this week, trading at over a month's low. On Wednesday it settled at 5.42 per cent, unchanged against Tuesday's rate.

The bond market gained renewed clarity on the prospects of a policy repo-rate cut after Reserve Bank of India (RBI) Governor Sanjay Malhotra said earlier this week there remained room for monetary easing.

Even then market sentiment remains divided, with participants

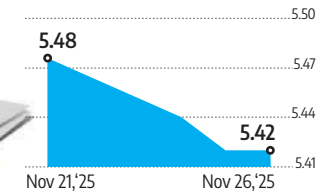


split between those expecting a cut in December and those who say policy uncertainty continues to warrant caution.

"The OIS curve is pricing in a 20 basis-point rate cut by February. The movement was seen in both government bonds and the OIS after the remark from the governor, with the markets affirming a 25 basis-point cut in December," said the treasury head at a private bank.

Ripple effect

1-yr OIS rate (in %)



Source: Bloomberg

The re-pricing followed Malhotra's statement in an interview on Monday, saying the scope for rate cuts, as highlighted in the October policy review, "has not diminished," with the recent data still supporting further easing.

In an OIS contract, two parties exchange a fixed rate for a floating rate linked to the RBI's overnight call rate. Because OIS rates are largely unaffected by liquidity or the bond

supply, they mainly reflect expectations of monetary policy. A decline in OIS rates signals that markets expect lower policy rates ahead.

Even so, some caution remains. Market participants said global uncertainties, currency pressures, and the data on gross domestic product (GDP), scheduled to be released this Friday, could still influence the decision of the Reserve Bank of India's Monetary Policy Committee (to cut rates or not).

"The OIS is indicating a rate cut of 20 basis points by the end of February. That's why the market was split between December and February. There could be some indication of 'accommodative' stance in December if not a rate cut. We are expecting an open market operation calendar of over ₹1 trillion; whether it will be announced during the policy, we will have to see," said the treasury head at another private bank.