FY24 borrowings at new high, softer RBI to help bonds

BHASKAR DUTTA
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Ahead of the Union Budget on Wednesday, most economists agree that the central government is likely to peg its gross market borrowing for the next financial year at a fresh record high of about ₹15.5 trillion from ₹14.3 trillion this year.

The market, however, does not seem overly perturbed by the prospect of an ever-increasing supply of government securities, with traders predicting only a slight rise in bond yields.

The equanimity among trading desks is all the more striking when one considers the fact that till five years ago, the government's gross borrowing had never crossed the ₹6 trillion mark. The huge increase since then has been largely spurred by the Covid crisis, which compelled the Centre to ramp up borrowing in order to spend more and revive the economy.

Broadly, there are two key themes that treasury officials say are likely to anchor bond yields amid the heavy supply.

First, the probability of the Reserve Bank of India calling an end to rate hikes and potentially considering softer monetary policy towards the latter part of 2023 as economic growth slows down. The RBI raised the repo rate by 225 basis points in 2022 to bring down high inflation.

The combination of a likely softer monetary policy and heavy supply of longer-dated securities is seen leading to a steeper bond yield curve by bringing down short-term bond yields while keeping their longer-term counterparts higher.

Short-term bonds are highly sensitive to interest rate expectations and liquidity conditions. The government tends to push through a large portion of its borrowing in longer-dated securities.

"Given that monetary policy is now poised to not continue on the hawkish path, there is room for the front-end yields to come down. I see the one-year T-bill yield coming down by around 40 bps. It would be the classic front-end fall in yields affected by monetary policy while the longer-end yields might go up a bit because of the supply concerns," Vikas Goel, MD, CEO PNB Gilts said.

"It is the portion of the curve beyond the 10-year yield where the steepness can come in. I don't see the 10-year yield sustainably above 7.50 per cent," he said.

On Monday, yield on the 10-year benchmark bond settled at 7.40 per cent. According to traders, the gap between 20-year and 30-year bond yields, currently at around 5-10 basis points, could widen to 20-25 basis points as the supply hits.

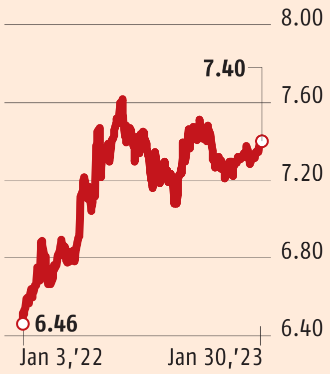
The second favourable aspect pointed out by traders is the continuation of firm demand for longer-dated government securities from entities such as insurance companies and pension funds.

Market participants pointed towards a thematic shift out of richly priced equities to safer, higher-yielding debt instruments, particularly for retirement funds, education investments and insurance.

"In fixed-income, finally after around 5 years, investors are getting a 5-5.50 per cent tax-free return which was as low as 3-3.5 per cent earlier. That's why people are not letting this opportunity go to fixed-income. Everyone is of the view that interest rates will come down at some point," Naveen Singh, head of trading at ICICI Securities Primary Dealership said.

ON A RISE

10-year bond yield (%)



Compiled by BS Research Bureau
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