# How demonetisation triggered rally in bonds

By *Saikat Das*, ET Bureau | Updated: Nov 14, 2016, 07.35 PM IST

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MUMBAI: An element of exuberance has silently set in the bond market amid the demonetisation of large-denomination currency notes that has led many to scramble for cash. The government move has inadvertently revived hopes for rate cuts.

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With banks likely to get swamped with deposits — State Bank of India has already reported more than Rs 75,000 crore of inflows since the demonetisation was announced on Tuesday — many would be driven to buy bonds, pushing down yields or jacking up prices — bond yields and prices move in opposite directions.

“There is a strong case for a rate cut as demonetisation move tends to be disinflationary,” said Ashutosh Khajuria, executive director at Federal Bank. “Despite dipping yields there is still juice left in the bond market.”

With limited supply of sovereign papers, there is a fair chance for bond prices to gain as some of the bank deposits will definitely flow into debt, he added.

The Reserve Bank of India had cut its policy repurchase rate by a quarter percentage point last month.

Mutual funds and insurers are now mostly seen buying government securities in large quantities.

Between November 10 and 13 (until 5 pm), about Rs 3 lakh crore of the demonetised Rs 500 and Rs 1,000 notes were deposited in the banking system, according to the finance ministry.

“Banks look to have garnered significant liquidity through public deposits in these days,” said Kumaresh Ramakrishnan, head of fixed income at DHFL Pramerica Mutual Fund.

With sluggish credit growth, some funds will flow into the government bonds, he said. “This sentiment has triggered a buying spree as bond yields may dip another 15-20 basis points by December end.”

During the same period, the benchmark yield dropped as much as 20 basis points, hitting 6.64% on Thursday compared with an intraday high of 6.84% on Tuesday, the day when the government announced demonetisation of the two currency notes.

The benchmark yielded 6.72% at the close of Friday’s trade. The bond market was shut on Monday due to a public holiday.

Globally, investors are seen exiting emerging market investments with rising US Treasury yields. But, the Indian bond market has bucked the trend when it comes to overseas investment.

In the past four trading sessions, foreign portfolio investors have invested Rs 2,459 crore in the Indian debt market versus net sales of Rs 2,163 crore in equities, show data from NSDL (updated till November 11).

Some dealers are expecting overnight rates may soon fall below the repo rate, now at 6.25%.

“If the CBLO (collateralised borrowing and lending obligation) slips, it will trigger another rally in benchmark bond prices,” said a dealer with a primary dealership company.

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