

MSS bond ceiling hiked to Rs 6 lakh crore

Relief for banks as they can park surplus liquidity and earn interest

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The

government, on Friday, increased the ceiling of special bonds that can be issued to mop up excess liquidity in the system to Rs 6 lakh crore, from the earlier Rs 30,000 crore – a fallout of the note ban.

This comes as a relief for banks, already burdened with rising cash deposits and the 100% incremental cash reserve ratio (CRR) imposed by the central bank on deposits of Rs 3.24 lakh crore.

The scheme, under which these bonds will be issued, is called market stabilisation scheme (MSS) and therefore, these bonds are known as MSS bonds. These are issued by Reserve Bank of India (RBI), on behalf of the government, with an expressed purpose to sterilise excess liquidity from the system.

The ceiling of Rs 6 lakh crore is a provision, and it is not necessary that the entire amount would be utilised.

The government's demonetisation drive has resulted in banks being flush with funds to the tune of Rs 8.45 lakh crore till November 27. After banks had parked Rs 5 lakh crore in the reverse repo window with RBI, the central bank imposed 100 per CRR requirement on deposits collected between September 16 and November 11. This hike, RBI said, would be reviewed before December 9.

The reverse repo window earns an interest of at least 5.75% for the banks, and RBI provides government securities (G-secs) as collateral to banks. With expectations of cash to the tune of Rs 10-11 lakh crore

coming into banks by way of banned notes, RBI is likely to have fallen short of G-secs to conduct reverse repo operations. It had around Rs 7 lakh crore of G-secs in June 2016.

The hike in CRR sucked out Rs 3.24 lakh crore from banks, an amount that will not earn any interest. For other deposits, RBI asks banks to provide four per cent CRR.

With the introduction of MSS bonds, of which the first tranche of Rs 20,000 crore was issued as 28-day cash management bill on Friday, the CRR requirement would be gradually brought down, maybe even at the central bank's policy meeting on December 6-7. Besides, the MSS bonds will also expand the RBI books and will allow it to hold more bonds, said Soumyajit Niyogi, associate director, India Ratings & Research (Ind-Ra).

The proceeds of MSS bonds don't go to the government, but sit in RBI's books under the head "MSS Account". However, in 2009, a part of the MSS bonds was used by the government to bridge its deficit and therefore, analysts say, it won't be surprising if this previous practice is followed this time too. In case that happens, it would only be in the next year.

With MSS bonds, RBI will be able to absorb the excess liquidity in the system that will come from the banned note deposits. For banks, the issuance of MSS bonds comes as good news, in the absence of adequate immediate investment opportunity. While CRR doesn't earn any interest, MSS bonds bear a coupon that can boost banks' income. MSS bonds can be issued in any maturity of bonds.

Besides, the MSS bonds can also be used to calculate banks' mandatory bond holding. The statutory liquidity ratio (SLR), presently at 20.75%, is the share of deposits banks have to invest in government bonds. MSS bonds can be counted as SLR bonds.

"For banks, MSS bills and reverse repo is almost similar, as RBI has recently allowed banks to include securities received through reverse repo for SLR. But being a discount instrument, it boosts banks' treasury profit," said Niyogi of Ind-Ra.

However, for the same reason, the existing government bonds will become unattractive and the yields of these should start rising, said Devendra Dash, senior bond trader at DCB Bank.