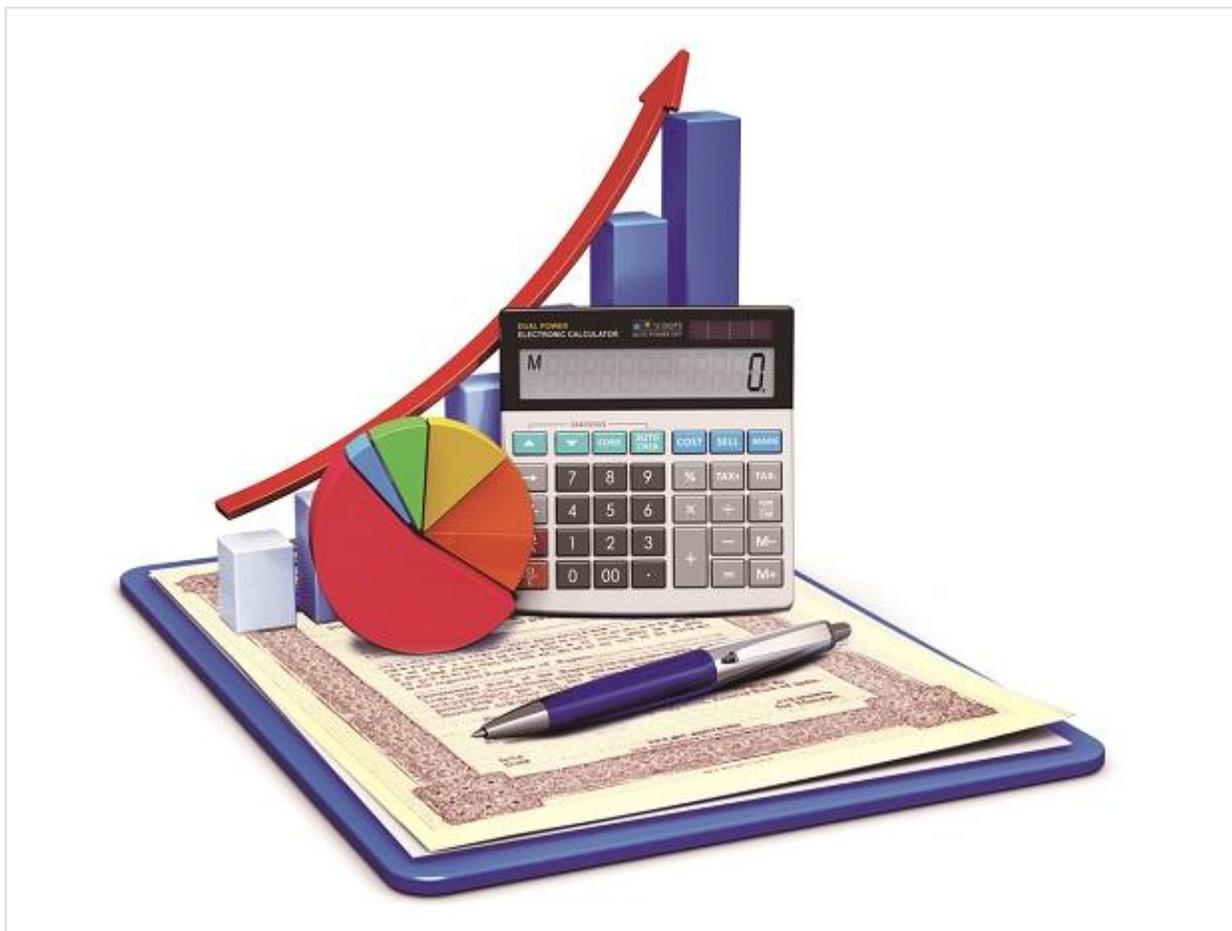


Business Standard

Year-end rise in yields puts banks in the soup

The yields on 10-year bonds have risen about 96 basis points since August even after a rate cut by RBI in that month

Anup Roy & Joydeep Ghosh | Mumbai/New Delhi December 29, 2017 Last Updated at 01:30 IST



With yields rising sharply, banks are caught between a rock and a hard place. And as the quarter for the banks ends on Friday, the treasury departments are hoping the yields scale back so that their losses, even nominal, can be minimised.

The yields on 10-year bonds have risen about 96 basis points since August even after a rate cut by the Reserve Bank of India (RBI) in that month.

From the start of this quarter, the yield movement so far has been about 73 basis points. One basis point is a hundredth of a percentage point.

What makes the situation miserable for banks is that the December quarter is also one in which banks must provide at least 50 per cent for stressed assets referred for bankruptcy proceedings, or accept haircuts through resolution.

The provisioning needed on account of this is about Rs 2 lakh crore, roughly the same amount the government has promised to be put in banks over three years.

The yield on the 10-year bond closed at 7.396 per cent, about 18 basis points higher than its previous close. This is the sharpest intra-day movement in yields since February 8, and triggered stop-losses in some banks.

Mid- and long-term debt mutual funds suffered heavy single-day losses on Thursday, with net asset values (NAVs) of some schemes losing as much 130 basis points in a single day. A Balasubramanian, CEO, Aditya Birla Sun Life Mutual Fund, said, “The increase in government borrowing created uncertainty in bond yields, pushing up the yield by 20 bps and resulting in the fall of bond prices. This is likely to gradually push up yields on other securities.” He sees some volatility in the short term.

Deepak Agarwal, debt fund manager, Kotak Mutual Fund, said that till the Budget presentation, the 10-year G-Sec yield would hover between 7.3 and 7.5 per cent. “Currently there is a perception that interest rates will not go up in the next six months. Unless that perception changes, there will be no impact on short term funds.”

The RBI will auction bonds worth Rs 15,000 crore on Friday. Much depends on how successful the auction would be. Bankers are hoping that there would be no “devolement”, which is a term used for unsold bonds.

However, chances of that happening are slim. First of all, the view in the market is that the yields could rise to 7.50 per cent, or even 7.80 per cent, around the Budget before cooling. And therefore, the bids to be placed for the auction would ask for higher yields, which is lower prices offered for a bond unit.

Bond dealers say the yields the market would ask for in the present situation the RBI is unlikely to accept. Being the money manager of the government, it is also the RBI’s job to see that the government borrows cheap.

Nevertheless, the market would be keenly watching the cut-off set by the RBI because that would be a kind of signal as to what yield level the central bank sees is appropriate at this current juncture. That directly should cool yields by a few basis points.

“The RBI must spell out where the yields should be. The market will be looking for a signal on Friday,” said a foreign bank treasury head.

“Under the present circumstances, much of the movement in yields has happened already. Now if the RBI finds the levels okay, the yields will rise further,” said a treasurer. According to the bond dealer, there could be a technical correction of about 10 basis points after the auction results are out.

There is also an outside chance that the government would tell the banks it owns to have an understanding among themselves and bid at a low yield level. That will not only cool the yield levels, it would also save banks the pain at the end of the book closure. After all, nationalised banks are used all the time to intervene in the currency markets.

A tell-tale sign of that happening would be if the cut offs significantly vary from the market yields. However, chances of that happening too are low because irrespective of banks buying huge amounts of bonds for now, the yields will rise eventually. And considering the outlook for the yields, the very bonds bought in the auction would be sold as quickly as possible in the market to cut losses.

“That kind of rigging doesn’t happen these days. The market is huge and transparent. Besides, nobody wants to book losses just to make one quarter look good,” said a bond dealer.

One of the reasons for not taking too aggressive a position in bonds is that banks are sitting on huge amounts of bond holding. The central bank has reduced the statutory liquidity ratio (SLR – the share of deposits to be maintained in government bonds) to 19.5 per cent from the usual 24 per cent.

The idea is to slowly replace the SLR with the liquidity coverage ratio (LCR), an international practice. But currently both are operational and therefore banks have to maintain extra bond holdings. Even then, in the absence of healthy credit growth, banks are sitting on an extra SLR of 8-10 per cent of their deposit base. Clearly, they are going slow on accumulating more bonds on their books and that is putting pressure on the yields.

But bankers also say these levels are value-buying ones as yields have moved too much in too short a period.

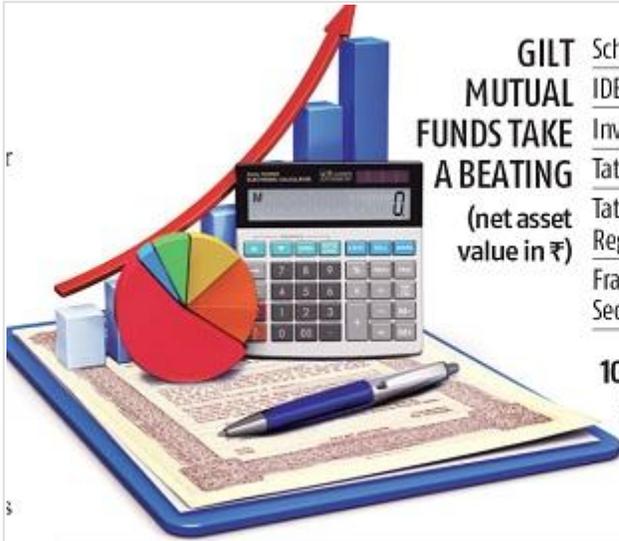
“Around 7.40 per cent should be the top for the yields for now, but it is not likely to come down in a hurry either,” said Jayesh Mehta, head of treasury, Bank of America Merrill Lynch.

Meanwhile, the recent rise in bond yields has not triggered a sudden shift from debt to equity in India's mutual fund sector from the investors' perspective. Debt investors continue to prefer debt schemes. However, fund managers said that funds which are balanced in nature (debt as well as equity) may have seen a slight tilt towards equity than debt instruments in their portfolio over the last few days. Going forward, they say fund managers would attempt to reduce duration in short-term and dynamic bond funds to 1.5 to 3 years to maximise gains given the upcoming slippages in the fiscal deficit.

Bond dealers largely blame communication from the government for the sharp yield movement. Even a month or two ago, top government officials maintained that they would honour the fiscal discipline set for themselves. Now with the short-term savings rate cut, chances of deficit financing through savings deposits also get hit. While the government has collected about Rs 1 lakh crore through small savings, how much of redemption would happen in the fourth quarter is not known. The net extra borrowing works out to about Rs 73,000 crore for this fiscal, including through treasury bills, which may push the fiscal deficit to a minimum of 3.5 per cent of gross domestic product, higher than the 3.24 per cent budgeted.

“Even if you take government’s argument that it is adjusting dated bonds with treasury yields, in a rising interest rate scenario nobody wants duration risk,” said a senior bond dealer with a primary dealer, explaining the sharp yield movement post government's borrowing plan.

(With contributions from Chandan Kishore Kant)



**GILT
MUTUAL
FUNDS TAKE
A BEATING**
(net asset
value in ₹)

Scheme	Dec 27	Dec 28	% Chg
IDBI Gilt Fund	14.1461	13.956	-1.34
Invesco India Gilt Fund	1,811.08	1,787.2025	-1.32
Tata Gilt Retirement Plan	22.5637	22.2667	-1.32
Tata Gilt Securities Fund- Regular Plan	49.7126	49.0585	-1.32
Franklin India Government Securities Fund	39.1842	38.6967	-1.24

10-YR G-SEC
(yield in %)



Source:
Bloomberg