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Government securities (G-Sec)

Why in news?

The latest inclusion of JP Morgan in the Indian bonds is expected to generate monthly inflows of around USD 2 billion for nine months, boosting demand for government bonds.

What are government securities?

> ***A bond*** *is a debt instrument in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate.*

- **G-Sec** – A Government Security is a ***tradable instrument*** issued by the sovereign government.

Short term G-Sec's	Long term G-Sec's
• Original maturities of less than one year • Also known as treasury bills or T-bills.	• Original maturity of one year or more • Also known as government bonds or dated securities

- **Issuing authority** – The Central government and the state governments.
    - **Central government** - Both *treasury bills and dated securities/ bonds*
    - **State governments** - *Only dated securities/bonds* which are referred to as *State Development Loans* (SDLs).
- **Issue** – They are issued through *auctions conducted by RBI*.
- Auctions are conducted on the electronic platform called the ***E-Kuber***, the Core Banking Solution (CBS) platform of RBI.
- All members of E-Kuber can place their bids in the auction through this electronic platform.
- **Significance** – It allow the *government to raise money* by issuing bonds and thus acknowledges government's debt obligations.

What are the types of Government Securities?

- **Treasury Bills** – These short-term investment instruments which come in three variations *91 days, 182 days and 364 days*.
- It does not offer any interest but issued *at a discounted rate*.
- When you redeem them, you get them at the face value.
- RBI auctions T-Bills every week or fortnight.
- **Cash Management Bills (CMBs)** – It was introduced in the year 2010 whose maturity period is *less than 91 days*.
- They generally fulfil temporary cash flow requirements of the government.

- **Dated Government Securities** - They are long-term investment instruments with tenures ranging from *5 to 40 years*.
- These securities either have fixed or floating interest rates.

Instruments of Dated Government Securities
• Fixed Rate Bonds • Floating Rate Bonds • Inflation Indexed Bonds • Capital Indexed Bonds • Bonds with Call/ Put Options • Special Securities • Separate Trading of Registered Interest and Principal of Securities (STRIPS) • Sovereign Gold Bond • 7.75% Savings (Taxable) Bonds, 2018

- **State Development Loans -** They are issued by the state government.
- They offer a higher interest rate in comparison to dated government securities.

What is Fully Accessible Route (FAR) Bonds?

- **Existing routes** – Investments can be done through
  - Medium-Term Framework (MTF)
  - Voluntary Retention Route (VRR)
  - Fully Accessible Route (FAR)
- **FAR Bonds** – They were introduced by RBI in 2020.
- It opens certain specified categories of government bonds fully for non-resident investors.
- **Aim** – To allow non-residents to invest in specified government bonds without restrictions like investment limits.
- RBI regulates the investment limit by Foreign Portfolio Investors (FPI) in government securities.

> ***Foreign portfolio investment** (FPI) consists of securities and other financial assets held by investors in another country. It does not provide the investor with direct ownership of a company's assets and is relatively liquid depending on the volatility of the market.*

- **Recent trends** – Foreign portfolio investments (FPI) under the FAR have nearly doubled in nine months, reaching Rs 1.93 trillion as of July 16, up from Rs 94,709 crore on September 22, 2023.
- According to data from the Clearing Corporation of India (CCIL), this surge follows JP Morgan's inclusion of Indian debt in its index.
- **Significance** – Eases non-residents' access to Indian government securities.
- Aids inclusion in global bond indices.
- Encourages stable foreign investment in government bonds.

What are the risks involved in holding G-Secs?

- **Market risk –** Market risk arises out of *adverse movement of prices* of the securities due to changes in interest rates.
- It will result in *valuation losses* on marking to market or realizing a loss if the securities are sold at adverse prices.
- **Reinvestment risk –** There is a risk that the *investor may not reinvest* these proceeds at the original investment yield if interest rates decrease by the time of cash flow receipt.
- **Liquidity risk –** It occurs when an i*nvestor can't sell due to a lack of buyers*, leading to no trades or a distressed sale at a low price, causing a loss.
- Over time, the maturity of a liquid bond shortens.

Liquidity in G-Secs means the ease of trading these securities, shown by available buy-sell quotes with narrow spreads.

What lies ahead?

- *Holding securities until maturity* can avoid market risk.*Rebalancing a*
- *portfolio* by selling short-term securities and buying longer-term ones helps manage risk but incurs transaction costs.
- Asset Liability Management (ALM) can also manage risk by matching cash flows and durations of assets and liabilities.
- Caution is essential in derivatives transactions, which should only be undertaken with a full understanding of their risks and complexities.

Quick Facts

Fixed Rate Bonds
• These are bonds on which the coupon rate is fixed for the entire life (i.e. till maturity) of the bond. • Most Government bonds in India are issued as fixed rate bonds.
Floating Rate Bonds
• It does *not come with a fixed interest or coupon rate*, and the interest income changes as per the prevailing market conditions. • These might be a good investment option for people who wish to protect their portfolio from any type of risk.
Treasury Inflation-Protected Securities (TIPs)
• They are available for a tenure of *5, 10 or 30 years*. • It has the *dynamic principal* issued to keep up with inflation. • They offer *interest every six months* and the *rates change once every year* in case of rising inflation.
Zero-Coupon Bonds
• They can be invested in them at a discounted rate. • They do *not offer any coupon rate or interest rate.*
Capital Indexed Bonds
• The rate of interest is calculated as a *fixed percentage over the wholesale price index*. • This offers investors effective protection against inflation.

References

1. Businessworld | Government Bond
2. Business standard | Foreign portfolio investments
3. RBI | Government Securities Market in India