

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
<ul style="list-style-type: none"> • Original maturities of less than one year • Also known as treasury bills or T-bills. 	<ul style="list-style-type: none"> • 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 *investor 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](#)

