Uncertainty in Indian bond Markets

What is the issue?

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RBI is taking steps to keep inflation in control but it is not potential to address the threats in Indian bond market.

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What is a Bond market?

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- The bond market is a financial market in which the participants are provided with the issuance and trading of debt securities.
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- It is also called the debt market or credit market.
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- The bond market primarily includes government-issued securities and corporate debt securities.
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- It facilitates the transfer of capital from savers to the issuers or organizations requiring capital for government projects, business expansions and ongoing operations.
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- In the bond market, participants can issue new debt in the market called the primary market or trade debt securities in the market called the secondary market.
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How inflation controls the bond market?

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- An Investor gains interest from the bond market either from the interest that bonds pay, or from any increase in the bond's price.
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- The twin factors that affect a bond's price are inflation and changing interest

rates.
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- A rise in either interest rates or the inflation rate will tend to cause bond prices to drop.
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- Inflation and interest rates behave similarly to bond yields, moving in the opposite direction from bond prices.
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- If inflation rises bond prices tends to drop, this is due to rising prices reduce the purchasing power of each interest payment a bond makes and vice versa.
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What is the role of RBI in addressing inflation?

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- Reserve Bank of India (RBI) could cut rates to lift growth, but that would fan inflation even further.
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- The problem gets accentuated when the RBI has an explicit mandate to contain inflation within a particular range.
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- This means as long as inflation ranges between 2 per cent and 6 per cent, the central bank's inflation targeting is working.
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- If, however, prices rise or fall beyond the range for three consecutive readings, the concerns raises.
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What are the threats to Indian bond market?

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- After demonetisation, there is an incessant supply of state government bonds has added to the uncertainty in the bond market.
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- Due to the increasing limitations foreign investors are also disinterested in Indian bond markets and can't participate in the auctions in the stock markets.
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- Banks are losing appetite for the papers as the rise in bond yields since the end of June is brining steep mark-to-market losses.

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- Cues from global markets are also not very encouraging as the US continues with its rate hikes. Click here to know more about US fed rate hikes

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What are the concerns with RBI's recent moves?

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- The RBI has kept its monetary policy stance "neutral" for a long time.

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- But bond yields have surged 70 basis points, suggesting that the debt market is not comfortable with the situation.

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- There are no indications coming from the central bank on its course of action except that it would be strictly data-dependent.

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- But the market scenarios expect on a rate hike eventually pushing up yields.

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Source: Business Standard

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