RBI's Decision to Revive Bond Market

Why in news?

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Reserve Bank of India has announced to buy bonds worth Rs 100 billion to meet durable liquidity needs.

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What is the status of bond market?

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- Earlier benchmark yield on government debt was 6.35 per cent at the time of demonetisation in 2016.
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- In 2017, the benchmark yield on government debt has shot up and now it is touching a very dangerous 7.8 per cent.
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- Inflation looks set to return, driven not just by domestic factors but also the uncertainty about the path of crude oil prices.
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- Recent months saw INR 90 billion flow out of the debt markets, the total outflow of Rs 155 billion was the highest in 16 months.
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- Due to thisthe markets have been flooded with sovereign and quasi-sovereign paper increasing unwillingness to mop up government debt, which caused treasury losses.
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What is the decision of RBI about?

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- In its latest effort to cheer up the market, the Reserve Bank of India has announced that it will buy bonds worth Rs 100 billion.
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- This decision is taken in order to meet durable liquidity needs going forward.
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- There was some hope on the RBI's behalf that greater openness to foreign portfolio investors (FPIs) would help send down bond yields.
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- As a result, the RBI after consultation with the Securities and Exchange Board of India announced a series of measures to liberalise the purchase of bonds by FPIs.
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- These measures were an apparent relaxation of the minimum residual maturity period requirement and crucially an increase in the limit for FPI investment in central government securities.
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What are the concerns with RBI's decision?

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- The residual maturity requirement was replaced by a stringent requirement that investment in securities of any category with residual maturity less than a year must be 20 per cent or less than of the FPI's total investment in that category.
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- RBI introduced "concentration" requirements, which have put off many investors, among other things an FPI could not buy a majority of any issue of a corporate bond.
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- The market saw these and other requirements as detached from ground realities and counter-productive, they also judged the macroeconomic and fiscal situation and have not done so favourably.
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- Thus RBI which is entitled to stabilise the currency's movements must avoid being seen as attempting and failing to fight the markets.
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Source: Business Standard

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