IAS PARLIAMENT
Information is Empowering
A Shankar IAS Academy Initiative

Rise in Bond Yields

Why in news?

With the Reserve Bank of India hiking rates to rein in inflation, bond yields have risen to their highest levels in three years.

What do the rise in bond yields mean?

- **Rise in bond yields**- The yield on benchmark 10-year government bonds has shot up by 149 basis points to 7.50% in the last one year.
- Since the start of the year, long-term yields have risen by over 100 bps, and short-term yields by over 150 bps.
- The rise in bond yields hints at the possibility of overnight rates rising to 6%-plus over the medium term.
- The rise indicates that the cost of funds in the financial system is rising and so are interest rates.
- **For the government**- It means the government will have to pay more as yield (or return to the investors), leading to a rise in cost of borrowings.
- This will put upward pressure on general interest rates in the banking system.
- Expectations of higher inflation and the possibility of a rate hike can trigger a flight of capital from bank fixed deposits to RBI sovereign guaranteed bonds.
- **For debt investors**- The rise in yields means investors expect higher interest rates and are selling their bonds which will affect the debt investors.
- When yields rise and bond prices fall, net asset values of debt funds, which hold a sizeable chunk of government securities in their portfolios, will also decline.
- It will also impact corporate bonds, which are priced higher than government bonds.
- **For equity investors**- Rising bond yields are generally not good news for equity investors as they raise the cost of funds for companies and start hurting their earnings.
- It thus leads to outflow of funds from equities towards a less risky debt instrument.

Traditionally, bond yields have an inverse relationship with equities as a rise in bond yields means that the risk premium on equities will have to go up.

What to expect now?

- It is tough to figure out the peak in the current market as global uncertainties remain.
- However, markets have already factored in a rate hike of another 100 basis points by RBI.
- While the yields may rise by another 25-50 basis points depending on the government's borrowing programme and global oil prices, debt fund managers say investors can go for

short-term duration investment for 1-2 years.

Reference

1. https://indianexpress.com/article/explained/why-bond-yields-are-rising-and-what-means-markets-investors-7961340/