Invited Article

Trends in Indian Bond Market

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Debt market in India played a very significant role in financing needs of both Governments (Central & State) and Corporate Sector. This article provides a comprehensive view on short-term and long-term investments that are widely used for financing and captures current trends in various segments of debt market. The article also takes in to consideration the likely future developments that would have impact on debt market based on recommendations of Khan Committee on Corporate Debt Market and moving over of large exposures from banks to bond market.

Introduction

The overall Indian Bond market has size of around Rs. 226.12 lakh crores as on 31st March 2017. This consists of various instruments such as:

i)	Central Government Security	Rs. 76.37 lakh crores
ii)	State Development Loan	Rs. 31.74 lakh crores
iii)	Bank Credit / Loan	Rs. 78.41 lakh crores
iv)	Corporate Debt	Rs. 24.04 lakh crores
v)	Commercial Paper (CP)	Rs. 3.97 lakh crores
vi)	External Commercial Borrowing (ECB)	Rs. 11.59 lakh crores

Government Bonds

The Indian Bond market carries around 50% weight of Government Bonds. Out of overall bond market of Rs. 226.12 lakh crores, Government Bonds including State Developing Loans outstanding is at Rs. 108.11 lakh crores and the other bonds outstanding as on 31st March 2017 is Rs. 118.01 lakh crores.

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The insurance companies invest their surplus funds in Government Bonds and Corporate Bonds as per the IRDAI Regulations. The interest rates on Government Bonds declining for the last 2 years in line with the repo rate and low inflation. Resultantly the overall yield on the insurance funds (Life funds & Non-life funds) is also declining. The main reason of declining yield on investments is sharp falling interest rates on Government Bonds and limited opportunities to invest in Corporate Bonds and other instruments carrying better yields.

Bank Credit, ECB & CP

Bank credit is playing a major role in debt market. The banks generally lend money to the corporates in the form of various above instruments along with financial institutions, insurance companies and mutual funds. There is no active secondary market for the above mentioned instruments in our country.

Bank credit growth was believed to be a leading indicator of the state of the economy as it indicated the extent to which funding was taking place for both investment and working capital requirements. However, in the last few years it has been observed that companies have also been accessing other sources of funds such as the corporate debt market and ECBs for long term funds and the CP market for short term funds.

The factors considered for the same are:

(i) Relative cost of the funds from various other sources are very attractive. Banks would normally lend at rates close to or above the base rate or MCLR. Interest rate transmission tends to be swifter when it comes to corporate debt or CP market, while global developments on monetary policy drive the interest rates in the euro markets.

(ii) Regulatory procedures to be followed for accessing various markets. Here the RBI regulation relating to CPs or ECBs and Securities and Exchange Board of India (SEBI) on corporate debt market are pertinent.

(iii) The willingness of banks to lend in the face of increasing NPAs has been another factor at work when taking a call on source of finance.

(iv) The relative state of evolution of the corporate bond market and the steps being taken by the regulators for deepening the same are other factors influencing such decisions.

(v) Credit rating of companies also impacts the source of funding as the better rated ones have access to the corporate debt market while the sub-investment grade borrowers may have to settle for bank lending.

(vi) Movement in exchange rates and the forex risk associated with currency would be another deciding factor for companies when considering overseas borrowing.

Against this background the changing pattern of debt can be gauged over the last 6 years with four sources being taken into account: bank credit, corporate debt, ECBs and CPs. A Non-Banking Financial Company (NBFCs) have been left out as they are borrowers in the corporate debt and bank loan markets and use these funds for on-lending. Instead of looking at absolute amounts raised in the markets, to maintain comparability, the outstanding debt in each segment is standstill. This would also address the issue of repayments made during the year.

Table 1

Year	Growth O/S Debt (%)
2011 – 12	18.8
2012 – 13	16.5
2013 – 14	14.1
2014 – 15	13.5
2015 – 16	11.7
2016 – 17	10.0

(Source: SEBI / RBI)

Quite clearly the overall quantum of outstanding debt in the market has grown at a slower rate over the years and came down from 18.8% in FY 12 to 10% in FY 17. Hence, the general picture derived from bank credit growth which has slowed down is also reflected in overall growth in flow of funds and is not hence restricted to just one source.

Outstanding credit in all these forms increased from Rs. 53.60 lakh crores in FY 11 to Rs. 118.0 lakh crores in FY 17, which is a CAGR of 14.1%. However, the annual growth rates indicate that they have been diminishing in value over the years. Several factors have contributed to this phenomenon.

Few of the significant factors are:

- Economic growth has been sluggish while gross fixed capital formation has come down.
- Companies have been deleveraging to an extent.
- The NPA issue has also come in the way of both demand and supply of funds as investors are cherry picking their clients.
- Some companies have been using their internal accruals to fund the same.

Growth in bank credit (CAGR) has been the lowest during this period while that in CP was the highest at 30.6%. The corporate debt market has shown an impressive increase of 18% during this time period followed by ECBs. Corporate debt market has become progressively important from the point of view of companies with higher rating who are able to borrow at more competitive rates. This is also borne out from the volume of new issuances which increased to a high of Rs. 6.5 lakh crore in FY 17 while growth in bank credit had reached a low of 4.4% (as of March 23, 2017). ECBs have been attractive as global interest rates have been low.

With the rupee being quite strong and better performing relative to other emerging markets currencies, there was a tendency for companies to feel secure when accessing this market. CP market too benefited from the RBI's policy of lowering the repo rate as the rates in this market decreased swiftly unlike the bank lending rates.

As a result of these developments the relative importance of banks in the flow of funds has been diminishing over time. The share of banks in total outstanding funds in the financial system decreased continuously from 73.6% in FY 11 to 66.4% in FY 17. The corporate bond market improved its share from 16.6% to 20.4% while that of CPs increased from 1.5% to 3.4% and ECBs from 8.4% to 9.8%.

Corporate Debt Market

The increased share of the corporate debt market is a good sign as it indicates that long terms borrowers are moving to this market and with the latest Khan Committee recommendations being implemented the market would witness a further impetus in the coming years. Also the RBI's notification on large exposures moving over to the corporate debt market would further aid in boosting this segment. As long term lending should ideally not be a major component of the bank lending portfolio given the asset-liability mismatches that are likely, banks can be seen to be progressively concentrating more on short term lending with long term being restricted to personal loans and non-infrastructure manufacturing. The CP market would continue to be a substitute for bank lending at the shorter end of the lending tenure while attractiveness of ECBs would vary with the relative interest rate and exchange rate scenarios.

Conclusion

In the last 6 years the share of banks in overall debt options has been reducing continuously.

Corporate debt and ECBs have replaced long term debt from banks while CP has been preferred for short-term finance.

Notwithstanding the above, the overall growth in debt has slowed down for the economy. This is due to a sluggish economic growth, declining capital formation, deleveraging by companies and use of internal funds to fund a part of the investment requirements.

The interest rates are likely to be stable or in declining trends. The yield on Govt. Bond is also declining continuously. This will definitely help to enhance size of corporate bond market and also short term bond market like commercial papers. Corporate bonds are rated carrying fixed yield higher than yield on govt. securities. Corporate bonds are serviced through trustee companies and also carry proper co-laterals.

In our country, we need to develop vibrant and active secondary market for trading the corporate bond long term and short term.

Reference

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