Demonetisation drives rupee bonds - IFR News
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By Krishna Merchant

MUMBAI, Jun 2 (IFR) - Bond issuance by Indian companies hit a record for any month of May on record, as issuers rushed to take advantage of the rate rally caused by the country's latest demonetisation scheme, a rising liquidity surplus and hopes of an extended pause by the central bank.

Domestic issuers raised Rs938bn (US$11.4bn) from rupee bonds in May, according to Prime Database, even though it is usually a sluggish month. This beat the previous May record issuance of Rs788bn set in 2020.

Among the top issuers, Housing Development Finance Corp raised Rs348.7bn, Power Finance Corp printed Rs71.3bn, Rural Electrification Corp raised Rs40bn, Small Industries Development Bank of India sold Rs50bn, Indian Railway Finance Corp printed Rs25bn, Tata Power Renewable Energy collected Rs7bn and India Infrastructure Finance took Rs5bn.

"We saw record issuance in May as issuers took advantage of the rally in the corporate bond market," said Venkatakrishnan Srinivasan, a bond market veteran and founder of Rockfort Fincap, a financial services company.

One-year and three-year AAA PSU (public sector undertaking, or state-owned enterprise) bond yields came down by 5bp–10bp during the month to 7.44% and 7.47% respectively, according to Refinitiv data. The one-year government bond yield is at 6.78%, the lowest level since January 31.

Bonds beat loans

"This window of opportunity of attractive yield from the rupee bond market has come almost after 18 months," said Manish Maheshwari, Head of Debt syndication and Debt Capital Markets at BOB Capital Markets. "For AAA and AA rated corporates it is cheaper to raise bonds by 75bp to 100bp compared to loans."

Funding via bonds is much cheaper than the one-to-three-year marginal cost of fund-based lending rate (MCLR) which is 8.5%–8.7%, as quoted by State Bank of India, and comes with reset risk.

The Reserve Bank of India decided to pause on April 6 after raising rates by a combined 250bp in six consecutive increases since May last year. This has also spurred a rally at the long end of the yield curve.

The 10-year government bond benchmark yield is around 6.98%, which is where it was before the rate rises started, according to Refinitiv data.

Market participants expect an extended pause by the RBI, while the US Federal Reserve has also hinted at a pause.

"The uncertainty premium which was built into the domestic bond yields due to rate hike concerns in the offshore and domestic market has gone down," said Pankaj Pathak, fund manager for fixed income at Quantum AMC.

Liquidity improves

The liquidity surplus in the banking system has also improved, after the RBI said on May 19 it will withdraw the Rs2,000 note from circulation by the end of September.

Liquidity in the banking system rose to Rs1.76trn as of May 31 compared to Rs419bn as of April 30 and Rs495bn as of May 19, according to RBI data.

Generally, there is a liquidity deficit in May, as there tend to be heavy cash withdrawals in January to May and government spending is high early in the financial year, which begins in April.

But forex purchases by the RBI and the withdrawal of the Rs2,000 note have boosted liquidity, which is expected to go up further after the central bank's announcement of a Rs874.16bn dividend to the government as a surplus for the fiscal year that ended in March, compared to budget estimates of Rs480bn, according to Soumyajit Niyogi, director at India Ratings & Research.

It is estimated that Rs1trn worth of the Rs2,000 notes will come back to the banking system in the coming weeks, said Deepak Sood, partner and head of fixed income at Alpha Alternatives, a multi-asset class asset management firm.

Mutual fund investors have also turned huge buyers of corporate bonds. Domestic mutual funds received heavy inflows in March prior to the loss of a key tax advantage over other fixed-income products from April 1.

“The bunched-up flows were deployed in the corporate bonds between April and May," said Pathak.

This combination of high liquidity and lower rates onshore has also encouraged some issuers like IRFC, which were waiting on the sidelines to tap the offshore US dollar bond market, to sell rupee bonds instead because of attractive rates.

(Reporting by Krishna Merchant; Editing by Daniel Stanton)