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10-year bond yields rise to a 20-month high on rate hike 'signal'

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Topics

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The 10-year bond yields rose to a 20-month high after the Reserve Bank of India (RBI) on Monday announced a surprise Rs 2 trillion variable rate reverse repo (VRRR) auction, which the market interpreted as the central bank's signal to tighten the rate much earlier than anybody had pencilled in.

The central bank announced the VRRR auction in the morning, and scheduled it for the same day. A surprised banking system offered Rs 81,160 crore to the central bank, instead of the Rs 2 trillion the central bank sought. The whole amount was absorbed by the RBI for a cut-off of 3.99 per cent, which is just about the repo rate of 4 per cent, indicating the central bank has jacked up rates in the money markets at least, even if it continues to project an "accommodative" policy stance for "as long as necessary …."

The new liquidity framework envisages only one rate as the operating rate for the policy. By pushing the short-term rates near the repo rate, VRRR fulfils that objective.

Starting next year, the fixed-rate reverse repo window that offers banks 3.35 per cent for parking their excess funds would become almost obsolete as the central bank switches to the VRRR mode as their main liquidity absorption tool.

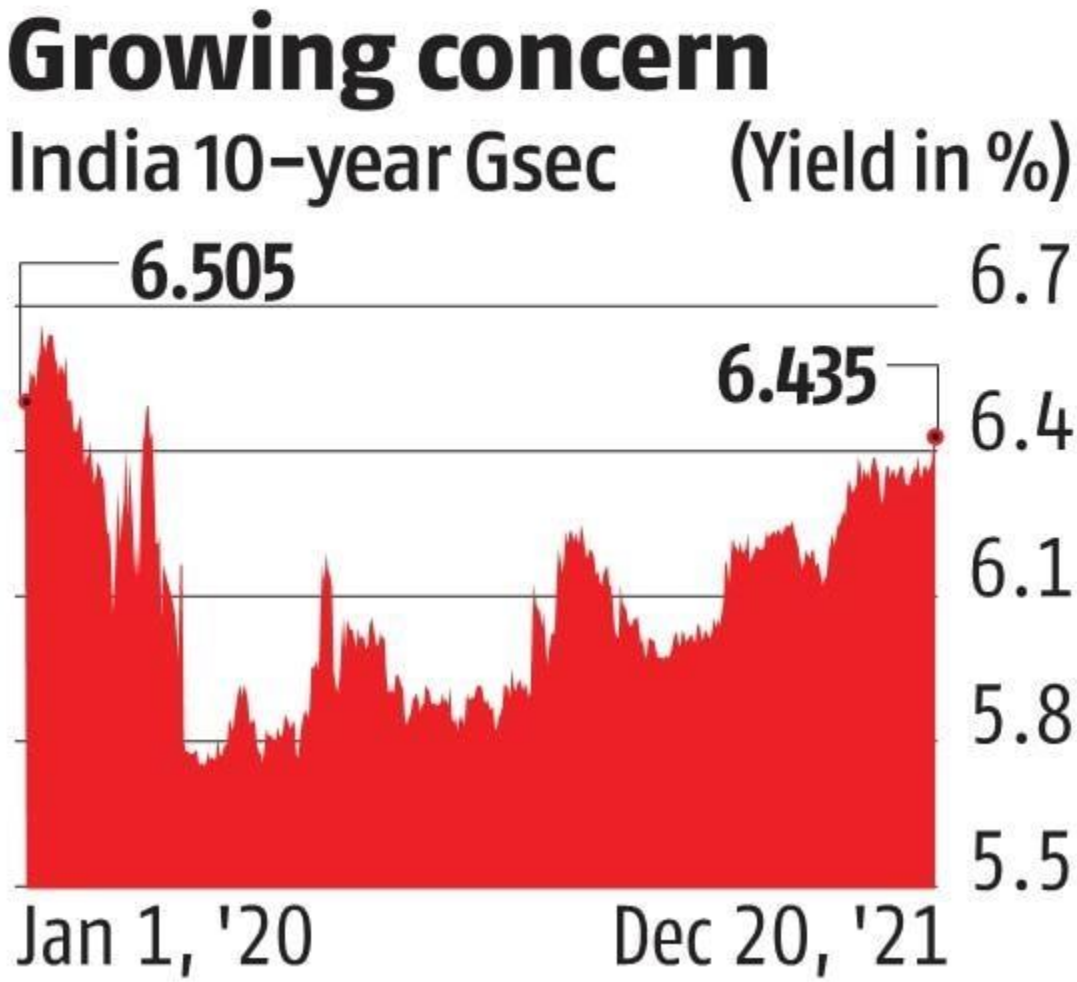
The 10-year bond yields closed at 6.44 per cent, up from their previous close of 6.41 per cent, and 6.38 per cent close on Thursday. Monday's close is the highest since April 16, 2020. The excess liquidity in the banking system continued to remain above Rs 6 trillion.

The rise in yields triggered stop losses. The call money rates touched as high as 3.99 per cent after the announcement.

Bond market participants said the Indian central bank is responding to the cues from the developed country central banks, such as the US Federal Reserve and the Bank of England (BoE), and the European Central Bank (ECB).

The Federal Reserve last week kept its policy rates unchanged but doubled the monthly liquidity absorption to $30 billion from $15 billion earlier. A majority of Fed members expected at least three rate hikes in 2022. The BoE increased its benchmark interest rate from 0.1 per cent to 0.25 per cent. Some ECB members sparred on the need to act faster, questioning the soft inflation narrative of the central bank.

These may have pushed the Indian central bank to shift its gears too, said bond market experts.



“Of course, global factors, such as policy actions by the Fed, the BoE, and the ECB last week, did create negativity but Monday’s announcement of an additional Rs 2 trillion three-day VRRR auction triggered the bond movement,” said Rahul Singh, senior fund manager at LIC Mutual Fund.

“The market is now expecting that the RBI will normalise faster than expected,” Singh said.

The central bank has, so far, held that its monetary policy will be determined by domestic factors, and it won’t be right to consider the monetary policy actions of the developed country central banks with India.

In a post-policy press conference, RBI Governor Shaktikanta Das had said developed countries’ inflation was way higher than their targets, which could be prompting them to tighten faster. However, in India, inflation was still within the 6 per cent range -- the operative band for the RBI. The central bank targets inflation at 4 per cent, with a tolerance band of 2 per cent on either side of the target.

Monday’s rise in bond yields was also triggered by the quarter-end selling by mutual funds and other investors, said bond dealers.

“After this VRRR signal, overnight rates will consistently trade around 4 per cent, which will slowly push up the long term rates too,” said Debendra Dash, head of asset-liability management at AU SFB.

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