Gilt-edged Market

Policy Measures

4.28 The amendment to the Securities Contracts (Regulation) Act, 1956 came into force from March 1, 2000. This has vested the Reserve Bank with regulatory powers in respect of dealings in Government and money market securities. RBI has permitted all entities having Subsidiary General Ledger (SGL) account and current account with the Mumbai office to enter into repos in Treasury Bills as well as Central/State Government dated securities.

4.29 The number of primary dealers (PDs) increased from 10 as on March 31, 1999 to 15 by March 31, 2000. From the current financial year, bidding commitments and performance in both primary and secondary markets are taken into account for fixing liquidity support to PDs under Level I (at Bank Rate) which is subject to a ceiling of three times their net owned funds. The Level II support to PDs (at Bank Rate +2 per centage points over Bank Rate) was withdrawn and the PDs were allowed to participate along with commercial banks in the Liquidity Adjustment Facility (LAF), which was introduced with effect from June 5, 2000.

4.30 The monetary and credit policy for 2000-2001 has allowed entities that have been allotted securities in primary auctions to sell them on the date of allotment itself. The transfer and settlement in respect of such sales will be effected in the next working day. Efforts are under way to upgrade the technology in respect of Government securities market through an electronic screen-based Negotiated Dealing System and computerisation of the Public Debt Offices. Technological upgradation on these lines will facilitate electronic bidding in primary issuance of Government securities, secondary market trading in Government securities and other money market instruments, including their derivatives. This will also facilitate connectivity for smooth settlement. At the time of Mid-Term Review of the monetary and credit policy for 2000-2001, the Reserve Bank announced final guidelines on categorisation and valuation of banks' investment portfolio (vide Box 3.4 of the previous Chapter).The Reserve Bank also announced final guidelines for issue of Commercial Paper (CP).

Centre’s Market Borrowing

4.31 The Union Budget for 2000-2001 has placed Centre’s net market borrowing at Rs.76,383 crore. Taking into account the repayments of Rs.41,321 crore, the gross market borrowing worked out to Rs.1,17,704 crore as against the actual borrowing of Rs. 99,630 crore in 1999-2000. Till January 16, 2001 Rs.105,433 crore or about 90 per cent of the budgeted amount was completed. While 89.3 per cent of this amount was borrowed via dated securities, 364-day Treasury Bills accounted for the remaining 10.7 per cent. After allowing for repayment/redemptions amounting to Rs.36,500 crore comprising both dated securities and 364-day Treasury Bills, net borrowing of the Central Government till January 16, 2001 worked out to Rs.68,933 crore or 90.2 per cent of the budgeted net market borrowing for 2000-01.

4.32 The current financial year started with a one per centage point reduction each in the Bank Rate, the Repo rate and the CRR. The very first sale through the reissue of a ten-year paper (12.29 per cent Government Stock 2010) through price based–auction held on April 11, 2000 could mobilise the notified amount of Rs. 5000 crore at a cut off-price of Rs. 112.32, giving a yield of 10.26 per cent on a 10 -year paper. Two more price-based auctions were held in April to mobilise Rs. 6000 crore: i.e. 9.9 per cent GOI stock 2005 with 5-year maturity and 10.70 per cent GOI stock 2020 with 20-year maturity. Though the value of bids received exceeded the notified amount in respect of the 20-year paper, bids worth only Rs.425.50 crore were accepted at par value of the security, giving a yield of 10.70 per cent and the balance devolved on PDs. This indicated expectation of higher returns on longer maturity paper.

4.33 The pressure in the foreign exchange market in May 2000 triggered expectations of higher yield and altered the bullish sentiment in the Government securities market, which prevailed in April 2000. Consequently, subsequent borrowing necessitated issuance of shorter maturity papers at higher yields in keeping with the market preference. However, with the addition to liquidity through the mobilisation of (Rs 25,662 crore) under the India Millennium Deposits (IMDs), the market sentiment improved. Table 4.7 shows the trends.

4.34 The figures show that the weighted average yield and maturity reflected the comfortable liquidity position at the commencement of the current financial year. However, subsequent developments created considerable uncertainty in the market which, in turn, led to decline in maturity and increase in yields. There was huge devolvement (comprising shortfalls in market absorption in

TABLE 4.7

Central Government's Market Borrowing during April-December, 2000

Month	Notified Amount (NA) (Rs. crore)	Private Placement/ Devolvement on RBI (% to NA)	Weighted Avereage YTM(%) (Nominal)	Weighted Avereage YTM(%) (Real)	Weighted Avereage Maturity (years)
April	11000	23.4	10.28	6.83	11.27
May	18683	31.5	10.45	6.76	8.93
June	4000	23.4	10.71	6.74	6.97
July	18500	67.8	10.68	6.32	6.75
August	12000	87.3	11.40	6.70	8.00
Sept.	3000	12.5	11.49	6.53	7.92
Oct.	6000	0.0	11.70	6.42	10.77
Nov.	10000	0.0	11.43	5.83	10.80
Dec.	7000	14.3	11.32	5.34	13.57

YTM : Yield to Maturity.

Fig. 4.3

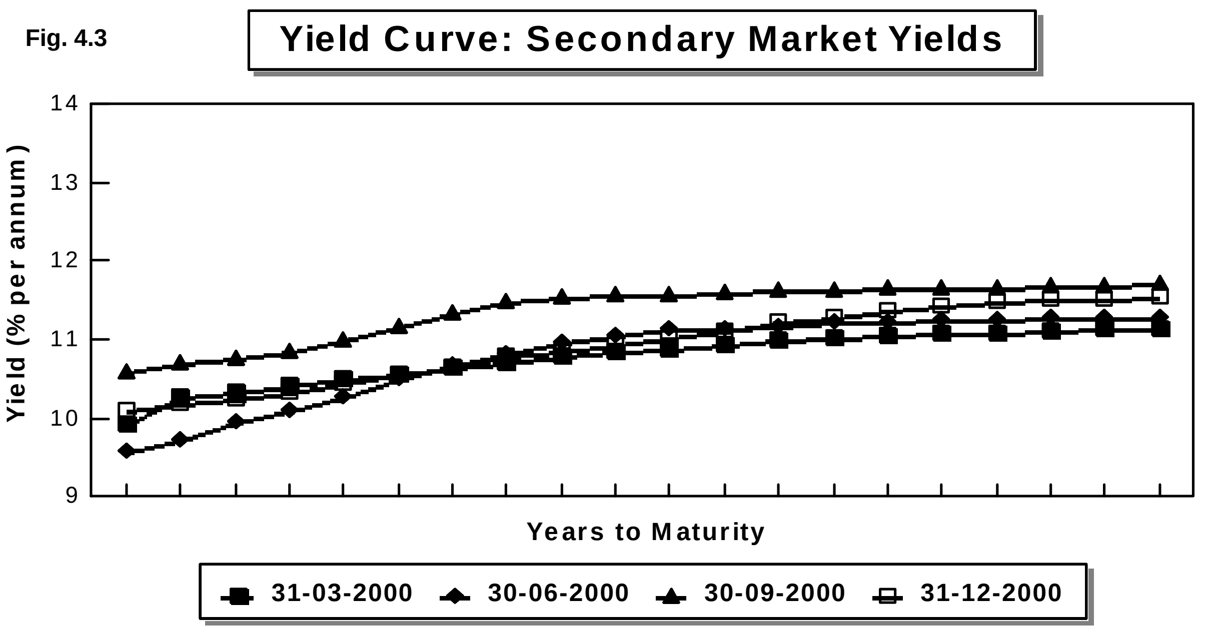


TABLE 4.8

Implicit Yield at Cut-off Price on Treasury Bills

(Per cent per annum)

Month	364-days Nominal	364-days Real	91-day Nominal	91-day Real
April	9.27	5.82	8.05	4.60
May	9.15	5.46	8.46	4.77
June	9.24	5.27	8.91	4.94
July	9.77	5.41	8.86	4.50
August	10.81	6.11	10.29	5.59
September	10.85	5.89	10.17	5.21
October	10.46	5.18	9.67	4.39
November	10.15	4.55	9.08	3.48
December	10.02	4.04	8.90	2.92
January	9.55	3.10	8.85	2.40

auctions and private placement with RBI) in July and August. As a result, the weighted average yield rose to 11-12 per cent range despite the reduction in the weighted average maturity. The inflows via IMDs facilitated a reversal of this situation in the third quarter of the current financial year. This is discernible from the Yield Curve (Fig. 4.3).

Nominal and Real Yields

4.35 Table 4.7 shows the trends in nominal and real yield during April through December in 2000-01.Real yield has been obtained by subtracting from the nominal yield the monthly average inflation rate (average of the weekly WPI-based annual inflation rates). In the subsequent section on Treasury Bills, similar figures are given in respect of 364-day and 91-day Treasury Bills.

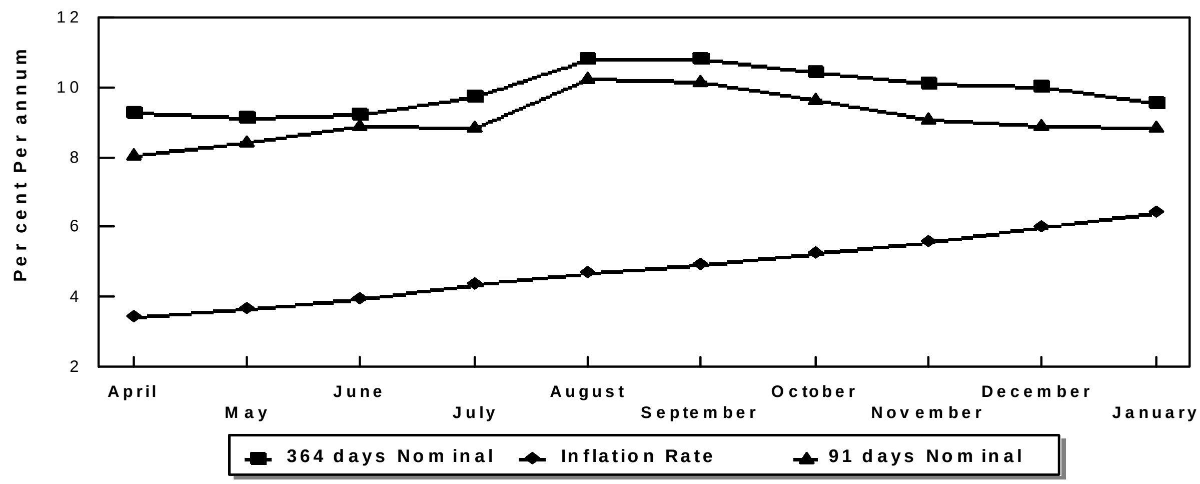
4.36 The current financial year witnessed hardening of interest rates on short term borrowing. Though the impact of the measures comprising reduction in Bank Rate, repo rate and CRR facilitated lower interest rates during the fortnights spanning the period April 4 to July 12, the subsequent fortnights up to end-November, witnessed increase in the yield on 364-Day Treasury Bills. As a result, the yield remained consistently above 10 per cent. However, the favourable impact on liquidity in November on account of the IMDs facilitated lower yield below 10 per cent by December 27, 2000. Similar trends were observed in respect of 182-Day Treasury Bills as well. The monetary tightening in July affected the short term interest rates (implicit yield) on 91-Day Treasury Bills also (Figure 4.4). Even in the case of 14-Day Treasury Bills, the yield crossed the 10 per cent mark in August, 2000.

Open Market Operations

4.37 The open market operations (OMOs) reflected the need for the RBI to adjust liquidity in response to the emerging interest rate scenario. During the period April-December, 2000, RBI purchased Government of India (GOI) dated securities only in the months of July and August whereas it sold them in each of the nine months during this period. While the purchase worth Rs.4471 crore was designed to add to liquidity in the wake of monetary tightening in July, sale worth Rs.23,667 crore aimed at draining excess liquidity from the

Fig. 4.4

Implicit Yields on Treasury Bills at Cut-off Price and Inflation Rate in 2000-2001



system. The Reserve Bank also resorted to OM purchases of Treasury Bills of varying maturities with a view to fine-tuning temporary asset-liability mismatches. During April-December, 2000 almost all OMOs in Treasury Bills constituted sales amounting to Rs.2679 crore.