Bond Market in India – the way forward

Nipa Sheth
Director
Trust Investment Advisors Pvt.Ltd.

Well-functioning capital markets are critical to the smooth running of modern economies. Periodically, though, capital markets are gripped by crisis of confidence emanating mostly from excessive leverage by certain industry players. As rightly said by Mr.Robert Skidelsky, "If only one person were perfectly informed there could never be a general crisis. But the only perfectly informed person is God, and he does not play the stock market." The current period of uncertainty in the corporate debt market has led to a fall in trading volumes. It is important that the regulators continue on the path of market reforms that they have embarked up on. Any economic crisis in a developing economy paves way to craft sustainable reforms; the hope is this that crisis will not be wasted either.

A country's capital market is divided into the equity and debt market. While India is at par with the equity market worldwide, we are still at an emerging stage when it comes to the debt markets. The Interim Budget of 2019-20 has most appropriately marked the beginning of what may be a radical reform for the bond markets in India. The proposed initiatives taken up in the budget reflects government's intent to deepen the bond markets through deepening markets for corporate bond repos, credit default swaps etc. ,with a special focus on infrastructure . Owing to the current liquidity situation in the NBFC sector ,an invigorating strategy has been proposed in the current budget. For purchase of high-rated pooled assets of financially sound NBFCs, amounting to a total of Rupees 1-lakh crore, or Rs 1 trillion, during the current financial year, government will provide one time six months' partial credit guarantee to Public Sector Banks for first loss of up to 10 per cent, this will help reinstate the confidence of the investors in the bond markets .PSU recapitalization of higher than expected amount of 70,000 cr ,the government indicates its ambition them with growth capital. The demand for sovereign debt from foreign institutional investors (such as sovereign funds, pension funds) has been on an increasing trend . In search for yields, the EM debt allocations have been on the increase in a world where interest rates are low/near zero/negative. On the supply side, the absolute level of Indian Government debt keeps increasing, even though fiscal deficit as a percentage of GDP is declining. The government intending a higher foreign capital infusion in the PSU and Private sector, the Indian markets are enroute to globalization.

In the developing state of a country, infrastructure sector becomes a key driver for economic development and is highly responsible for propelling India's overall development .It enjoys intense focus from Government owing to a high investment in this sector .As stated by CRISIL Year book 2018,it is estimated that by 2023 the infrastructure capex requirement would be of Rs 55.2 trillion to have sustainable development in the country which would be 48% of the over the Rs 37.2 lakh crore made in the five years through fiscal 2018. The top five sectors – roads, power (generation, transmission and distribution), railways, irrigation, and urban infrastructure that would account for ~90% of the total spend. A~30% debt funding is expected, of which Rs 6-7 lakh crore would come from the bond market . On the supply front, sector wise breakup of primary issuances is dominated by the financial and infrastructure companies which would account for 90-92% of the total outstanding during 2017-19. Whereas on the demand side the institutional investors are the key investors in the debt market due to the limited appetite among the retail investors. The total corpus invested of Rs.27.4 lakh crore growing at 10-15% p.a. is expected to increase to 52-56 lakh crore by FY23. Inorder channelize these investments in development of infrastructure in operating assets it is crucial that the regulatory restriction need to be eased for the investments made by these pension funds and long term liabilities .This can enhance the participation by domestic savings into debt capital market on long term basis. For the exponential growth of these sectors and economy it is imperative and critical that the domestic debt markets to deepen further and reduce the burden on the commercial lending markets.

Some crucial steps that can develop and aggrandize the Indian Debt markets have been mentioned below :

- Enable Indian Bonds for EUROCLEAR settlements – making the settlement process easier will help a larger number of FIIs to participate in Indian bond markets.
- Engage with the global benchmark indices to include Indian bonds – Exposure to Indian bonds for many foreign portfolio managers is an off index bet. Inclusion of Indian bonds will lead to long term passive inflows into Indian debt markets.
- Increase limits for FII holdings – one precondition for inclusion in global indices is that local limits should be freely available
- Deepening the Indian sovereign bond market by increasing participation of long horizon FII investors and endorsement of the FPI's to subscribe to listed debt securities issued by ReITs and InvITs, will

have a beneficial impact on demand situation for the securities in domestic market. This will also enable better transmission of rate cuts thus boosting growth.

- An active Credit Default Swap (CDS) market could also increase the liquidity in the corporate bonds across ratings. The CDS market on Indian Paper is liquid outside India but mainly non-existent in India. Some steps to develop the aforesaid market in India would be allowing FII participation by making it more capital efficient, tax efficient, less stringent regulations.
- The Reserve Bank of India (RBI) had introduced repos in corporate bonds in 2010, but the response had been lukewarm. A vibrant repo market is important to deepen the bond markets in the country , government to endeavor to further policies to promote the development of the repo markets in the country.
- While, trading in equities is largely electronic – secondary trading in corporate bonds has seen little progress. If electronic trading can be introduced by improving standardization in corporate bonds – that would be a welcome development. Increasing direct reach to investor through digitalization would encourage debt IPO issues making it relatively a cost efficient option.
- A lot of work has been undertaken on a Bond guarantee fund. This would help companies improve their borrower profile through credit enhancements such as full or partial guarantee offered by the fund. It is time now to get this fund from the drawing board to the marketplace.
- To increase retail participation, providing tax incentives by creating a separate category for investments in corporate bonds (either directly/indirectly) needs to be considered.

From, being accounted amongst the Fragile Five a few years ago, India has come a long way since the past decade, be it bond market guidelines or settlement infrastructure but now more than ever there is a compelling need for an institution overarching a leadership role to govern the acts & movement, be a market maker , ensure that the guidelines issued are duly implemented and ensure liquidity in the market. With several years of belt tightening behind us, the economy is well placed to resume its march onwards. India is amongst the few countries with well-functioning legal systems, requirement for capital and delivering returns on invested capital. Increased FII participation in government bonds would create more headroom for domestic investors to invest in corporate bonds. It is thus likely to be much in demand from foreign capital struggling with low returns globally. With measure like the government requiring large companies (long term borrowing > Rs. 100 cr. to borrow at least 25% from the bond market, a constant effort to make the domestic markets robust is being done. A combination of foreign and domestic investors force multiplied by vibrant bond markets is critical to the Indian debt markets for taking it to its rightful place.