Indian Corporate Bond Market

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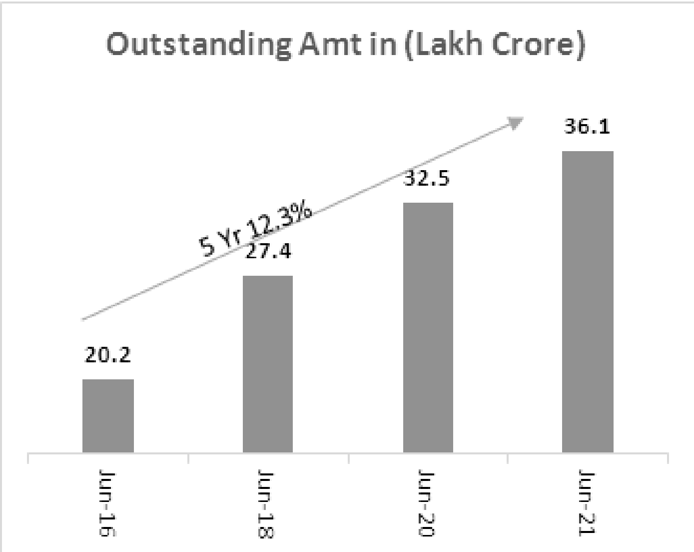
Corporate bond market at a fundamental levels bridges the gap between low risk capital and entrepreneurial capital appetite. Globally, the corporate bond market is expected to be in excess of US$ 40 trn. The US corporate bond market size alone is in excess of US$ 11 tn while the Chinese corporate bond market is more than U$ 8 tn. In contrast, the Indian corporate bond market is at around US$ 500 bn, which is around 17% of the GDP.

The development of corporate bond market has lagged as compared to government bond market in India. For the nation of our size, potential and aspiration, this penetration level is too little. The Indian corporate bond market has remained relatively small in size despite a long history, several committee recommendations, and continuous reforms.

Despite visible progress being made in the right direction, the corporate bond market growth faces a few headwinds. Most important of them is the illiquid secondary market, the narrow investor base, the lack of diversity of instruments and the crowding out by large public issuance. At that, the high costs of borrowing, the information asymmetry,, the limited number of repo options etc are also an issue. Additionally, the absence of well-functioning derivatives market and credit enhancement facilities that could absorb interest and default risks are also withholding the market.



Source: Bloomberg

The GDP growth is in many ways pegged on the nation's ability to raise and resolve debt in a fluent manner. See it this way: you can build your house 20-25 years hence once you have accrued sufficient cash through regular flows. Or, you can take debt now based on your future cash flow projection and have your house now.

At larger scale, this insufficiency of the Indian corporate bond market has hampered our growth needs for infrastructure financing, capacity development, trade competitiveness and overall capital productivity. Amongst the major economies, India may be the only market where the corporate bond market is less in extent and depth than the equities market.

Insight into the Present Corporate Debt Segment:

Sectorwise Corp Bond Issuance	June-21 (%)
Financial Services/Investments	41
Banking/FDs	25
Housing Finance	11
Civil Construction/Real Estate	4
Auto	4
Telecom	4
Power	4
Others	7

Source: Care Ratings

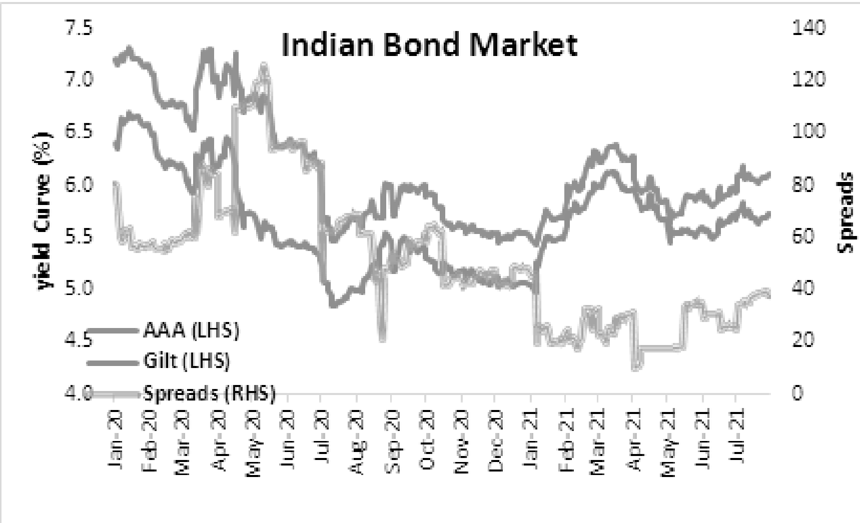
Borrowings by corporates from the bond markets have been muted in the current financial year compared with year ago. However there has been improvement in the bygone quarter. As per the provisional data, corporate bond issuances in June'21 was Rs 38,685 crs, which is up 27% from May'21 but still lesser by 29% from last year issuance.

Almost all the corporate debt issuances in June'21 were via private placement. Around 38% of the issuances in June'21 carried a tenure of 1 to 5 years and 36% of funds raised were of 5 to 10 years maturity. 62% of the total issuances in June'21 carried a credit rating of AAA. Nearly 30% of the issuances belonged to the AA category (AA+, AA- and AA). A category and below rated issuances accounted for 10% of the issuances.

Thoughts on Scaling the Market:
The most liquid market today in Indian debt space is the government securities (gsec) market. Coprorate bonds typically trade at a spread over the gsec. Thus, the gsec market has also provided a robust backbone for the development of the corporate bond market. Stable credit spreads (difference between government securities and corporate bond yields) over long periods of time stand testimony to the relatively smooth transmission of impulses from the government securities segment to the corporate bond market. The Government bonds trade via an anonymous trading platform called NDS-OM. This has led to quantum surge in secondary market trading volumes in comparison to pure OTC (over the counter) market

For corporate bonds, currently we have RFQ (Request for Quotes) platform which has been mandated for only mutual funds. RFQ is an online platform where participants can quote bids and offers for debt securities. This platform is an improvement over the OTC market that is presently prevalent.

The absence of mandatory participation by institutional investors such as banks, pension funds, insurance companies, corporate Treasuries etc leaves the platform wanting for depth. It is therefore not a surprise that our corporate bond market is marred by issues of liquidity, skewed yields, especially during crises



Source: Bloomberg

It is therefore imperative that the policy makers come together to ensure the transition of other financial institutions (non mutual funds) into the RFQ market. **This may also bring in liquidity, institutional demand, transparency and depth to the corporate market. This in turn could ensure better transition of credit, lower capital cost and better credit offtake**

The corporate bond market also needs to have access to more types of derivative bond / debt securities. **In essence, the corporate bond market must have ability to create leverage, apart from mere hedging for its investors.** Debt leveraging has a money / capital multiplier effect on the economy. While everything in excess can be troublesome, the almost complete absence of leveraging capability in the corporate bond market is restrictive. Both, the risk-seeking investors as well as debt starved creditors suffer as a result. In a nation where fly-by-night chit fund operators raise thousands of crores from speculative investing, leveraged bond funds (with tightly defined contours) may be any area of innovation to be worked upon. Vehicles for such strategies could be mutual funds apart from PMS and AIFs. This will likely enable risk capital to enter debt market and attempt to increase the liquidity and depth in the market. This could also further bring down the debt cost, increase the depth and the improve rate transmission.

These in turn could probably stimulate growth in the corporate bond market and reduce the credit offtake pressure on the banking sector.

Other than that, the inclusion of India in the global bond indices too will assist in attracting foreign capital into Indian corporate debt.

WayAhead:
As per a study by CRISIL, the Indian corporate bond market to rise to INR65-70 lakh cr by FY 2025. This growth is likely to come primarily from infrastructure, NBFCs, HFCs and innovative products. As per the same study, the demand fillip is expected to primarily come from incremental demand from MFs, insurance and retirement funds. There is demand tailwind from policy measures and tax rationalization. For additional measures, enablers such as ESG may be needed to attract FIIs (Foreign institutional investors)and ETFs (exchange traded funds).