10 year Benchmark G-sec yield flirts with 8% mark for the first time in 3 years, witnesses steepest hardening in recent times

Recent Monetary Policy Review saw Reserve Bank of India's first rate hike in more than four years, a change in stance that saw 10 year benchmark G-sec yield almost touching the 8% mark for the first time in 3 years (since June 2015). The 10 year benchmark G-sec acts as a fair indicator of the investors sentiment of the Indian fixed income market. The benchmark yield has seen the steepest per annum increase in yield in recent times with ~180 bps hardening since the trough of 6.18% achieved in November 2016.

Domestic debt market has been primarily dominated by Government securities. In FY17-18, the amount outstanding in Government securities reached Rs. 53.2 trillion representing a sizeable market share of ~65% in sovereign debt market (constituting G-secs, T-bills and State Development Loans) and ~45% in the entire Indian fixed income market. With an average ~30% share of secondary market trades in the Indian G-sec market, the 'on-the-run' 10 year benchmark G-sec represents the most liquid maturity segment of the G-Sec market.

The NIFTY 10 yr Benchmark G-Sec Index captures the price change and accrued interest of on-the-run 10 year G-Sec. Additionally, NIFTY 10 yr Benchmark G-Sec (Clean Price) Index captures only the price change of 'on-the-run' 10 year G-Sec.

Performance analysis of various phases of NIFTY 10 yr Benchmark G-Sec Index

Exhibit 1 below depicts the 10 Year G-Sec yield and index values of the NIFTY 10 yr Benchmark G-Sec (Clean price) Index. As observed, the NIFTY 10 yr Benchmark G-Sec (Clean Price) Index depicts the standard inverse relationship between bond prices and yields. Additionally, the NIFTY 10 yr Benchmark G-Sec Index tracks the total returns (TR) of 'on-the-run' 10 year G-Sec (including price change and accrual returns). With a sharp hardening of ~180 bps in yields during the recent Phase 6, both NIFTY 10 yr Benchmark G-Sec (Clean price) Index and its TR variant delivered negative returns for the first time in all the 6 phases analyzed for the period between April 1998 (inception) and June 2018.

Performance of NIFTY 10 yr Benchmark G-sec index during various phases

Phase	Phase 1	Phase 2	Phase 3	Phase 4	Phase 5	Phase 6
Duration	Apr 1998 - Apr 2004	Apr 2004 - Jul 2008	Jul - Dec 2008	Dec 2008 - Jul 2014	Jul 2014 - Nov 2016	Nov 2016 - Jun 2018
Yield Levels	12.13% to 5.14%	5.14% to 9.32%	9.32% to 5.30%	5.30% to 8.72%	8.72% to 6.18%	6.18% to 7.99%
Yield movement (bps) (Total)	-699	418	-402	342	-254	181
Yield movement (bps) (per Year)	-115	98	-	61	-109	118
PRI return (annualized)	6.68%	-6.48%	30.27%	-6.02%	5.85%	-9.02%
TRI return (annualized)	17.24%	0.78%	33.94%	1.61%	14.17%	-2.39%

Key factors	**Phase 1** • was characterised by sharp softening in yields resulting in sizeable rise in total returns • GDP growth slowed down from 6.2% in 1998-99 to 3.9% in 2002-03 • Inflation dropped during the phase	**Phase 2** • Yields witnessed significant hardening, TR variant found support from coupon payments to remain flat • GDP growth increased from 7.8% in 2004-05 to 9.8% in 2007-08 • WPI inflation steadily increased to 6.7% in 2007-08	**Phase 3** • Yields saw sharp drop of ~400 bps within 5 months, resulting in healthy total returns of 33.9% • Global Financial Crisis 2008-09 • GDP growth dropped to 3.9% in 2008-09	**Phase 4** • was marked by fairly hiked yields as clean price index reported negative returns, TR variant found support from coupon payments to record marginally positive returns • Fiscal deficit touched 6% in 2008-09 and 2009-10 • GDP growth increased from 3.9% in 2008-09 to 6.4% in 2013-14	**Phase 5** • Yields dropped by ~250 bps as total returns index delivered healthy returns of 14.17% during Phase 5 • CPI Inflation slowed down to 3.9% in 2016-17 from 8.3% in 2013-14 • GDP growth took a hit due to demonetization initiative	**Phase 6** •Steepest hardening in yields with highest yield movement per year(118 bps) in all 6 phases analyzed •Returns of both PRI(-9.02%) and TRI(-2.39%) have turned negative for the first time in all 6 phases analyzed • Hike of 25 bps announced by RBI in June MPC review • GDP growth picking up gradually • CPI inflation spiked to 4.9% in May 2018

*Data ended June 7, 2018
#Returns reported during Phase 3 are absolute returns for the 5 month period between August 2008 to December 2008.

Signing off....

10 year benchmark G-sec yield, which is a fair indicator of the investor sentiment in domestic fixed income market, currently points at an interesting phase in Indian economy in general and fixed income market in particular. On 6th June 2018, Reserve Bank of India announced its first rate increase in more than four years with 25 bps hike in repo rate. Multiple domestic and global factors such as inflation control, macroeconomic indicators, asset quality of banks, crude oil prices, US fed rate hike cycle, etc. seem to have driven the change in stance of Monetary Policy Committee (MPC). Going forward, key factors such as domestic economic growth, RBI's next policy decision and inflation levels are expected to play a major role in 10 year benchmark G-sec yield trajectory and might determine whether the yield hardens further, remains flat or softens from the psychological barrier of 8 per cent.

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NIFTY 50

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India Index Services & Products Ltd. (IISL), a subsidiary of NSE, provides a variety of indices and index related services for the capital markets. IISL focuses upon the index as a core product. IISL owns and manages a portfolio of indices under the NIFTY brand of NSE, including the flagship index, the NIFTY 50. IISL equity Indices comprises of broad-based benchmark indices, sectoral indices, strategy indices, thematic indices and customised indices. IISL also maintains fixed income indices based on Government of India securities, corporate bonds and money market instruments. Many investment products based on IISL indices have been developed within India and abroad. These include index based derivatives traded on NSE, Singapore Exchange Ltd. (SGX), Chicago Mercantile Exchange Inc. (CME), Osaka Exchange Inc. (OSE), Taiwan Futures Exchange (TAIFEX) and a number of index funds and exchange traded funds. The flagship 'NIFTY 50' index is widely tracked and traded as the benchmark for Indian Capital Markets.

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