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'RBI may not opt for more open market operations to infuse liquidity'

Markets are not factoring in... that the nominal GDP has come down due to fall in inflation: HDFC Bank's Ashish Parthasarthy

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While foreign investors have pulled out funds from the Indian debt market amidst uncertainties across global financial markets, yields on government bonds remain attractive. As global markets stabilise, we should see more inflows, says Ashish Parthasarthy, Treasurer, HDFC Bank. Excerpts from an interview:

THE BL INTERVIEW

After the US Fed hiked rate in December, slower economic growth and uncertainties elsewhere across global financial markets —Bank of Japan adopting the negative interest rate strategy being one — have raised doubts on further rate hikes. What do you expect the US Fed to do?

That's a tough call to take. Right now the data seems to suggest that there's hardly any possibility of a further rate hike during the year, which is what the market is pricing in. But data can change and rate hikes cannot be ruled out altogether. If the global environment stabilises then it can pave way for rate hikes. At best there can be two more rate hikes in 2016.

How will such rate hikes impact our markets?

It is unlikely that there will be a direct impact on our markets. What will change is the hurdle rate for any overseas investor to participate in the domestic bond market. Foreign investors have more or less, utilised their full limits. A large pull-out of debt markets is also unlikely because yields on our government bonds are still attractive. While the rupee has seen some volatility in recent times, it can stabilise over the year.

But the rupee has been one of the worst performing currencies in recent times. Why?

Our domestic equity market has performed poorly when compared to other markets this year. Most markets were hit hard last year, while India remained relatively untouched. So to some extent our equity market is playing catch up, factoring in global uncertainties — rising US rates, worsening global environment or reduced risk appetite. So there has been a significant foreign outflow from our equity market which has impacted the rupee.

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> ASHISH PARTHASARTHY
> Treasurer, HDFC Bank

What about outflows in debt market?

While there is some amount of pull-out from our debt market, overall rates remain attractive and as global markets stabilise, we should see more inflows. The only part that has not been strongly embraced by the foreign investors is buying bonds on the longer end. With a view to nudge foreign investors to long-term bonds the RBI had barred investment in less than three year maturity. Currently some large investors are not looking at investing on the longer-end, but this will change gradually as our yields remain high.

Coming to that point, why has yield on government bonds not moved lower in the past year? Why is there a wide divergence in 10-year G-sec yield and the repo rate?

For one, the bulk of the rate action by the RBI —125 basis point repo rate cut — is done with and the market is pricing this in. Even if inflation moves lower to 4 per cent at best we can expect a further 50 basis points rate cut. Also, other factors such as banks' SLR requirement coming down have slowed demand for government bonds. With supply of these bonds remaining high this has had an impact on yields. There will be additional supply of bonds under the Centre's UDAY scheme too in the coming months. So the yield-curve at the medium and long-term can steepen further.

The RBI has been following the term repo route to infuse liquidity into the system through most of this fiscal than OMOs that can suck up the excess liquidity of government bonds. Has this also impacted yield?

There are two types of liquidity deficit that the RBI manages. One is the short-term gap which is managed by term repo. The longer liquidity deficit is addressed by OMOs (open market operations) and addition to FX reserves. As far as the RBI goes, it believes that there is sufficient reserve money growth to support the bank credit growth. So it does not want to infuse permanent liquidity through OMOs as it may eventually lead to inflation.

What the markets are not factoring in at this point of time is that the nominal GDP has come down, due to fall in inflation. Monetary policy actions and expected earnings growth have to take a lower nominal GDP growth into account. So bank credit growth, which is a function of the growth in the economy, has to take this into account.

So, there are unlikely to be a large number of OMOs going forward.

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