



## Analysis of SLR Investments in current FY 2011-12

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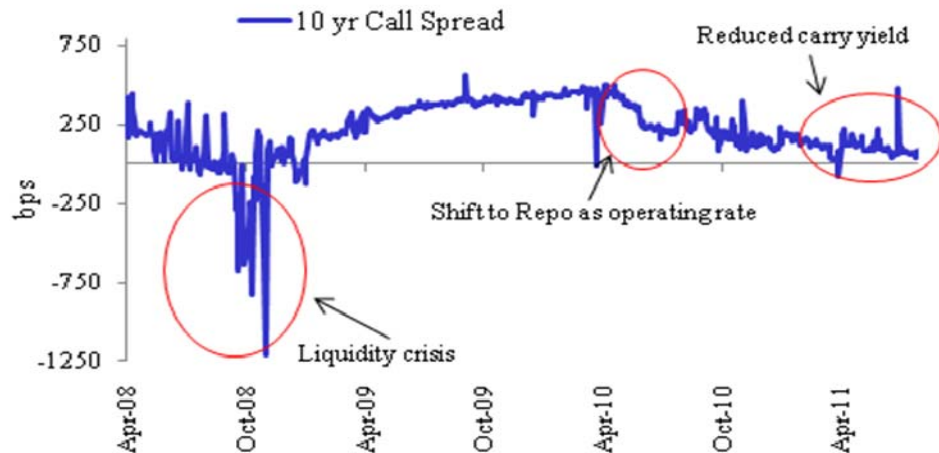
The Union Budget pegged the gross market borrowing for FY 2011-12 at Rs.4,17,000 Cr, much below market expectations as well as the borrowing seen in the last couple of years. Despite this comfortable platform, the G-Sec market started trading on a subdued note in wake of the emerging macroeconomic scenario. The successive rate hikes announced by the RBI further led to flattening of the yield curve. The longer tenor yields witnessed lesser volatility as compared to the shorter end of the curve. The transmission of the aggressive rate tightening has been limited on the curve beyond a 10 year tenor. Apart from a rate view for a horizon of 10 year and beyond, a significant factor in the containment of these yields has been the support received from bank buying.

This report aims at studying the yield movement in light of the investments in SLR securities by banks. It analyses the bank buying pattern in comparison to last year amidst the evolving macroeconomic conditions.

### *Analysis of SLR Investments*

#### **I. Background & History:**

Amidst continuing rate tightening, the current fiscal has marked tumultuous times for the G-Sec market. Most macro factors have led to a rise in the overall interest rate scenario and have impacted bond prices adversely. However, several other factors have capped the rise in yields. The issuance of new 7 year (at 7.83%) and a new 10 year security (at 7.80%) at the beginning of the year itself helped to pull down the yield curve. Several comments from various Officials to talk down yields have comforted prices. The Eurozone crisis as well as a softer US Treasury yield too has aided sentiment.



The graph shows the spread (bps) between the 10 year yield and the indicative call money rate. Tracking the Lehman collapse the 10 year yield



plummeted from a high of around 9.5% in July 2008. However the spread was a huge negative tracking the liquidity crisis that led to soaring money market rates. With substantial monetary easing by the RBI for the next one year the spread went on increasing from the negative bottom. The RBI started hiking rates since March 2010 which led to a compressed spread as the Repo rate caught up with the 10 year yield. Before the start of the rate hike cycle, the spread remained above 200 bps as the Reverse Repo rate was the effective operating rate. This spread earned a good carry yield. However, 2010 marked the shift to Repo rate as the operating rate. The carry yield thus reduced substantially. The current spread roughly stands at 45 bps with the 10 year yield broadly at around 8.45% and the Call rate at around 8%.

Higher yield and maturity of Issuance

	2010-11	2011-12
Gross Market Borrowing	437000	417000
Total Devolvement	5772.65	1506 *
Average yield of Issuance	7.89	8.39 *
Average maturity of Issuance	11.18 years	12.34 years *
OMO purchases	67246.27	-
<b>10 year yield:</b>		
Start of the year	7.8	7.98
End of the year	7.98	8.45 *
High	8.23	8.46 *
Low	7.38	7.86 *
Difference (High - Low)	85 bps	60 bps
Cumulative hike in Repo	175 bps	125 bps

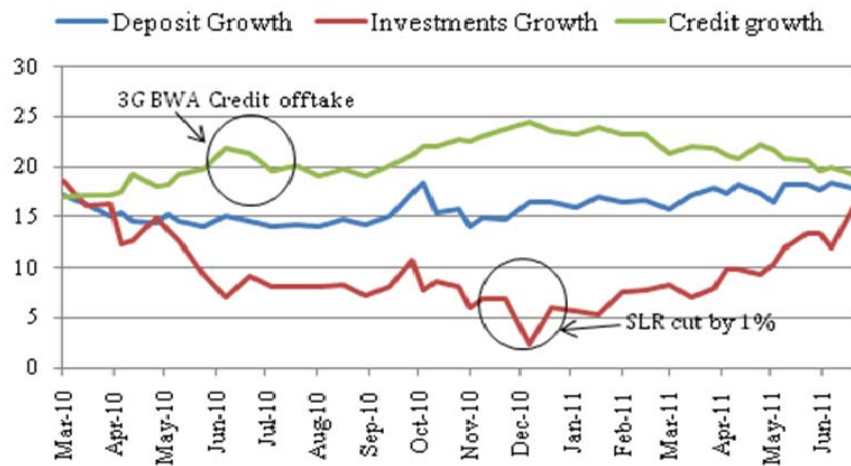
(\* Till July 31 2011)

The table reflects the volatility in the 10 year yield. The yield has moved 60 bps in the first four months as against 85 bps seen in the whole of FY 11. The 125 bps rate hike explains the movement. The average yield of issuance as well as the average maturity of issuance has risen.

## II. Emerging Scenario for Banks:

In line with the evolving macroeconomic conditions, the various monetary aggregates have witnessed huge volatility post the crisis.

The graph shows the trend observed in the year on year growth for Deposit, Credit and Investments seen since April 2010. The credit growth picked up post June 2010 tracking the money lent to telecom companies for 3G and BWA auctions. The investments marked a sudden dip around December 2010 in wake of the SLR cut from 25% to 24% announced by the RBI.



A reversal of the trend was observed since Jan 2011 wherein the credit growth started stalling however investments continued to be robust despite the SLR cut. The slowdown in credit can be attributed to the successive rate hikes announced by RBI. Tracking a huge sell-off post the SLR reductions, the YoY growth rate declined substantially.

### III. Banks SLR:

The graph shows the investments by banks in SLR securities over the last five years.

Robust SLR investments by banks



SLR Investments (LHS), YoY Growth (RHS)  
FY 2011-12 (Till July 15 2011)

The rationale for having SLR is that it has worked as a macro prudential tool. SLR makes banks invest in government bonds which are risk-free assets and reduces the overall systemic risk in the banking sector. The SLR has been gradually brought down by the RBI over the years.



However, it still provides a substantial support for the smooth completion of Government borrowing. Robust investments by banks have been a major support for G-Secs in FY 2011-12.

A specific reason for the investments slowdown in FY 2010-11 has been the strong credit off-take (primarily to telecom companies for 3G & BWA payments) as compared to the credit off-take that stalled in FY 2009 and FY 2010 post the crisis.

#### IV. Credit Conditions:

The deposit growth in the current fiscal has been robust tracking the higher interest rate scenario that attracted huge deposits. The incremental rise in aggregate deposits in the current FY so far has been Rs.2,09,275 Cr as against Rs.1,03,899 Cr seen in the same period last year.

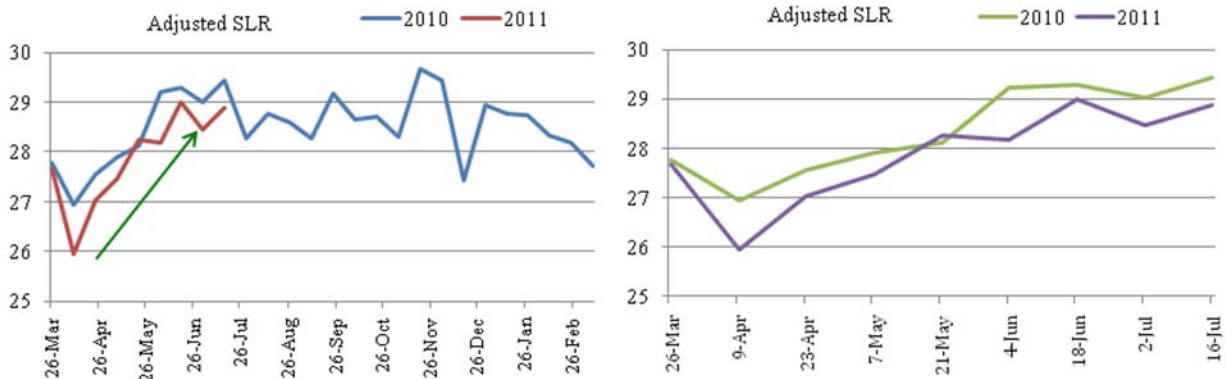
The table below provides a look at the credit off-take for the Indian economy.

Credit (as on Jul 15)	Financial year so far		Year On Year	
	Rs. Cr	% growth	Rs. Cr	% growth
FY 2010-11	119379	3.7	590666	21.3
FY 2011-12	72473	1.8	650389	19.3

FY 2012 marks a slowdown in credit when compared to the previous year same period. In absolute terms the difference in credit-off take up to July 15 stands at around Rs.47,000 Cr. This figure hints at an equivalent upward push in investments this year. In terms of percentage growth credit growth in this FY so far is less than half of that observed last year. The YoY growth rate too has marked a decline. The slowdown in the pace of credit offtake is the major reason for the increase in investments by banks this year.

#### V. Contribution by Banks:

The following graphs show the adjusted systemic SLR in FY 2010 and FY 2011 over different time frames. The growth in SLR holding since April 2011 has remained robust. An interesting fact remains that adjusted SLR recovered sharply and is almost in line with the numbers seen last year despite the fact that last year same time the statutory SLR was 25% whereas this year it stands at 24%.



The table below gives the segmental Buy-Sell data based on percentage share of various market players in G-Secs in the secondary market in the period April-July. The banks remained net sellers to the tune of Rs.478 Cr in FY 11 whereas they have remained buyers to the tune of Rs.5,158 Cr in FY 12 till July end.

Up till July end	2010-11	2011-12
Foreign Banks	-14120	-27768
PSU Banks	11379	32279
Private Banks	2263	647
Mutual Funds	7651	720
Others	14134	19707
Primary Dealers	-21306	-25585
	<b>-478</b>	<b>5158</b>

A look at the following table gives the buying pattern by banks seen in the last 3-4 years in comparison to the total G-Sec market borrowing by the Government.

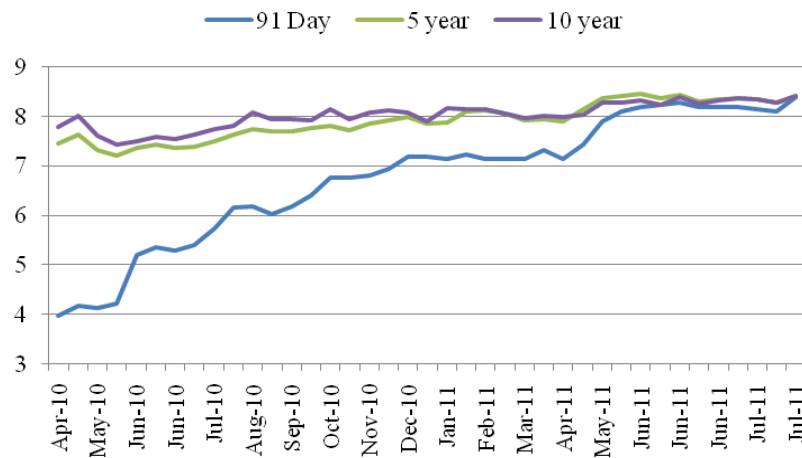
Rs. Cr	Market Borrowing	Investments by SCBs	% of market borrowing
FY 2008-09	261000	194031	74.3
FY 2009-10	418000	216273	51.7
FY 2010-11	437000	115287	26.4
Up to 15-Jul-12	159000	170504	<b>107.2</b>

FY 2012 has marked buying by banks to the tune of 107.2% of the G-Sec market borrowing via auctions. This is a huge increase compared to the buying pattern seen in the earlier years. However, it would be partly on



account of the secondary market buying. The market borrowing number presented above excludes the increase in the issuances of T-bills. The investment by SCBs stands higher than the market borrowing on account of the investment by banks in T-Bills and SDLs. The current fiscal has marked a huge rise in the T-Bill issuances. The total gross borrowing via T-Bills and CMBs amounted to Rs.1,93,000 Cr up till July 15. This is higher than the G-Sec borrowing at Rs.1,59,000 Cr.

## VI. Impact on Yields:



The graph shows the 91 Day T-Bill, 5 year and 10 year G-Sec yield since the tightening began in March 2010. While the shorter end of the curve has responded to the rate tightening, the 10 year curve seems almost flat with a hardening bias. The longer end of the curve has been supported by the robust buying from banks.

### Conclusion:

The G-Sec market has received a huge support from the bank buying in the current fiscal. The yields have been contained to a reasonable extent despite the aggressive rate tightening. This can be primarily traced to the slowdown in credit growth as compared to same period last year. The scheduled Government borrowing could sail through smoothly in case the robust buying by banks continues. The buying of Gsecs and other securities would depend on the pan out of credit off-take. It is likely that the aggressive pace of resource raising by banks which has been seen in the past would be consciously reduced in the absence of good credit opportunities.

Further an increase in the borrowing programme cannot be ruled out as the subsidy burden on the fisc increases with elevated crude and food prices. The yields could rise further in case rate tightening is carried on by the RBI to bring inflation to its target level. We are of the view that systemic SLR has peaked and would not touch the 30% mark. Thus an upward pressure on yields during the second half of the fiscal year remains possible.



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