



Analysis of a New 10 year Issuance

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Post 2008 the gross borrowing amount during a year has been almost three times that observed before the crisis. The average gross borrowing by the Government in the earlier years used to be in the range of around Rs.1,25,000 – Rs.1,75,000 Cr per year. This amount of borrowing was more or less represented by the benchmark 10 year security. With the borrowing amount rising substantially in recent years, the number of liquid securities required to conduct the total borrowing has risen. The volumes seen in the near 10 year segment securities are on an uptrend. However, issuance of a new 10 year security has not lost its significance as it still broadly defines the market sentiment.

The last couple of years have witnessed several issuances of securities playing the role of the benchmark 10 year. As against a single 10 year benchmark security for a particular year, recent times have seen two or more securities serving as the benchmark in the same year. The RBI has announced the issuance of a new 10 year security for the week ended April 8 2011. Largely as per trend, the market dynamics have certainly been altered around the issuance of every new 10 year security.

This report aims at studying the market behavior around the issuance of a new 10 year security in the last few years. It analyses the performance of the past benchmark securities with evolving macroeconomic conditions. The report also presents the possible impact on G-Sec yields post issuance of this new 10 year security to be auctioned on Friday.

Analysis & study of 10 year Issuance

I. Background & History:

Generally the issuance of a new 10 year security happens in the first month of the new fiscal year itself. This reflects the market sentiment and market appetite at the start of the year. It also roughly defines the interest rate curve for the year to follow.

Recent times have been somewhat different in the trend of the ten year being issued in April itself. We have witnessed several 10 year issuances in months other than April. The period under review for our study begins April 2008 and extends till date. We would thus cover the issuance of 8.24% GS 2018, 6.05% GS 2019, 6.90% GS 2019, 6.35% GS 2020, 7.80% GS 2020 and the yet to be issued new 10 year security.

The last decade started with gross borrowing figures being well within a tenable limit. Borrowing via 364 Day T-Bills was too a part of the total gross borrowing figure. The trend has changed since 2009 wherein the gross borrowing implies borrowing only via dated G-Secs.



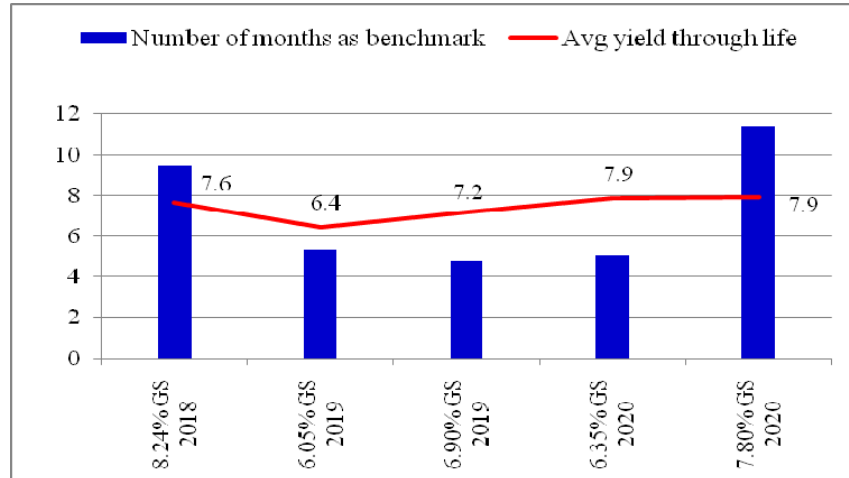
Fiscal year	Gross borrowing	Security		Issued on
		New 10 year	Nearest 10 year	
2001-02	133801	9.39% GS 2011		2-Jul-01
2002-03	151126	6.85% GS 2012		5-Apr-02
		7.40% GS 2012		3-May-02
2003-04	147636		7.27% GS 2013	3-Sep-02
2004-05	106501	None	7.37% GS 2014	16-Apr-02
2005-06	160018	None	7.38% GS 2015	3-Sep-02
2006-07	179373	7.59% GS 2016		12-Apr-06
2007-08	188205	7.99% GS 2017		9-Jul-07
2008-09	318550	8.24% GS 2018		22-Apr-08
2009-10	451000	6.05% GS 2019		2-Feb-09
		6.90% GS 2019		13-Jul-09
			6.35% GS 2020	2-Jan-03
2010-11	437000	7.80% GS 2020		3-May-10
2011-12	417128	?		8-Apr-11

The issuance of the benchmark 10 year security in the last 10 years has been as shown in the table. Several years did not have the issuance of an explicit 10 year paper. The table highlights the nearest tenor papers that formed the then benchmark security.

The last three years have also marked an instance wherein the security whose tenor was nowhere close to 10 years, i.e. 6.35% GS 2020 was traded as a benchmark. The paper was issued in 2003, however had its residual maturity as 10 years. The security witnessed active trading as the 10 year benchmark. A similar case was observed in FY 2011 wherein the 2022 maturity papers closely represented the 10 year liquid segment.



II. Performance of recent Benchmark securities:



Higher number of Benchmark securities recently

- Average yield reflects interest rate scenario

The graph above highlights the number of months that the 10 year securities served as the benchmark paper. The fact that five securities served as benchmark since 2008 indicates the huge total gross borrowing in the last three years. Barring 7.80% GS 2020, no other security has been able to retain the 10 year benchmark status for a whole year. FY 2009-10 specifically witnessed three securities playing the role. A new 10 year was issued every time the security hit the issuance cap.

10 year benchmark	Outstanding amount (Rs. Cr)
8.24% GS 2018	50,000
6.05% GS 2019	53,000
6.90% GS 2019	45,000
6.35% GS 2020	61,000
7.80% GS 2020	60,000

The red line in the graph indicates the average closing yield of the security as long as it remained the benchmark. The level broadly indicates the interest rate scenario in the economy through the life of the security as benchmark. 8.24% GS 2018 marked an average yield of 7.6% reflecting the steep fall seen in the yields post the Lehman crisis. Whereas post issuance of 6.05% GS 2019, the average yield had been higher than 6.05% indicating a rising interest rate scenario.

An interesting fact being that the market expectations for the new 10 year security hover in the range of 7.80% – 7.85%. This is just 0 – 5 bps higher than the last cut-off of 7.80% in May 2010. This is despite the fact that the Repo rate has risen by 150 bps and the Reverse Repo by 200 bps since May 3rd 2010 (issuance of 7.80% GS 2020).



III. Market movement around 10 year Issuance:

10 year benchmark	8.24% GS 2018	6.05% GS 2019	6.90% GS 2019	6.35% GS 2020	7.80% GS 2020
Auction date	21-Apr-08	30-Jan-09	10-Jul-09	30-Nov-09	30-Apr-10
Outstanding amount (at the time of being benchmark)	0	0	0	11000	0
10 year yield range in the week before auction		5.72 - 6.11%	6.83 - 7.06%	7.17 - 7.22%	8.06 - 8.10%
10 year cut-off yield	8.24%	6.05%	6.90%	7.52% (30 Nov)	7.80%
Auction day 10 year closing yield	8.19%	5.92%	6.87%		7.76%
10 year yield in the week after auction	8.14 - 8.18%	5.78 - 5.91%	6.79 - 6.85%	7.56 - 7.67%	7.61 - 7.74%
10 year yield of the old benchmark in the week after auction		6.17 - 6.49%	No trades (6.98%)	7.33 - 7.48%	7.90 - 8.05%

The table gives the market movement around the auctions held for the issuance of a new 10 year security. The issuance of a new 10 year paper typically gets along with it fresh market appetite. Thus in most cases the cut-off yield at the auction is lower than the broad trade range observed in the week earlier. The 10 year security remains in high demand when freshly issued and the closing yield on the day of the auction is also lower than the cut-off yield witnessed at the auction. The table above indicates that all four freshly issued 10 year papers closed at a yield lower than the cut-off on the very same day. 6.35% GS 2020 remains an exception as it was not a new 10 year security, however, traded as the benchmark 10 year.

Because of the fresh demand, the trading yield range observed post the auction usually marks a softening bias in the week ahead. A very contrary trend is observed for the older benchmark security which gets replaced by the new security. The illiquidity premium gets priced in and the yields rise for the older benchmark security in the week post the auction.



IV. Expectations from the New 10 year:

Bullish sentiment

*- 10 year cut-off expected
in the range of 7.80% -
7.85%*

The G-Sec market in the current fiscal year has had a buoyant start in wake of the announcement of a new 7 year and a new 10 year security in the very first auction to be held on April 8, 2011. The lower than expected gross borrowing for the whole year has also held up the sentiment. The most liquid 2022 maturity papers currently trade in the range of 8% - 8.10%. The current 10 year security 7.80% GS 2020 trades in the range of 7.90% - 8%. The market sentiment seems to have a bullish bias and the market players expect the cut-off yield for the new 10 year to be in the range of 7.80% - 7.85%.

Unlike other instances, the 2022 maturity papers would probably not lose significantly with the issuance of the new 10 year paper. Post three four auctions a broad trend for selection of auction securities would emerge. The 2022 papers would then be impacted depending on whether the RBI retains them as liquid securities. The existing 10 year security 7.80% GS 2020 may take a hit in terms of the price and volume traded as it will lose the benchmark status and has already reached the issuance limit.

The RBI would probably adopt a similar strategy as that observed in the last fiscal and retain the benchmark status for the new 10 year paper through the year. Auction of several securities in rotation would keep them all liquid.

With regards to the average yield of the security through the year, a lot would depend on the evolving macroeconomic scenario. The high inflation already poses risks for a rising interest rate scenario. The cost of borrowing would be lower in case the borrowing is supported by OMO purchases as seen in the last fiscal.

Conclusion:

On the verge of issuance of a new 10 year security we expect the cut-off yield to be set in the range of 7.80% - 7.85%. As seen earlier, the cut-off is expected to be bullish than the current market yield. The security will find fresh demand at the start of the new fiscal year. The new 10 year would trade strong in the near future reflecting the good liquidity conditions. The market would easily absorb the supply for atleast the first two three auctions in this paper. The performance of the paper would then depend on the pan out of the systemic liquidity and the interest rate decisions by the RBI. The RBI would probably stick to a hawkish stance for sometime till food and oil prices remain elevated. The market has factored in a 25 bps hike in the May 3rd monetary policy. The 10 year yield may witness a spike around the policy.



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