Current Developments in Money and Government Securities Market

It gives me great pleasure in being with you, today, to share some thoughts relating to money and government securities market where the Reserve Bank of India has a pivotal role to play not only as the debt manager to the Government but also as the monetary authority of the country. I am indeed thankful to Shri M.R.Ramesh for giving me this opportunity to participate in this Seminar.

As all of you are aware, in order that the Central Bank conducts the monetary policy effectively with the help of market based instruments, a well developed money and government securities market is an important prerequisite. The effective presence of such markets is felt, once a well- developed financial system is in place, wherein both financial markets and financial institutions have important roles to play. As it is well known, the East Asian crisis is an outcome of the lack of well-developed money and capital markets.

Crises are part and parcel of the financial world we live in, resulting in financial stress not only in the respective market segments but also calls for dexterity on the part of the Central Bank, since it is the Central Bank that takes up the onus of such crisis management. Evidences suggest that during times of financial stress there is likely to be a large demand for liquidity which only deep and liquid markets can provide. Let me at this juncture remind you that the Indian financial system went unscathed by the onset of Asian crisis because of the cautious and gradual reform measures taken by the Reserve Bank and Government of India. We could also come out rather easily from the situation we were in a year ago during the Kargil incident.

These instances would corroborate the inherent soundness of the policy decisions that the authorities have contemplated in the past.

Before I touch upon the micro aspects in the development of Money and Government Securities Markets, let me briefly make a mention of the economic fundamentals. The market analysis is now placing heavy reliance upon technicalities and sentiments and taking a view on the short term I think it has to focus on the fundamentals in order to take a long term view. Evidences show that in the recent years, the Indian Economy has exhibited strong degree of resilience. Economic growth continued to be buoyant and monetary conditions were supportive of growth. The monetary policy efforts in ensuring availability of sufficient credit and softening of interest rates were facilitated by general absence of inflationary pressures. The external sector gained in strength with the enlargement of invisible surplus and capital flows.

In the above context, I present before you the fact sheet. The overall economic performance during 1999-2000 remained healthy with the GDP showing a growth of 6.4 per cent. This compares favourably with the trend growth rate of 6.7 per cent during 1995/96 - 1998/99 and 5.1 per cent during the period 1990/91-1994/95. This is in spite of some weaknesses in the agricultural growth. It is a welcome feature that growth rate of industrial sector is showing clear signs of revival from 3.7 per cent in 1998-99 to 7.5 per cent in 1999-2000. On the price front, notwithstanding the year-end spurt, the low order of inflation during the major part of 1999-2000 led to the decline in the average rate of inflation (measured by WPI) on a weekly basis to a low of 3.3 per cent in 1999-2000 as against 5.9 per cent in 1998-99 and the average of 9.0 per cent during 1990/91 -1997/98. The inflation rate as measured by CPI also moved in tandem and reflected a steep decline, as the average inflation rate for the year moved down to 3.4 per cent in 1999-2000 from 13.1 per cent in 1998-99. The external sector continued to be comfortable and the resilience of the Indian economy was again demonstrated notwithstanding the significant increase in oil import payments. The current account deficit (CAD) was restricted to less than 1 per cent. Strong capital flows led by a turn-around in portfolio inflows, resulted in an overall balance of payments surplus for the fourth successive year. This enabled an increase in foreign exchange reserves by US $ 5.5 billion during 1999-2000 to US $ 38.00 billion by end-March, 2000. Net investments by FIIs was buoyant during 1999-2000 and resulted in a large net inflow of around Rs.10,000 crore as against a net disinvestment of around Rs.800 crore during 1998-99.

Financial markets in India remained relatively stable during 1999-2000. The recovery of South East Asian market economies has had a favourable impact on domestic financial market conditions. Let me emphasise that a significant feature of the financial market activity during the nineties has been the growing inter linkages among the money, foreign exchange and government securities markets. Furthermore, according to the Report on Currency and Finance, 1998-99, there is an increased integration of different segments within short-term financial market which is reflected in the co-movement of interest rates.

Let me now turn to the developments in the money and government securities market. The activity in the call money market is largely driven by the cash reserve requirements. Recent years have been witnessing a relatively higher level of activity in the call market and this could partly be attributed to the evolution of a new institutional channel in the form of Primary Dealers. The average daily turnover in the recent period is more than Rs.30,000 crore. The turnover and interest rates in the call money market generally reflect varying liquidity conditions. The monthly average call rates for a greater part of fiscal 1999-2000 ruled in the range of 8-10 per cent. The pressure on call rates however continued during the month of June in the current fiscal and stabilised afterwards.

Among several recent developments, Liquidity Adjustment Facility (LAF) has received much attention. By now every one is familiar with the scheme and it has stabilised. It would be appropriate to continue with the scheme as originally envisaged. The scheme would eventually meet its ultimate objective of providing desirable quantum of liquidity according to the needs of the system with flexible rates and help impart greater stability. Let me say that we have carefully noted all the suggestions received and shall address all the relevant issues taking into account the suggestions. One suggestion is advancing the time of announcement of results. Let me inform you, we shall announce the LAF auction results by 12.30 p.m. and this measure would give the market participants sufficient time to assess their funds requirements and act appropriately. We shall implement this with effect from Monday, July 31, 2000.

Turning to the Government borrowing programme, in 1999-2000 Government's borrowing programme was well managed without exerting an upward pressure on interest rates. In fact, interest rates generally moved down during the year particularly at the long end of the market. The debt management operations helped in moderating the interest rates and in influencing the maturity pattern of the debt issues towards medium to long duration. The borrowing cost to the government was stabilised at a relatively low level as reflected in the weighted average interest rate of 11.77 per cent as against 11.86 per cent in 1998-99.

As all of you are aware, the net market borrowing programme for the current fiscal was budgeted at a Rs.76,383 crore. Considering the repayment obligations at Rs.41,321 crore, the gross borrowing requirements of the Central Government amount to Rs.1,17,704 crore. So far, Government has raised an amount of Rs.56,683 crore representing 48 per cent of the gross amount (budgeted). Our own assessment at this stage is that the market borrowing would not overshoot this budgeted amount. On our part, we are quite confident of completing the Government's market borrowing programme without much difficulty.

A word on policy measures. The monetary measures recently announced by the Reserve Bank are warranted by technical factors to address what are otherwise construed as transitory developments in the market. The fact is, even before these announcements by RBI, there was an upward movement in the yields. I would urge you to consider and rationalise all the developments contextually. Any interpretation out of context will not be helpful. It is our endeavour to make our policy approaches more and more transparent and we welcome all comments and suggestions in this regard.

On the question of short-term and long-term paper, let me say that the results of sale of two securities of 6 and 10 year maturities yesterday i.e., on July 28, 2000 clearly indicate the good appetite for the long term paper, as evidenced from the market interest for the ten year paper. There is demand for long-term paper by institutional investors like Life Insurance Corporation (LIC), pension funds and we will continue to cater to that demand. You would appreciate that in the ultimate analysis the investment decisions are related to economic logic and economic fundamentals. Our strategy will continue to be a mix of auctions, tap sales, private placements and with issues of short-term and long-term instruments.

I may take this opportunity to flag another important issue which is critical for the further development of the Government securities market. This relates to the development of the retail market for Government securities. A wider investor base eventually would have a favourable impact on the cost of borrowing. Appreciating this, the Reserve Bank of India is engaging its attention for an appropriate policy approach to develop this market. My colleague Mrs. Usha Thorat will deliberate on this issue in detail. I would appreciate if some concrete suggestions emerge out of the deliberations here.

Technological upgradation is a part of the reform of debt market. RBI is planning to set up an Electronic Dealing System which will facilitate (i) electronic bidding in auctions and (ii) dealing in Government securities and money market instruments amongst market players and also with RBI. Such an electronic system will provide transparency on prices and volumes traded on real time basis to the market. To facilitate settlement in Government securities transactions, the dealing system will be linked to securities settlement system in PDO. This will include screen based trade reporting system for settlement, supported by RBI's INFINET, located in this city of Hyderabad, as communication backbone. This system will broaden the participation in the auction system and improve the speed of settlement of secondary market transactions.

The Reserve Bank has taken on hand a comprehensive integrated project on PDO computerisation and negotiated dealing screen system. The integrated project would facilitate on-line screen based execution for trade settlement in Government securities transactions. The systems will reside at a main location termed as Central PDO at Mumbai while regional PDOs would have linkages with Central PDO thus acting as extended arms of Central PDO. The new project will be implemented in phases.

Now, on the issue of a modern settlement system, Governor made a mention in October 1999 and April 2000 on the need for setting up of a Clearing Corporation for money and debt securities. It is expected that such a corporation, *inter alia*, would pave the way for further opening up of the repo market to PSU bonds and bonds of financial institutions held in demat form in depositories. The proposal to set up such a Corporation has since come from the PDs and action to establish such a Corporation is being initiated. A “Core Group” has been set up to prepare the project report/indicate a road map and work out all modalities for setting up of the Clearing Corporation for debt securities. To begin with, the Clearing Corporation would be for settlement of all Government securities and other debt securities in demat form to facilitate repo transactions by all the market participants as also for money market and forex settlement. I may take this opportunity to urge the PDAI to speed up all the process of preparatory work so that we can quickly move forward. The establishment of the Corporation will be another major land mark in the institution building for development of markets.

Primary Dealers have to play a significant role in stabilising the markets for Government securities; any measures by market players to contain volatility can greatly contribute to the orderly development of markets. As you are aware, from time to time adequate support has been extended by RBI to the PDs in their endeavours to play their role effectively in the Gilts market. Increasingly they should be exploring new sources of funds. They should be playing a market-making role in the repo market. They should be raising and providing funds more and more in the repo market and develop a sound secondary market in the Gilts.

Wrapping up the discussion, let me say -

(i) The LAF will continue as a major instrument of liquidity management and as we go along we can consider refinements. One measure we could straight away implement is advancing the time of announcement of results to 12.30 p.m.

(ii) Our assessment is that all economic fundamentals/factors are conducive for the successful completion of the Government borrowing programme this fiscal.

(iii) The strategy of auctions, tap issues and private placements will continue. There will be adequate demand for long term paper and we shall continue to issue short and long term instruments.

(iv) We will make further progress in bringing in technology - mediated systems in dealings and settlements.

(v) The Core Group should endeavour to complete the preparatory work for the new Clearing Corporation expeditiously.

(vi) Primary Dealers have a role to play in stabilising the markets - viewing all the policy measures in the proper context.

(vii) Primary Dealers also have to look for alternate sources of funds and more and more recourse to Repo market is expected.

(viii) We should take all measures to develop a strong secondary market in Government Securities.

Let me thank you for giving me this opportunity to talk to all of you and let me wish the seminar all success.

I am thankful to Shri R.K. Pattnaik, Director and Shri R. Gurumurthy, Assistant General Manager of Internal Debt Management Cell, Reserve Bank of India for their assistance.