



Falling Bond Yield

Why in News

Recently, the [Reserve Bank of India's \(RBI\)](#) decision to step up purchase of [Government Securities \(G-Sec\)](#) under the [Government Securities Acquisition Programme \(G-SAP\)](#) led to the **yield on the benchmark 10-year bond falling below 6%**.

- In India, the **yield of 10-year G-Sec is considered the benchmark** and shows the overall interest rate scenario.

Key Points

▪ Bond Yield:

- Bond yield is the **return an investor realizes on a bond**. The **mathematical formula** for calculating yield is the **annual coupon rate divided by the current market price of the bond**
 - **Bond:** Is an **instrument to borrow money**. A bond could be issued by a country's government or by a company to raise funds.
 - **Coupon Rate:** It is the **rate of interest paid by bond issuers on the bond's face value**.

▪ Effect of General Movement of Bond Yields:

- Movements in yields depend on trends in interest rates, **it can result in capital gains or losses for investors**.
 - A rise in bond yields in the market will bring the price of the bond down.
 - A drop in bond yield would benefit the investor as the price of the bond will rise, generating capital gains.

▪ Reason for Decreasing Bond Yields:

- Due to **economic uncertainty caused by Covid-19**.
- In April 2021, the RBI launched **G-SAP** which has **caused a decrease in G-sec yields** which has continued since then.

▪ Impact:

◦ Better Equity Markets:

- A decline in yield is also **better for the equity markets because money starts flowing out of debt investments to equity investments**.
 - **Equity market:** It is a **market in which shares of companies are issued and traded**, either through exchanges or over-the-counter markets. **Also known as the stock market**.
 - That means **as bond yields go down, the equity markets tend to outperform** by a bigger margin and as bond yields go up equity markets tend to falter.

◦ Reduced Cost of Capital:

- When **bond yields go up**, the cost of capital goes up. That means that **future cash flows get discounted at a higher rate.**
 - **Discounting** is the process of determining the present value of a payment or a stream of payments that is to be received in the future.
- This compresses the valuations of these stocks. That is one of the reasons that **whenever the interest rates are cut by the RBI, it is positive for stocks.**
- **Reduces Risk of Bankruptcy:**
 - When **bond yields go up**, it is a signal that **corporates will have to pay a higher interest cost on debt.**
 - As debt servicing costs go higher, **the risk of bankruptcy and default also increases** and this typically makes mid-cap and highly leveraged companies vulnerable.
- **RBI's Stand:**
 - The RBI has been **aiming to keep yields lower as that reduces borrowing costs for the government** while preventing any upward movement in lending rates in the market.
 - A rise in bond yields will put pressure on interest rates in the banking system which will lead to a hike in lending rates. The RBI **wants to keep interest rates steady to kick-start investments.**

Government Securities Acquisition Programme

▪ About:

- The RBI, for the year 2021-22, has decided to put in place a secondary market **G-SAP 1.0.**
 - It is part of RBI's [Open Market Operations \(OMOs\)](#).
- Under the programme, the **RBI will commit upfront to a specific amount of Open Market Purchases of G-Secs.**

▪ Objective:

- To **avoid volatility in the G-sec market** in view of its central role in the pricing of other financial market instruments across the term structure and issuers, both in the public and private sectors.

▪ Significance:

- It will **provide certainty to the bond market participants** with regard to RBI's commitment of support to the bond market in [Financial Year](#) (FY) 2021-2022.
- It will **help reduce the difference between the repo rate and the 10-year government bond yield.**
 - That, in turn, will **help to reduce the aggregate cost of borrowing for the Centre and states in FY 2021-22.**
 - **Repo rate** is the rate at which RBI lends money to commercial banks.
- It will **enable a stable and orderly evolution of the yield curve** amidst comfortable liquidity conditions.
 - **Yield curve:** It is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates.
 - The slope of the yield curve gives an idea of future interest rate changes and economic activity.

Source:IE

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