Falling Yield on Government Securities

For Prelims: **Government security (G-sec)**, Debt instrument, **Bond Yield**

For Mains: Concept of G- Sec and their significance, Compare G-secs with alternative investment options

Why in News?

The yield on the benchmark 10-year **government security (G-sec)** in India has witnessed a **decline**, posing a question to **retail investors about their investment strategy.**

- The **Reserve Bank of India (RBI)** have opened up the government securities market to **retail investors,** but their **participation has been relatively low.**

Why did the Yield of G-secs Decline?

- The yield on the benchmark 10-year government security (G-sec) has fallen to 6.9 % (May 2023) from 7.4 % in early March 2023 after changes in **debt mutual fund taxation.** It is **currently trading at around 6.96-6.99%.**
  - The benefit of indexation in the calculation of long-term capital gains on debt mutual funds was removed.
- Various factors such as changes in **debt mutual fund taxation, the RBI's decision on the repo rate, and declining** inflation have influenced the downward movement of government security yields.

What are the Reasons for Low Participation of Retail Investors in G-Secs?

- **Lack of Investor Guidance:**
  - Retail investors find it complicated to invest in **government bonds** and require guidance, possibly through intermediaries, to navigate the process.
- **Limited Liquidity:**
  - The G-Sec market lacks liquidity, making it challenging for **retail investors to find buyers in the secondary market** when they want to sell their securities.
    - This lack of liquidity can result in investors being stuck with their investments.
- **Complexity of Investment:**
  - Retail investors, **especially uninformed participants,** may find the investment process in G-Secs daunting and **prefer more simplified** investment options like **fixed deposits.**
    - The RBI Retail Direct platform is **beneficial for informed investors** but **may not cater to uninformed participants** who require a simpler investment process.
- **Low Trading Volumes:**
  - The traded volume in the **secondary market** for G-Secs **has been relatively low**, further reducing the attractiveness for retail investors.
- **Alternative Investment Options:**
  - Retail investors may consider other investment avenues such as **fixed deposits**, which have seen increased interest rates, or exploring new bonds, **NCDs (Non-Convertible**

Debentures), and post office deposit schemes.

What are Government Securities?

- **About:**
  - A G-Sec is a tradable instrument **issued by the Central Government or the State Governments.**
  - A G-Sec is a **type of debt instrument issued by the government** to borrow money from the public to finance its Fiscal Deficit.
    - A debt instrument is a financial instrument that **represents a contractual obligation by the issuer to pay the holder** a fixed amount of money, known as the principal or face value, on a specified date.
  - It acknowledges the **Government's debt obligation.** Such securities are **short-term** (usually called **treasury bills**, with original maturities of less than one year- presently issued in three tenors, **namely, 91-day, 182 day and 364 day**) or long-term (usually called Government bonds or dated securities with an original maturity of one year or more).
  - In India, the Central **Government issues both, treasury bills and bonds or dated securities** while the State Government issue only bonds or dated securities, which are called the **State Development Loans (SDLs).**
  - G-Secs carry **practically no risk of default and,** hence, are called risk-free gilt-edged instruments.
    - Gilt-edged securities are **high-grade investment bonds offered by governments and large corporations** as a means of borrowing funds.
  - The RBI conducts (Open Market Operations) OMOs for sale or purchase of G-secs to adjust money supply conditions.
    - The RBI sells g-secs to **remove liquidity from the system** and buys back g-secs to infuse liquidity into the system.
- **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.** Price and yield are **inversely related: As the price of a bond goes up, its yield goes down**, and vice versa.
    - **Bond:**
      - It 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.**

What are the Types of G-Secs?

- **Treasury Bills (T-bills):**
  - Treasury bills are zero coupon securities and pay no interest. Instead, they are issued at a discount and redeemed at the face value at maturity.
- **Cash Management Bills (CMBs):**
  - In 2010, Government of India, in consultation with RBI introduced a new short-term instrument, known as CMBs, to meet the temporary mismatches in the cash flow of the Government of India. The CMBs have the generic character of T-bills but are issued for maturities less than 91 days.
- **Dated G-Secs:**
  - Dated G-Secs are securities which carry a fixed or floating coupon (interest rate) which is paid on the face value, on half-yearly basis. Generally, the tenor of dated securities ranges from 5 years to 40 years.
- **State Development Loans (SDLs):**
  - State Governments also raise loans from the market which are called SDLs. SDLs are dated securities issued through normal auction similar to the auctions conducted for dated securities issued by the Central Government.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q. 1 In the context of the Indian economy, ‘Open Market Operations’ refers to (2013)

(a) borrowing by scheduled banks from the RBI
(b) lending by commercial banks to industry and trade
(c) purchase and sale of government securities by the RBI
(d) None of the above

Ans: (c)

Q.2 Consider the following statements: (2018)

1. The Reserve Bank of India manages and services Government of India Securities but not any State Government Securities.
2. Treasury bills are issued by the Government of India and there are no treasury bills issued by the State Governments.
3. Treasury bills offer are issued at a discount from the par value.

Which of the statements given above is/are correct?

(a) 1 and 2 only
(b) 3 only
(c) 2 and 3 only
(d) 1, 2 and 3

Ans: (c)

Source: IE