Bond market sees signals of normalisation in RBI move on 7-day reverse repo

Updated at September 29, 2021 00:03 IST

In what is being interpreted as a normalisation signal by the bond market, the Reserve Bank of India (RBI) on Tuesday let the cut-off for the 7-day variable rate reverse repo at 3.99 per cent, or the existing repo rate.

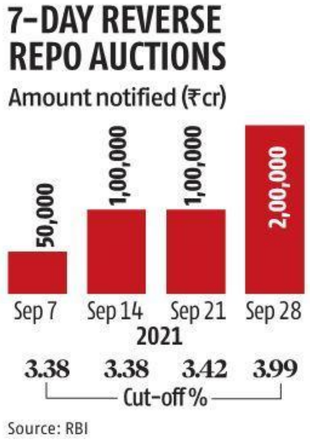
RBI accepts excess overnight liquidity from banks at 3.35 per cent, its reverse repo rate. But it also conducts a separate variable rate auction for a longer period under its variable rate reverse repo window. Ideally, the rate should be closer to the reverse repo rate, but the latest cut off touches the repo rate of 4 per cent.

The central bank is tight-lipped about normalisation, but other global central banks have started sounding hawkish. The US Federal Reserve will announce its tapering plan in November, and from December, it will start its tapering exercise. Many emerging markets central banks, especially those dependent on exports, have started raising rates or have moved towards tightening of policies. The RBI’s stance is accommodative with comfortable liquidity for as long as necessary to ensure durable signs of growth.

The RBI will announce its monetary policy on October 8 and may continue with its policy stance, but the reverse repo cut-off has intrigued the market.

“Reverse repo cut-offs indicate that the RBI is not comfortable with overnight and short-term yields. They want the operating rate to inch towards the repo rate,” said Rahul Singh, senior fund manager at LIC Mutual Fund.

The 10-year bond yield rose 2 basis points from its previous close despite the second-half borrowing announced being lower than what the market had expected. The government said the second-half borrowing of Rs 5.03 trillion includes goods and services tax (GST) compensation shortfall. That took away the extra borrowing concern, and many expected yields to fall on Tuesday. But it didn’t as US yields inched up even further and oil prices firmed up.



The US 10-year treasury was trading at 1.56 per cent, higher from its previous close of 1.50 per cent. The yields have rapidly climbed up from 1.30 per cent in just about a month and a half. The Indian bond yields are closely following the cue, bond dealers say.

Similarly, the rupee also came under pressure as the stock indices tumbled. The Indian rupee closed at 74.06 a dollar, down from its previous close of 73.84.

“Fed turning hawkish and rising oil prices, both are pushing yields higher. Higher yields and higher oil prices are double negatives for the rupee, as it can trigger outflows," said Anindya Banerjee, deputy vice president, currency and interest rate derivatives at Kotak Securities.

The rupee is expected to trade within a range of 73.70-74.70 a dollar in the near term.