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Bond market won't be hit even if PSBs start aggressive lending

With public sector banks (PSBs) consolidating their balance sheets, corporate are increasingly shifting to the debt market to benefit from lower rates. **Kumaresh Ramakrishnan,** *head of fixed income, DHFL Pramerica Asset Managers, tells* **Shakti Patra** *that while the spread between the rates in the bond market and MCLRs of banks will shrink from 150 basis points at present, top-rated corporates will continue to tap the bond market.*

What's your take on the health of the corporate debt market?

I think markets are getting into a sweet spot again after a good spell in recent months due to a combination of factors. Rate cuts by the Reserve Bank of India (RBI), together with abundant liquidity in the system, have driven rates lower. Yields have fallen over the last six months and with a view to accelerating transmission, the RBI has pushed for higher liquidity. As liquidity improved and the system liquidity deficit declined, rates started declining steadily.

Do you fear that once public sector banks start lending in a big way and marginal cost of funds-based lending rates (MCLRs) drift lower, the bond market might get affected?

I am sure once PSBs get back to shape and start making fresh loans at lower MCLRs, they would take some of the business that is now entirely moving to the bond market. Having said that, for higher-rated corporate, the bond market will still make sense, because it allows them to borrow at rates that banks can never match.

Given that the spread between the lowest MCLR and AAA-rated corporate bonds is close to 150 bps now, how much do you think it will shrink once PSBs start lending aggressively.

The rates in the bond market will largely depend on liquidity. Banks' lending rates, on the other hand, will reduce once deposit rates get fully re-priced. So, I think, going forward, the spread between MCLRs and AAA-rated corporate bond yields may shrink to about 80-100 bps.

Non-banking financial companies (NBFCs) have been the main issuer of fresh papers hitting the bond market. Given this and the fact that yields have significantly dropped , do you think there's a bubble in some pockets?

Historically, financial services have been the biggest piece within the borrowing segment. Three years back, banks

themselves used to be big borrowers. NBFCs then were far smaller in size. But today, this space has grown to become very large. They have grown at a strong pace in the last few years and their balance sheets are in pretty decent shape. So, while their borrowing appears to be high, we don't think there's a bubble.

As far as rates are concerned, they get indexed very quickly, particularly in the commercial paper (CP) market. Moreover, liquidity has been ample and there's subdued supply from other sectors. This combination has helped CP rates for NBFCs to come off rapidly.

With is the industry not hitting the bond market as much as one would have expected, has it become difficult for you to stick to sector limits for NBFCs?

There's a sector limit of 25% for NBFCs and a combined limit of 35% for NBFCs and HFCs. So, in the absence of quality paper from other sectors, we invest selectively in corporate and other PSU/PFI names. Quasi government issuers are also a larger borrowing segment which is excluded from sector limits. The recent NCD issuances of Ultratech Cement, M&M and Tata Steel, however, are signs of the fact that even the industry will soon aggressively hit the bond market.

A lot of the liquidity that is pushing yields lower is being provided by banks themselves, given that they are aggressively investing in bonds and CPs. Do you think the current rates will hold once they pull out and start lending again?

We are currently in a falling rate cycle and liquidity is playing its part here. But as and when the investment cycle picks up and banks start to grow their loan books yields are likely to plateau. In the near term, however, inflation expectations are subdued and could thus offer some more scope for rate easing.

Fresh corporate debt issuance hit a record high of Rs 2.1 lakh crore in Q2FY17, while bank lending to the industry saw a negative y-o-y growth in August. Are we at an inflection point or is this trend likely to continue and even get stronger?

Given the falling rate cycle, some higher-rated corporate have already started to access the bond market to re-finance their existing bank borrowings. We expect this trend to continue and build up up over the next few months. Most of this fresh capital raising is primarily for re-financing purposes to arbitrage lower rates in bonds as compared to loans. Simultaneously, fresh loan disbursement from banks still remains muted as fresh capex is still very modest. This explains the negative growth in loan books for banks. Since we are in the early stages of recovery in the economic cycle and corporate still enjoy some slack in capacities, broad based investment appears to be a few quarters away.

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