Company bond sales witness a sharp drop on rising yields

State governments' bonds offering higher returns edge out corporates

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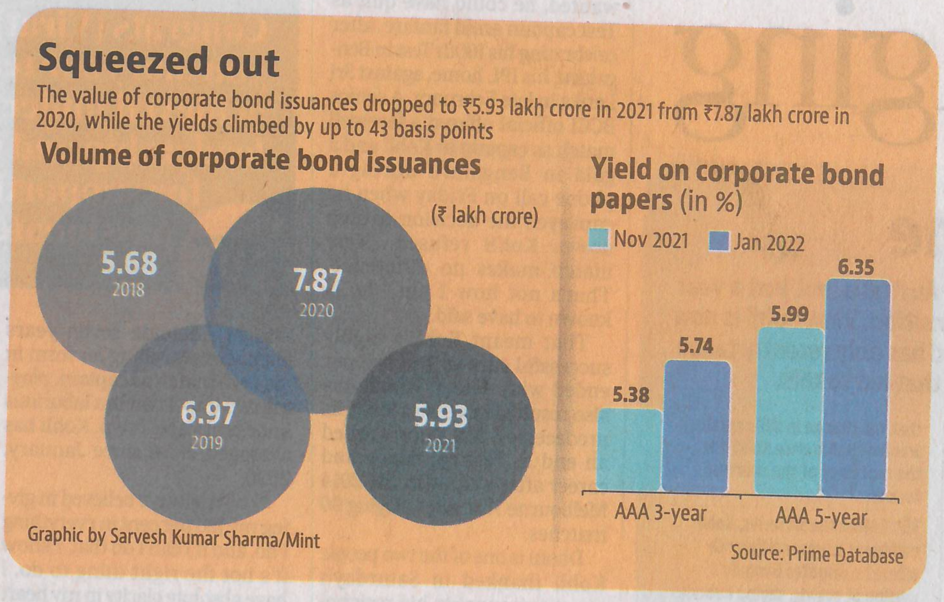

MUMBAI: India Inc. may have to offer higher returns on fresh domestic bond issuances to investors as they compete with state government bonds offering higher yields, experts said.

Rising yields are already causing a decline in corporate bond issuances. Since last November, the yield on three-year AAA-rated corporate paper has increased by 43 basis points to 5.74%, and that on five-year AAA paper by 36 basis points to 6.35%. As a result, market participants saw a sharp drop in corporate bond issuances while state development loans have increased in past few months.

Data provided by Prime Database showed that the volume of corporate bond issuances dropped to ₹5.93 lakh crore in 2021 from ₹7.87 lakh crore in 2020. To be sure, the government's borrowing costs have risen despite surplus liquidity in the banking system, with the yield on the benchmark 10-year government bond increasing from about 6.1% in April to 6.58% in January.

"Corporate bonds issuances have seen a drop amid rising G-sec rates. Investors are looking for higher yields, and they feel yields will go up further from here. There is also a larger quantum of state development loans (SDLs) available at higher yields. Investors, therefore, prefer a higher yield instrument," said Ajay Manglunia, managing director and head, institutional fixed income, JM Financial.

In December, the cost of debt funds for the states touched the highest level so far this fiscal with the weighted average cut-off crossing 7.16 percentage points at the latest auctions, reflecting hardening yields even for government securities, the Press Trust of India reported on January 5. The hardening of rates at the first auction of the quarter comes in the wake of an expected large supply of debt from states, estimated at ₹3.2 trillion in the fiscal fourth-quarter, an increase of ₹10,000 crore.

Meanwhile, companies are tapping cheaper funding sources, such as external commercial borrowings, or ECBs.

Recently, Reliance Industries raised $4 billion in the largest foreign bond issuance. It raised $1.5 billion at a coupon rate of 2.875%; $1.75 billion at 3.625%; and $750 million at 3.75%. The sale was considered the tightest ever implied credit spread over the respective US Treasury across each of three tranches by an Indian corporate.

For the past couple of years, corporate borrowing from banks has been muted, with companies repaying an estimated ₹2 lakh crore of debt in the period. However, lenders are hopeful that lending to companies will recover as capital expenditure plans stabilize over the next few quarters.

In addition, borrowers who turned to the commercial paper market due to abundant liquidity would return once interest rates rise, the lenders said.

"The costs of funds for larger and higher-rated companies have declined with the spread between AAA corporate bond and G-Sec at multi-year lows. While the fiscal deficit inched up during the pandemic in 2021, most large corporations benefited from market-share gains, better pricing and lower costs, which led to improved profitability and cash flows. The credit spread for low credit rating borrowers, however, continued to rise through 2021," Nomura said in an 11 January note to clients.

The brokerage expects interest rates in India to trend higher this year. "Our rates team expects the 10-year government bond yield to rise to 6.75% by end-2022 and further to 7% by 2023, up from 6.5% currently. The yields are likely to move higher on the back of global liquidity tightening, higher rates and higher government deficit," it said.