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Economic Times , Delhi
Saturday, 16th June 2018; Page: 8
Width: 17.05 cms; Height: 28.24 cms; a3; ID: 29.2018-06-16.83

Welcome Reform in India's Bond Market

There are welcome steps underway to have a liquid secondary market for corporate bonds, an institutional shield against future non-performing assets arising from banks funding long-term infrastructure projects they are ill-suited to, given the short maturity of their deposits. The National Stock Exchange (NSE) has launched a platform to facilitate repo, or repurchase obligations, between counterparties holding or seeking to hold such bonds. A liquid secondary market implying ready option for exit would shore up value and lead to more efficient price discovery for such instruments (read: bonds).

A thriving market for corporate bonds is crucial for modern transparent arm's-length finance to eschew excessive reliance on opaque bank funding, especially for long-gestation investment projects. A liquid secondary market leads to better discovery of the cost of capital for issuers in the primary market. Further, developing a liquid bond market would boost essential insurance products like credit default swaps. Meanwhile, the Reserve Bank of India (RBI) has liberalised the norms for interest rate futures and recently mandated swaptions for such products. Also, the RBI has raised the trading limit for currency derivatives and two-way contracts to $100 million. Corporates do need to better manage myriad risks on bond defaults, interest rate dynamics and currency exposure.

Consolidation and re-issuance of corporate bonds to limit the number of International Securities Identification Numbers and extending the hours for derivatives trading are in the right direction. Removing the Securities Transaction Tax and rationalising capital gains tax should follow. We need a thriving market for risk management products in the bond-market and banks. Banking reforms is not just about banks.