India's Interest Rate Cut to Boost Indian Bonds

TORONTO, March 5, 2015 /CNW/ - In an unscheduled move, the Reserve Bank of India (RBI) cut its benchmark rate by 25 basis points to further stimulate growth in the world's fastest growing economy. This is the second rate cut so far this year with the first cut of 25 basis points made on January 15.

"This move will benefit the bond market which is expected to be a major source of funding for development initiatives, especially infrastructure spending, as the country's growth accelerates," says David Kunselman, Senior Portfolio with Excel Funds Management Inc. India's economy grew by 7.4% last year and is forecasted to grow in the range of 8% to 8.5% in fiscal 2016. "The rate cut will likely stimulate even higher growth," suggests Kunselman.

India's fiscal 2016 budget projects capital expenditure to increase by 25.5%, comprising primarily of a 52% increase in spending on railways and a 174% increase in roads and bridges. "It is estimated that bonds will be issued to fund a significant percentage of the capital expenses," says Kunselman.

In a strong growth environment, Kunselman says "the private sector is expected to issue more corporate debt in 2015 to avoid more expensive bank financing. As a result, Indian corporate debt issuance this year is expected to surpass 2013 and 2014 levels." Last year, foreign investors invested more money in India's bond market than they did in its equity market, in spite of the fact that the equity market was one of the best performing in the world.

The decision by the RBI to cut interest rates prior to its next meeting scheduled for April 7, 2015, comes on the back of an agreement between Prime Minister Narendra Modi and RBI Governor Raghuram Rajan to give the Central Bank autonomy over maintaining price stability in the economy.

The agreement calls for an inflation target of 4%, with a band of plus or minus two percentage points. Inflation, which is expected to decline to 5% by the end of the year, has fallen largely due to lower oil prices but remains relatively high compared to India's Asian counterparts.

"While Indian bond yields will fall due to the rate cut, they remain relatively high compared to developed market bonds," says Kunselman. He adds, "falling yields will result in capital appreciation for bond investors, so it will remain a win-win situation."

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