G-Sec Yields

Why in news?

The government said that it had decided to keep interest rates on small savings instruments unchanged for the July-September quarter given the sharp rise in government security (G-sec) yields over the last three months.

What are Government securities?

- **G-secs**- Government Securities or government bonds, are instruments that governments (Central Government or the State Governments) use to borrow money.
- Governments routinely keep running into deficits thereby spending more than they earn via taxes.
- Investors in government securities will either hold them to maturity or sell them to other investors on the secondary bond market.
- **Classification of G-secs** - Government Securities are
    - Short term (usually called treasury bills, with original maturities of less than one year)
    - Long term (usually called Government bonds or dated securities with original maturity of one year or more)
- In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs).

What is unique about G-secs?

- **Risk-free gilt-edged instruments**- G-secs carry the lowest risk of all investments as the chances of the government not paying back your money are almost zero.
- **Lower interest rate**- The tradeoff of buying risk-free securities is that they tend to pay a lower rate of interest than corporate bonds.
- **Calculation of G-sec yields-** Every G-sec has a face value, a coupon payment and price.
- The price of the bond may or may not be equal to the face value of the bond.
- At this point, the face value of this G-sec is equal to its price, and its yield (or the effective interest rate).

A coupon or coupon payment is the annual interest rate paid on a bond, expressed as a percentage of the face value and paid from issue date until maturity.

How do G-sec yields go up and down?

- If the government floats just one G-sec, and two people want to buy it, competitive bidding will ensue, and the price of the bond may rise.
- However, the coupon payment on the G-sec is still the same.

- If the price of the bond goes up, then the yield will fall.
    - For instance, if a bond is bought at Rs 100 and the yield is 5%, but if the price of the bond goes up to Rs 105 then the yield will fall to 4.76%.

What do G-sec yields show?

- G-sec yields are a good way to figure out the broader trend of interest rates in the economy.
- **Demand from private**- If G-sec yields are going up, it would imply that lenders are demanding even more from private sector firms or individuals because anyone else is riskier when compared to the government.
- **Risk-**As such, if G-sec yields start going up, it means lending to the government is becoming riskier.
- The G-sec yields are going up, it suggests that the bond prices are falling because fewer people want to lend to the government.
- **Ability of the government to pay back**- And that in turn happens when people are worried about the government's finances.
- The government's finances may be in trouble because the economy is faltering and it is unlikely that the government will meet its expenses.

References

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Quick facts

- **Treasury bills**- T-bills, which are money market instruments, are short term debt instruments issued by the Government of India and are presently issued in three tenors, namely, 91 day, 182 day and 364 day.
- Treasury bills are zero coupon securities and pay no interest.
- Instead, they are issued at a discount and redeemed at the face value at maturity.
- **Cash Management Bills (CMBs)-** CMBs are short-term instruments to meet the temporary mismatches in the cash flow of the Government of India.
- The CMBs have the generic character of T-bills but are issued for maturities less than 91 days.
- **Dated G-Secs-** They are securities which carry a fixed or floating coupon (interest rate) which is paid on the face value, on half-yearly basis.
- Generally, the tenor of dated securities ranges from 5 years to 40 years.

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