Stock Market Volatility

Why in news?

\n\n

Stock indices witnessed an extraordinary swing recently, due to a panic sell-off by investors.

\n\n

What happened?

\n\n

\n
- The Sensex moved 1,500 points between its high and low during the day and eventually lost around 280 points.
\n
- The Nifty fluctuated between 370 points and lost around 90 points at the end of the day.
\n
- The overall market breadth was extremely weak with almost 2,200 stocks in the red as against only 542 gainers.
\n
- Also, the Sensex to plunge 1,785 points in the five trading days.
\n

\n\n

What is the reason?

\n\n

\n
- Infrastructure Leasing & Financial Services Ltd. (IL&FS) is an infrastructure development company, which provides finance and loans for major infrastructure projects.
\n
- One of the projects is the Chenani-Nashri tunnel — India's longest road tunnel at 9 kilometers (5.6 miles).
\n
- The company describes itself as the pioneer of public private partnerships.
\n

- IL&FS group of companies has a total consolidated debt of close to Rs 1 lakh crore, and it started to miss deadlines on its debt obligations beginning last week of August 2018.
  \n
- Fears grew among the investors that the default problem will spread to other NBFCs, leading to a sharp fall in the stocks of housing finance companies (HFCs) and NBFCs (which operate on borrowed funds).
  \n
- With this underlying fear, debt papers of DHFL were sold by DSP Mutual Fund, at the discount rate of 11% in the secondary market. (Normal yield was 10%).
  \n
- This was viewed as a precursor to higher borrowing costs for NBFCs.
  \n
- Hence investors sold their stocks in housing finance firms, leading to stock market plunge.
  \n
- A bunch of algorithmic trades also quickly escalated the magnitude of the fall.
  \n

\n\n

Why IL&FS defaulted?

\n\n

\n
- Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note with a maximum validity of one year.
  \n
- IL&FS have raised a huge amount through CPs.
  \n
- But the interest rates have soared to multi-year highs for short-term borrowings.
  \n
- Additionally, some of IL&FS's construction projects have faced cost overruns amid delays in land acquisition and approvals.
  \n
- Disputes over contracts have locked about 90 billion rupees of payments due from the government.
  \n
- These have made IL&FS run short of cash.
  \n

\n\n

How did the IL&FS default play out?

- It has already defaulted on around Rs 450 crore worth of inter-corporate deposits to SIDBI and more defaults are likely in the coming weeks.
- Insurance companies, state-owned banks and their provident funds and pension funds, and mutual funds (MFs) have exposure to the debt papers of IL&FS; state-owned banks have also extended term loans to IL&FS.
- Following the defaults, rating agencies ICRA, India Ratings and CARE abruptly downgraded IL&FS and its subsidiary from high investment grade (AA plus and A1 plus) to junk status, indicating actual or imminent default.

Could this spill over into the broader market?

- Despite the fluctuations, there was a significant recovery from the lows due to strong institutional buying.
- Hence the fall was believed to be a temporary correction in a bull market.
- However, the panic in the fixed income market due to the IL&FS default has led to a liquidity freeze.

Source: The Hindu, The Indian Express

Quick Fact

Discount Rate

\n

- In finance, discount refers to a situation when a bond is trading for lower than its par or face value.
\n
- For example, if a bond with a par value of $1,000 is currently selling for $990 dollars, it is selling at a discount of ($1000/$990) - 1 = 1%, or $10. The reason a bond will trade at a discount is if it has a lower interest or coupon rate than the prevailing interest rate in the economy.
\n
- In other words, since the issuer is not paying as high of an interest rate to the bondholder, the bond must be sold at a lower price to be competitive, or else no one would buy it. **(Invsetopedia)**
\n

\n\n

\n\n

\n