Fixed Income Market October 2016 Review

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Are banks demanding higher yields?

October, bond yields increased significantly as developments in the Fixed Income Market forced yields to rise during the month. The previous month of October witnessed major activity after the PIB auction of 19th October 2016 causing yields to climb from low to high drastically. Major activity was seen as the fixed income market remained stagnant throughout the month due to yields bottoming out and Banks/DFIs/FIs showing little to no interest therefore major selling of off the run and ready issues were witnessed. The participation of the PIB auction of 19th October 2016 further cemented the position of Banks/DFIs/FIs as it equaled to PKR 72 billion out of which 3 years PIB received bids worth of PKR 62 billion, 5 years PIB received PKR 10 billion and 10 years PIB received only PKR 2 billion. The insignificant amount as well as higher yields resulted in the auction being rejected. The rejection paved way for activity in the fixed income market. The yields saw an average increase of 10 basis points as selling pressure remained high on the money market on month ended October 2016. The yields for latest 3 year PIB (21-4-2016 to 21-4-2019) floated around 6.28%, yield for 4 year remaining bond (26-03-15 to 26-03-2020) also increased going from 6.45% on 1st October 2016 to 6.60% in month ended October 2016. Also PIBs of longer tenors such as 5, 6, and 10 year also increased, with their yields prevailing at 6.86%, 7.10%, and 7.96% respectively. The swift increase in bond yields occurred due to no change in the MPS of 24th September 2016 as financial institutions expected a rate cut. The results of the latest T-bill auction of 26th October 2016 showed a different trend as the cut off for 3month increased from 5.8571% to 5.9017% while the cut offs for 6month, and 12 month were maintained at 5.9046%, and 5.9148% respectively. The target amount set for the auction amounted to PKR 200 billion out of which a meager total of only PKR 90 billion was accepted. Due to the upward trend witnessed in month ended October 2016 bond yields will remain high in the near future. The CPI for YoY October 2016 equaled to 4.21%, 0.2% higher than the previous month CPI of 3.9%.

	Discount Rate (%)	**Cut Offs (%)**		
		3 year	5 Year	10 year
Jul-13	9	10.44	10.9	11.65
Dec-13	10	12.1	12.56	12.95
Jul-14	10	12.38	12.8	13.2
Dec-14	9.5	10.6	10.8	11.7
Jul-15	7	8.09	9	9.25
Dec-15	6.5	7.02	7.99	9.1
Jul-16	6.25	6.2	6.7	7.8

Looking at the above table the gap between discount rate and bond cut-off yields (3 & 5 year mainly) were always in the range of 1.00-2.00%. Only from July 2016 the gap between cut-off yields and discount rate reduced leading to 3 years PIB trading at lesser than the discount rate by 0.05%. Judging from the prevailing trend bond yields will be on the rise up until yields stagnate. If incase FED stretches it treasury rates, the PKR interest rate can also set an upward trend.