June 1, 2023

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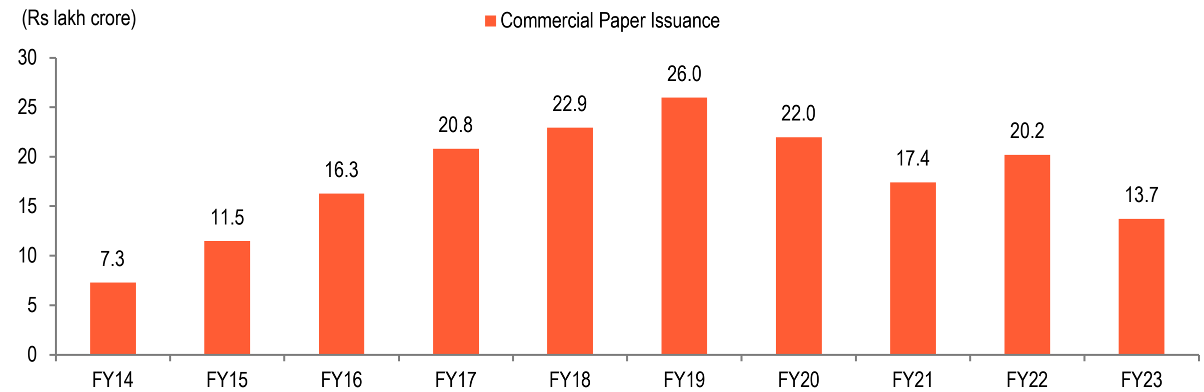
How funding through CPs have evolved?

Commercial Paper (CP) issuances have carved an important space historically and remained a preferred choice for better rated corporates for raising capital in a cost effective way from the market. Further, flexibility in terms of adjusting the maturity of instruments to match expected cash inflows and buyback options, have put them at an advantage at times. Notably, in all these years (except FY18, which is a period of partial rising rate cycle), falling interest rate regime have given a cost advantage for borrowing through this route.

The peak of CP issuances occurred in FY19, supported by stronger appetite from non-financial corporations for working capital needs *(RBI Monetary Policy Report – October 2018)* and also supported by easy liquidity conditions especially in H2 of the same year (~on an average Rs 84,300 crore).

The moderation in issuances in FY20 and FY21 despite a favourable interest rate regime can be attributed to the Covid-19 induced slowdown. *In FY23, RBI's cumulative hike of 250bps in the current cycle had led to fall in issuances, on account of higher borrowing cost.* From Rs 20.2 lakh crore, issuances fell to Rs 13.7 lakh crore in FY23. In Apr'23 and May'23 (till 26 May 2023), issuances amount to Rs 1.11 lakh crore and Rs 1.04 lakh crore respectively.

Figure 1: Commercial Paper Issuances have moderated in FY23



Source: CMIE, Bank of Baroda Research, Note: Only issuances in the primary market are accounted for as this comprises of around 77% of overall issuances

On an outstanding basis, CPs amounted to Rs 3.5 lakh crore in FY23, almost at the same level as seen in FY22. This is on account of rollover of CPs i.e. replacing one CP with another. The outstanding amount does not match with the issuance amount as many of the CPs are redeemed during the period. *Comparing the outstanding CPs amount with overall outstanding bank credit, clearly shows that in years where bank credit growth has slowed down, there has been a preference for CPs. In quantum, of course the two sources of funds are not comparable. Years such as FY15, FY17 and FY21 reflect the same.* Ratio of outstanding CP to the total sources of fund have gained momentum since FY14-FY19 (normal growth years without any shock). However, in FY23, the ratio dropped on account of higher interest rate regime and normalization in liquidity conditions of the economy.

Table 1: CP and Bank credit picture

	CP Outstanding amount, Rs lakh crore	% YoY	Bank Credit, Rs lakh crore	% YoY	Ratio of o/s CP to total sources of fund
FY14	1.1	-2.4%	59.9	13.9%	1.7%
FY15	1.9	81.3%	65.4	9.0%	2.9%
FY16	2.6	34.7%	72.5	10.9%	3.5%
FY17	4.0	52.9%	78.4	8.2%	4.8%
FY18	3.7	-6.4%	86.3	10.0%	4.1%
FY19	4.8	29.7%	97.7	13.3%	4.7%
FY20	3.4	-28.7%	103.7	6.1%	3.2%
FY21	3.6	5.8%	109.5	5.6%	3.2%
FY22	3.5	-3.3%	118.9	8.6%	2.9%
FY23	3.5	0.4%	138.6	15.0%	2.5%

Source: CEIC, CMIE, Bank of Baroda Research, Note: Double digit growth are marked in green, Total sources of fund is funding through CP and Bank Credit

Are borrowings through CPs are cheaper?

Table 2 shows that CPs have benefited on account of lower interest rate (6 out of 10 years have been associated with falling interest rate cycle, and one year has been pause). *In all the years, bank lending rates have been higher than the CP rates.* Though it's a broad form of aggregation as the tenor vary, but this gives an indicative picture of the cost analysis. In 6 out of the 10 period of observation, the spread between CP rates and Bank lending rate have been more than 200bps.

Table 2: A comparison of rates

	Repo rate cut (-)/hike (+)	Average cost of CP issuances	Bank Lending Rate (WALR on fresh loans)	Spread between Bank lending rate and CP
FY14	50	9.32	10.25	93
FY15	-50	8.74	10.86	212
FY16	-75	7.97	10.29	232
FY17	-50	7.22	9.56	234
FY18	-25	6.70	9.04	234
FY19	25	7.91	9.09	118
FY20	-185	6.93	8.48	155
FY21	-40	4.90	7.24	234
FY22	0	4.74	6.90	216
FY23	250	7.05	8.67	162

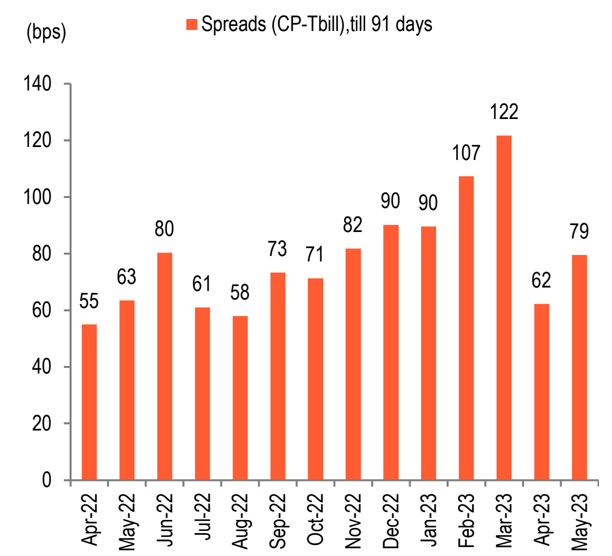
Source: FIMMDA FTRAC, CCIL TR FTRAC, Bloomberg, CEIC, CMIE, Bank of Baroda Research, Note: Bank Lending rate is WALR for fresh rupee loans by PSBs, FY14 figure for Bank Lending rate is the median base rate of PSBs, for CP rates, till FY18, Weighted Average Yield (WAY) from FIMMDA FTRAC have been used post that WAY from CCIL FTRAC have been used, Green are the years where repo rate cut happened.

How CP rates have evolved Vis a Vis TBill?

CP & TBill rate: The impact of current hike cycle of RBI has been sharper in case of TBill yields which have witnessed quite a sharp upturn. We look at how CP rates of similar maturity have moved when RBI has cumulatively raised repo by 250bps. The CP rates for all tenors have been higher than corresponding TBill yield. *Notably, the spread between CP and TBill for the 91 days tenor accelerated at the sharpest pace between Aug-Mar'23 (from 58bps in Aug'23, it rose to 122bps in Mar'23), where it peaked. This is on account of sharper pace of increase in CP rates compared to the corresponding maturity TBill rates.*

The spread between other tenor papers (181-days and 364-days) have been shown in the Appendix.

Figure 2: Spread data shows CP rates are increasing at a faster pace



Source: CCIL TR FTRAC, Bloomberg, Bank of Baroda Research, Note: Data for May till 26 May 2023

Table 3: Comparison of yield

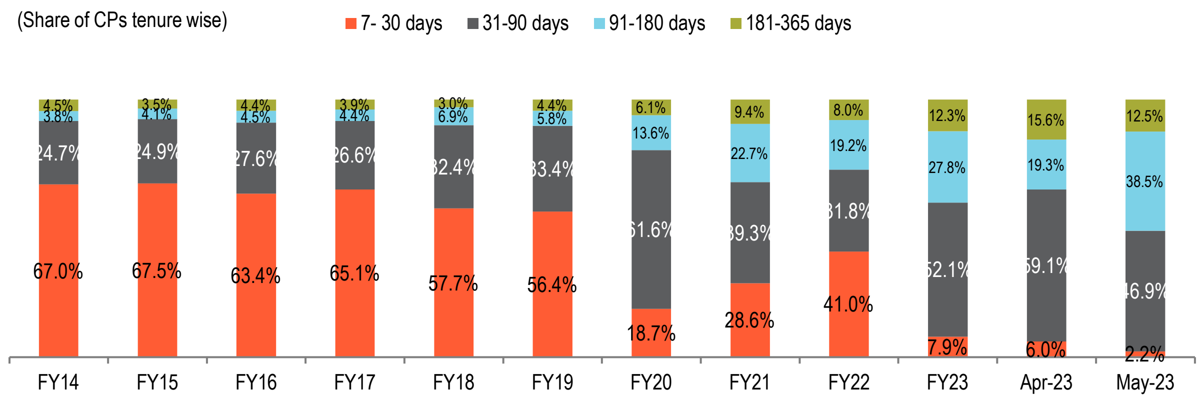
Till 91days	Tbill rates	CP rates
Apr-22	3.93	4.48
May-22	4.70	5.34
Jun-22	5.02	5.82
Jul-22	5.27	5.88
Aug-22	5.56	6.14
Sep-22	5.79	6.52
Oct-22	6.24	6.96
Nov-22	6.42	7.24
Dec-22	6.37	7.27
Jan-23	6.39	7.29
Feb-23	6.71	7.78
Mar-23	6.87	8.09
Apr-23	6.77	7.40
May-23	6.83	7.62

Source: CCIL TR FTRAC, Bloomberg, Bank of Baroda Research, Note: Data for May till 26 May 2023

Maturity Pattern of CPs:

The changes in the maturity pattern of CPs is interesting. *There has been clear shift from 7-30 days paper to 31-90 days paper, on account of liquidity adjustment*. From around 67% concentration towards 7-30 days paper as seen in FY14, the ratio was significantly lower at 7.9% in FY23. On the other hand, share of 31-90 days paper went up from 24.7% to 52.1% during the same period. Interestingly, in May'23, the share of 91-180 days paper also rose.

Figure 3: Concentration is heavily skewed towards 31-90 days paper

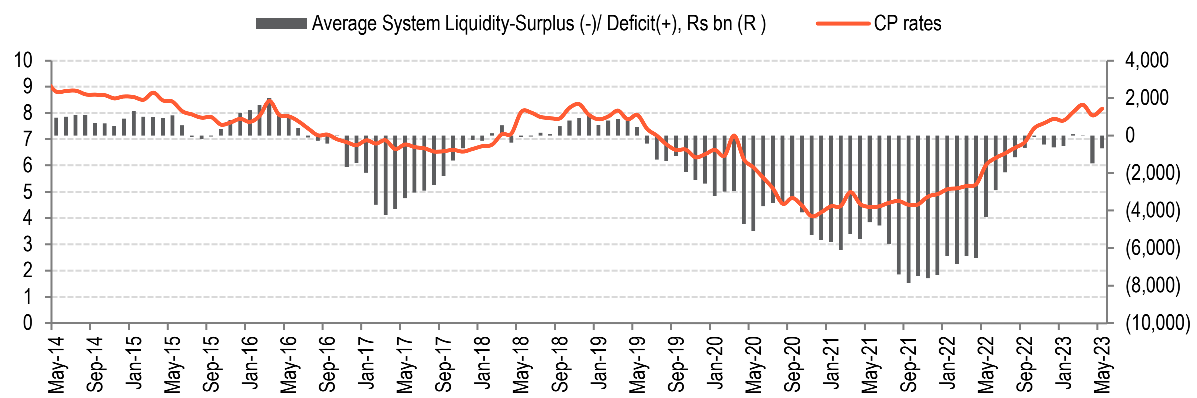


Source: CCIL TR FTRAC, Bank of Baroda Research, Note: Data for May till 26 May 2023

Liquidity and CP rates:

There is a strong degree of co-movement between CP rates and market liquidity. In episodes of liquidity deficit such as H2FY16, CP rates inched up sharply in consonance with rising liquidity deficit. Further in H1FY18, in line with increasing surplus liquidity, CP rates inched down. So for the entire Covid period, when system level liquidity went into record surplus, CP rates fell down sharply. Currently with normalization in liquidity level, some upward pressure on CP rates cannot be ruled out.

Figure 4: System liquidity and CP rates moved in tandem



Source: RBI, CCIL TR FTRAC, CEIC, Bank of Baroda Research, Note: Data for May till 26 May 2023

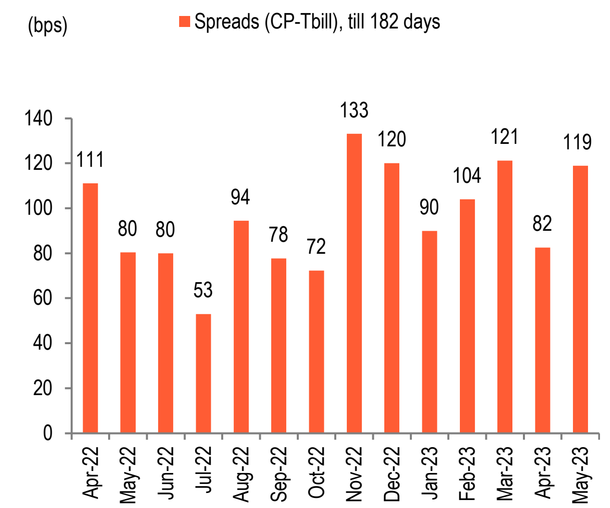
Conclusion:

- The impact of RBI's rate hike cycle since May'22 have impacted issuances of CPs which showed considerable degree of moderation in FY23.
- Higher interest cost and tighter liquidity may be attributable towards the same.
- Also preferences have shifted from very short end of the short curve (7-30days) to slightly higher maturity days (91-180 days) on account of liquidity factor.
- In terms of interest cost, CPs are relatively cheaper than bank borrowing. Historical data suggests that CPs have gained space in total sources of fund. In years where bank credit growth has remained muted, CPs have supplanted that, though in quantum the two are not at all comparable.

- When compared to other short term rates, especially of similar maturity TBill, analysis suggests that in the latest hike cycle of RBI, pace of increase in CP rates have been faster compared to other instruments.
- Going forward when there are talks about pause and even some hint of easing in policy rate, contingent on growth slowdown, CP rates are likely to show some moderation and issuances might pick up. But all this is dependent on the evolving liquidity dynamics of the economy.

Appendix:

Figure 5: In May'23, faster pace of increase in CP rates have resulted in higher spread



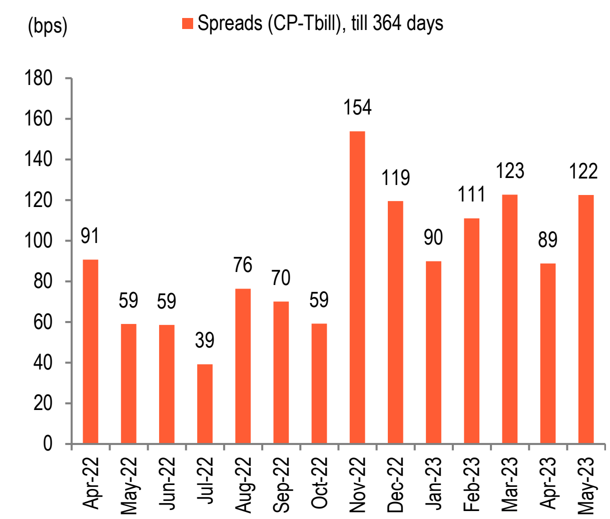
Source: CCIL TR FTRAC, Bloomberg, Bank of Baroda Research Note: Data for May till 26 May 2023

Table 4: Comparison of yield

Till 182 days	Tbill rates	CP rates
Apr-22	4.31	5.42
May-22	5.21	6.01
Jun-22	5.60	6.40
Jul-22	5.73	6.26
Aug-22	5.88	6.83
Sep-22	6.23	7.01
Oct-22	6.66	7.38
Nov-22	6.70	8.03
Dec-22	6.71	7.91
Jan-23	6.77	7.67
Feb-23	7.04	8.08
Mar-23	7.24	8.45
Apr-23	6.97	7.79
May-23	6.94	8.13

Source: CCIL TR FTRAC, Bloomberg, Bank of Baroda Research Note: Data for May till 26 May 2023

Figure 6: For 364days paper as well, spread is inching up



Source: CCIL TR FTRAC, Bloomberg, Bank of Baroda Research Note: Data for May till 26 May 2023

Table 5: Comparison of yield

Till 364 days	Tbill rates	CP rates
Apr-22	4.70	5.61
May-22	5.67	6.26
Jun-22	6.16	6.74
Jul-22	6.17	6.56
Aug-22	6.21	6.97
Sep-22	6.48	7.18
Oct-22	6.87	7.47
Nov-22	6.88	8.42
Dec-22	6.86	8.05
Jan-23	6.88	7.78
Feb-23	7.10	8.21
Mar-23	7.29	8.51
Apr-23	7.02	7.91
May-23	6.94	8.16

Source: CCIL TR FTRAC, Bloomberg, Bank of Baroda Research Note: Data for May till 26 May 2023

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