INTEREST RATE OUTLOOK

30 September 2019

Adherence to borrowing glide path implies lower yields

Centre has maintained its guidance of gross borrowings at Rs 7.1tn in FY20. Net borrowing in H2 is estimated at Rs 1.33tn. Notably, >10 year issuances in H2 are at 75.4% (42% outstanding) thus implying continuous bias for a steeper yield curve. The government today announced disinvestment including 100% stake sale in certain CPSEs. This will meet any revenue shortfall. For driving growth higher, we expect fiscal deficit at 3.5% of GDP in FY20 and inflows from small savings schemes to support the same.

Sameer Narang
+91 22 66985713
chief.economist@bankofbaroda.com

Dipanwita Mazumdar
dipanwita.mazumdar@bankofbaroda.com

Jahnavi
jahnavi@bankofbaroda.com

H2FY20 gross borrowing at Rs 2.68tn: Despite lower than Budgeted collections (4.2% in FYTD20 versus FY20BE of 9.5%) along with recently announced reduction in peak corporate tax rates (estimated impact at Rs 1.45tn), the government has announced gross borrowing of Rs 2.68tn, in-line with BE. With H1 borrowing at Rs 4.42tn, overall borrowing in FY20 is Rs 7.1tn. The government today also announced stake sale in 5 CPSEs to ensure it not only meets but exceeds its disinvestment target of Rs 1.05tn in FY20.

Bias continues towards longer-end maturity: In comparison with FY19 (35% of issuances > 10years), there has been a significant increase in the issuance of long-end dated securities in FY20. For instance, in H1FY20 as much as 67.6% of issuances were in the greater than 10 year bucket. This has now increased to 75.4%. As on Sep'19, only 42% of outstanding stock of government securities has a maturity of greater than 10 years. Thus steepening bias of the yield curve is likely to persist. At present difference between 10Y yield and 1Y T-Bill is 110bps in Sep'19 vs 78bps in Aug'19.

RBI to remain accommodative, yields to decline: H2FY20 borrowing will support 10Y yield which has inched up by 20bps in Sep'19 after announcement of reduction in corporate tax rate. The fiscal data released today shows that the government has reduced its fiscal deficit to Rs 5.5tn in Apr-Aug'19 compared with Rs 5.9tn in the same period last year. The government is looking at meeting revenue shortfall from 1) higher dividend transfer from RBI (Rs 1.48tn in FY20 versus BE of Rs 900bn), 2) disinvestment in CPSEs and 3) expenditure management. With a thrust on reviving growth, we believe government may look at increasing the fiscal deficit to 3.5% of GDP. Government may rely on small saving schemes to meet the gap as sovereign issuance is unlikely in the near-term.

KEY HIGHLIGHTS

- Gross borrowing in H2FY20 maintained at Rs 2.68tn.
- Disinvestment roadmap key to meet fiscal gilde path.

FIG 1 – BORROWING MATH

(Rs bn)	FY17	FY18	FY19RE	FY20BE
H1	3,410	3,570	2,760	4,080*
H2	2,420	2,310	2,950	2,680
Gross borrowing	5,830	5,880	5,710	7,100
Repayments	(1,748)	(1,373)	(1,483)	(2,369)
Net borrowing	4,082	4,507	4,227	4,731
Buyback	(597)	(416)	0	(500)
Net Switching	11	11	0	0
Short-term borrowing	55	449	250	250
NSSF	674	1,026	1,250	1,300
State provident funds	177	158	170	180
Others	861	54	84	595
External debt	180	79	(49)	(30)
Drawdown of cash	(89)	41	412	511
Total debt receipts	**5,356**	**5,911**	**6,344**	**7,038**

Source: Budget Documents, Bank of Baroda Research, * As on 20 Sep 2019

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For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

+91 22 6698 5713

chief.economist@bankofbaroda.com