



Union Budget 2010-11: Expectations of the Market Borrowing Programme & its impact on G-Sec yields

Feb 23, 2010

The contours of the upcoming Union Budget hold a promise to remain unique amidst the existing dilemma with regards to the twin challenges of growth and inflation currently being faced by the Indian economy. While measures taken earlier were imperative to get the economy back on the high growth trajectory and protect it from the global crisis, the imprints left behind in terms of the fiscal profligacy would have to be retraced and erased. The Government would have to steer its way to fiscal consolidation and impart momentum to the long pending reforms whilst mending the dent created already. The Budget would continue to retain the emphasis on inclusive growth while trying to curb the expenditure and maintain fiscal prudence. The center of attention this time around would be the numbers budgeted for the fiscal deficit and the market borrowing programme.

This report aims at throwing light over the current apprehensions - estimation of fiscal deficit vis-à-vis market borrowing and its effect on Government securities' yields. The Union Budget for the year 2009-10 exhibited a conservative stance with regards to revenues and maintained an accommodative stance with regards to expenditure. The upcoming Budget would probably adopt a muted stance towards expenditure and project an improved revenue scenario.

The Current mix

I. Revenues:

Positives: Higher tax revenue, 3G auction, disinvestment

- *Higher revenue expectations*

We expect that Budget 2010-11 would not initiate any major changes in the tax structure despite the lobbying from industry to bring in concessions to the corporate tax regime as also in individual tax rates as the government moves towards implementing the Direct Tax Code. A hike in the tax revenues is projected, seeing the buoyancy in the corporate bottom lines. Tax revenues can be expected to grow at a healthy rate of 20% as against a decline witnessed in the current year. The Cenvat rate for excise duty is expected to be raised by 2%. With a robust growth observed in the industrial production, the customs and excise collections too may be projected to rise after the decline observed in the current year. The current Budget that penciled in only Rs.1,120 Cr as disinvestment proceeds, marked a conservative approach in budgeting Non-Debt Capital Receipts. However the estimates for disinvestment proceeds for FY 2010-11 could be buoyant at Rs.30,000 - 35,000 Cr. The ambiguity with regards to the funds from the 3G auction, and the probability that the same would be deferred to the next fiscal, leads us to expect a realization of Non-Tax Revenues of Rs.35,000 Cr (as budgeted in the current fiscal) in the next year. Overall, the revenue side of the Budget 2010-11 promises a brighter outlook as compared to the current year.



II. Expenditure:

Expenditure to be kept in check

- Total expenditure estimation: Rs.11,12,200 Cr

The emphasis of Budget 2010-11 would remain on reining in expenditure. The Plan Expenditure would be in line with the Gross Budgetary Support approved by the Center. It is estimated at Rs.3,73,000 Cr for FY 2010-11 marking a YoY growth of 14.7%. Considering Non-Plan Expenditure, the defense services would be supported with a 15% hike. Interest payments and repayments are bound to go up by 15%. The Fisc would not be burdened with extraordinary inclusions such as 6th Pay Commission Arrears or the farm loan waiver scheme. Marking a trend based growth in the expenditure for various other heads, the total non-plan expenditure is estimated around Rs.7,40,000 Cr. The total expenditure for the year to come is projected in the range of around Rs.11,12,200 Cr.

III. Budget Financial Outline:

Fiscal deficit seen around Rs.3,70,000 Cr

- Lower than current fiscal

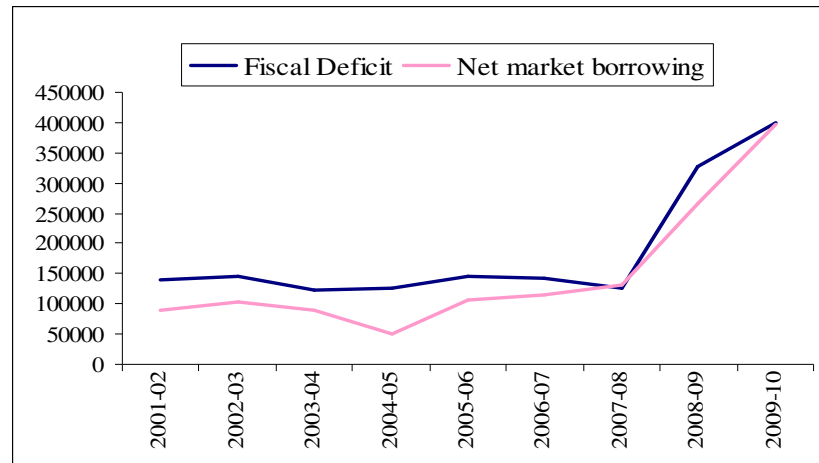
Head	Budget Estimates 2009-10 (Rs. Cr)	Our Estimates 2010-11 (Rs. Cr)	YoY change (%)
Revenue Receipts	6,14,497	7,09,061	15.4
Tax Revenue (Net)	4,74,218	5,69,061	20.0
Non-Tax Revenue	1,40,279	1,40,000	-0.2
Non-Debt Capital Receipts	5,345	34,000	536.1
Total Receipts	6,19,842	7,43,061	19.9
Plan Expenditure	3,25,149	3,73,000	14.7
Non-Plan Expenditure	6,95,689	7,39,213	6.3
Total Expenditure	10,20,838	11,12,213	9.0
Fiscal Deficit	4,00,996	3,69,151	

Considering the revenue and expenditure our fiscal deficit estimation for FY 2010-11 stands at around Rs.3,70,000 Cr lower than Rs.4,00,996 Cr for the current year. CSO's latest advance estimate for GDP growth at market prices for the year 2009-10 was marked at 10.6%. Estimating a growth of 11% for the next fiscal the GDP at market prices would stand between Rs.68,00,000-69,00,000 Cr. Fiscal deficit at Rs.3,70,000 Cr would then imply a fiscal deficit to GDP ratio of 5.4%, close to the figure of 5.5% that has been targeted in the several statements made by various Finance Ministry Officials.



IV. Government Borrowing:

The Budget deficit pegged at Rs.3,70,000 Cr can be financed via two options, viz. external finance and internal finance. Internal finance is further segregated into Market Borrowings, Other Borrowings and draw down of cash balances. Other borrowings comprise of small savings, state provident fund, special deposits, etc.



Huge net borrowing

**- Gross borrowing:
Rs.4.60 - 4.75 lakh Cr**

Considering the historical data, apart from market borrowing we expect the deficit to be financed up to an extent of Rs.16,000 Cr via other options mentioned above. We expect the small savings collections to rise substantially in the coming year, with a concomitant rise in the Other Borrowing estimates for the upcoming fiscal. This leaves us with a Net Market Borrowing in the range of Rs.3,50,000 Cr to Rs.3,60,000 Cr. Redemptions for the year 2010-11 sum up to Rs.1,14,323 Cr. Summing up the net market borrowing and the redemptions for the year, we estimate a Gross Market Borrowing in the range of Rs.4,60,000 - 4,75,000 Cr in comparison to Rs.4,51,000 Cr for the current year. With such a large borrowing and with limited tools to aid the same (viz. OMO purchases, MSS buyback, MSS de-sequestering, etc. as seen in the current year), the Central Bank faces the challenging task of ensuring a smooth completion of Government's borrowing alongside the withdrawal of the accommodative policy stance.

V. Managing the market borrowing programme:

Given the sheer size of expected market borrowing, the expected pick up in credit off-take and the gradual tightening of monetary policy, the borrowing is expected to be front-loaded. The start of the financial year could see a spike in the 10 year yield tracking the huge supply of



Tough task for RBI

*- 10 year yield seen
between 8 - 8.25%*

primary issuances, the advance tax outflow around mid-March, the inflation figure coming in higher and possible rate tightening in the April Policy. The 10 year yield could cross 8% and spike to as high as 8.25% depending upon the appetite seen in the primary auctions of Government Securities commencing in April 2010. The pressure on yields may ease marginally with large amount of redemptions in the month of May 2010.

To ensure a non-disruptive borrowing, the RBI would try and maintain a marginal surplus liquidity in the system of around Rs.20,000-30,000 Cr and ensure that the system does not move into deficit zone. The buoyancy expected in the capital inflows would help retain a comfortable liquidity scenario. Another option that could be tapped for greater G-Sec appetite is raising the FII investment limit in G-Secs (currently \$5 Bln). With the rise in the interest rates as monetary policy is tightened, the silver lining would be the incremental SLR demand arising from a rise in bank deposits. As compared to the current year growth in bank deposits (17%), the growth for the next year is expected to be in the range of 20-25%. The incremental SLR demand arising from a 20% increase in the deposits would be around Rs.2,20,000 Cr. The same may not completely translate into appetite for fresh issuances as the current systemic SLR is well above the mandated 25% (in the range of 29-30%), however even a proportion of this demand from the banking sector would remain the source of support in the G-sec auctions next year.

Conclusion:

We expect a fiscal deficit in the range of around Rs.3,65,000 - Rs.3,75,000 Cr. The same would mean a Gross Market Borrowing in the range of Rs.4,60,000 - 4,75,000 Cr. The huge borrowing would definitely put upward pressure on G-sec yields and the 10 year yield is seen in the range of 8.00-8.25% in the first quarter of FY 2010-11.



STCI
Primary Dealer Ltd

Fixed Income & Macro-Economic Research
Meghna Patel

STCI Primary Dealer Ltd.

Marathon Emperor, Marathon Nextgen Compound, Off Ganpatrao Kadam Marg, Lower Parel (W), Mumbai-400013

Dealing Room: (022) 24991094-97, (022) 66202217-20 • Settlements: (022)66202262-64, Fax (022) 66202288

Delhi Office: (011) 23351091 • Bangalore Office: (080) 22208891

Please mail your feedback to stcipd@stcipd.com • Website: <http://www.stcipd.com>

THIS COMMUNICATION IS FOR PRIVATE CIRCULATION ONLY. IT IS BASED UPON THE INFORMATION GENERALLY AVAILABLE TO PUBLIC AND CONSIDERED RELIABLE. THIS REPORT DOES NOT CONSTITUTE AN INVITATION OR OFFER TO SUBSCRIBE FOR OR PURCHASE OR SALE OF ANY SECURITY AND NEITHER THIS DOCUMENT NOR ANYTHING CONTAINED HEREIN SHALL FORM THE BASIS OF ANY CONTRACT OR COMMITMENT WHATSOEVER WITH STCI PRIMARY DEALER