



## 3G spectrum and Broadband Wireless Access (BWA) Auctions: Impact on the Government Securities market

June 23, 2010

Financial year 2010-11 holds a promise to remain unique amidst the Center's cheer with regards to the sale of 3G and BWA spectrum. An estimate of Rs.35,000 Cr set as expected revenue from the sale of 3G spectrum and BWA in the Union Budget 2010-11 proved to be a massive underestimation of the fiery desire for growth among the telecom industry players. Initial apprehensions to the Budget that mulled revenues to be overstated in a bid to curb the fiscal deficit now stand erased following the unprecedented demand for frequency spectrum. The 3G spectrum auction and the BWA auction that commenced in April 2010 witnessed an unparalleled response from the telecom players and has impacted both equity and bond markets. This report aims at throwing light on the effects of the 3G and BWA auctions on the G-Sec market and at what it portends for interest rates.

### *3G spectrum and BWA Auctions*

#### **I. Auction brief:**

3G and BWA sale:  
Rs.1,06,262 Cr

*- Higher than budgeted  
revenues*

An initiative that commenced in August 2008 (in the form of guidelines issued by the Department of Telecom for the sale of 3G spectrum and BWA) finally took form in the fiscal year 2010-11. Post several delays through two years the Government had a reason to be more than delightful on the response generated and the unexpected boost received to bring finances back on its path to fiscal consolidation. After several rounds of postponement, the 3G auctions finally began on April 9, 2010. The e-auction was conducted over 34 days (from 9<sup>th</sup> April to 19<sup>th</sup> May, 2010) and involved 183 rounds of bidding across service areas. All the 71 blocks that were put up for auction across the 22 service areas in the country were sold. The total revenue generated from the 3G auction amounted to Rs.67,719 Cr with the service area of Delhi winning the highest bids totaling to Rs.13,268 Cr and Bharti Airtel being the highest payer across service areas to the tune of Rs.12,295 Cr. The payments were made on 31<sup>st</sup> May, 2010 draining the system by Rs.67,719 Cr (as against a projected revenue of around Rs.20,000 Cr). Post completion of the 3G auctions on 19<sup>th</sup> May, the BWA auctions started within 5 days on May 24<sup>th</sup>. The e-auction was conducted over 16 days (from 24<sup>th</sup> May to 11<sup>th</sup> June, 2010) and involved 117 rounds of bidding across service areas. All the 44 blocks that were put up for auction across the 22 service areas in the country were sold. The revenues generated from this sale amounted to Rs.38,543 Cr (v/s estimates of around Rs.15,000 Cr), this time Mumbai gaining as the highest paid service area at a total of Rs.6,879 Cr and Infotel Broadband Services paying almost one-third of the total



amount - Rs.12,848 Cr for BWA across all 22 service areas. The payment for the same was scheduled for June 22, 2010. The success of these auctions added revenues to tune of Rs.1,06,262 Cr in the Government's kitty as against a budgeted estimate of Rs.35,000 Cr.

## **II. Pre-Auction market scenario:**

The beginning of the new fiscal year 2010-11 marked the Repo rate at 5%, the Reverse Repo rate at 3.5% and the CRR at 5.75%. The RBI had announced an inter policy hike on 19<sup>th</sup> March preparing the economy for the rate tightening phase. The systemic liquidity remained excess in the range of around Rs.40,000-Rs.50,000 Cr. Inflation remained in the range of 9-10% while IIP marked buoyant double digit growth rates. The Budget in February had pegged the gross G-Sec borrowing at a massive Rs.4,57,143 Cr and the G-Sec auction calendar was scheduled to borrow Rs.2,87,000 Cr in the first half of the fiscal. Amidst all these negatives, the 10 year Government security yield hardened from 7.8% at the beginning of the fiscal to 8.10% levels. The 10 yr yield was widely expected to touch 8.5% amidst fears of overwhelming G-Sec supply and tepid demand from the banking sector as credit demand rose.

No comfort from monetary or fiscal front

*- G-Sec market outlook bearish at the start of the year*

## **III. Auction impact on G-Sec market:**

The higher revenues from the 3G and BWA auctions have influenced the G-Sec market in two ways:

- Short term impact
  - The shorter end of the curve being influenced by the liquidity aspect
- Long term impact
  - The longer end taking cues from the interest rate scenario bearing in mind the positive consequences on the fiscal front

Auctions had short and long term influences

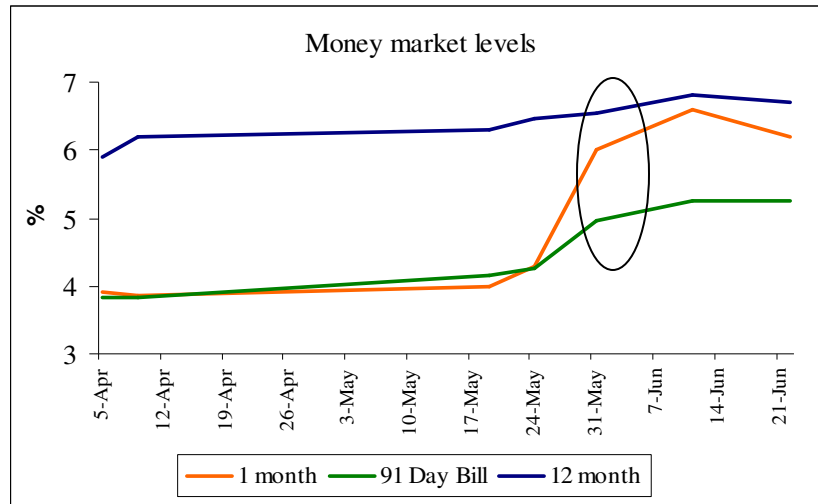
*- Liquidity and Interest rate scenario impacted*

### Short term impact:

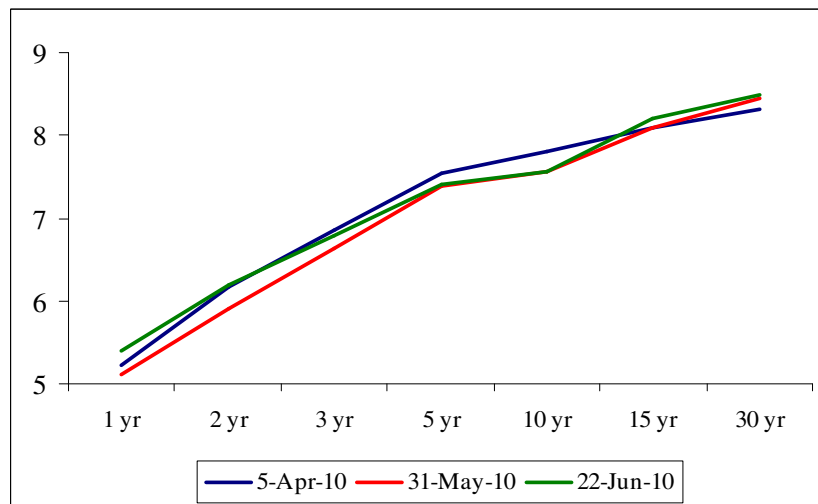
The 3G auction outflows directly impacted the systemic liquidity. The shorter tenor securities, viz. the money market instruments such as T-Bills, CDs and CPs clearly reflected this crunch in liquidity tracking the outflows arising from the auction payouts. The effective money market rate rose a whole 150 bps from the Reverse Repo rate (at 3.75%) to the Repo rate (at 5.25%). Consequently the 1 month CD rate rose from around sub 4% levels to above 6%. The 91 Day T-Bill too moved from around 3.85% levels to around 5.30%. Market participants started accessing funds from RBI's LAF Repo window (around Rs.60,000 Cr) as against parking excess funds via RBI's LAF Reverse



Repo window observed before the auctions (Rs.1,15,000 Cr). The chart below indicates the sudden spike in the money market yields observed around May 31 (payment of 3G fees).



Long term impact:



The yield curve as shown above exhibits the bullishness observed in the G-Sec market post the 3G auctions. The yield curve marked a downward movement exhibiting the fall in yields despite all macro-economic factors being against any such decline in G-Sec yields. In contrast to a secular shift of the yield curve, the 10 year yield declined the most, tracking the introduction of a new 10 year benchmark paper.

The Center's revenue collection of Rs.1,06,262 Cr against projected revenues of Rs.35,000 Cr gave the bond market fresh hopes as the



Government would directly benefit by around Rs.71,000 Cr on the fiscal deficit front. The Center's budgeted fiscal deficit of Rs.3,81,000 Cr got translated into a net market borrowing of Rs.3,45,000 Cr which further meant a gross borrowing of Rs.4,57,143 Cr. With the buoyancy seen in the 3G and BWA revenues, the market cheered in anticipation of a reduced market borrowing via sale of Government securities.

#### IV. Financial Snapshot:

|                          | Pre-Auction | 3G     |        |         | BWA    |        |         |
|--------------------------|-------------|--------|--------|---------|--------|--------|---------|
|                          |             | Start  | End    | Payment | Start  | End    | Payment |
| As On                    | 5-Apr       | 9-Apr  | 19-May | 31-May  | 24-May | 11-Jun | 22-Jun  |
| Call rate                | 3.4         | 3.3    | 3.76   | 4.99    | 3.89   | 5.15   | 5.33    |
| Repo rate (money market) | 3.3         | 0.5    | 3.66   | 5.19    | 3.96   | 5.26   | 5.31    |
| Liquidity (LAF)          | 49145       | 115295 | 43045  | -3710   | 4540   | -45450 | -65125  |
| 1 month CD               | 3.9         | 3.85   | 4      | 6       | 4.3    | 6.6    | 6.2     |
| 91 Day T-Bill            | 3.83        | 3.82   | 4.16   | 4.95    | 4.25   | 5.25   | 5.26    |
| 10 year yield            | 7.8         | 8.01   | 7.44   | 7.56    | 7.4    | 7.61   | 7.57    |

#### V. Measures taken by RBI

The quick reactions from various markets to the 3G auctions mandated RBI to take several measures to ease the smooth functioning of these markets. Liquidity tightness remained the primary concern post these auctions.

Liquidity easing measures introduced

*- Additional liquidity via eased SLR, LAF window, Buy backs announced*

Liquidity crunch arising from the outflow of these payments (again hovering around advance tax payments) led the RBI to:

- Permitting scheduled commercial banks to avail additional liquidity support under LAF to the extent of up to 0.5% of their NDTL. For any shortfall in maintenance of SLR arising out of availment of this facility, banks were permitted to seek waiver of penal interest
- Introduce a second LAF window

Both these measures being ad-hoc and temporary till July 2, 2010.

Tracking the surplus funds with the Government, the RBI revised its calendar for T-Bill auctions for the remaining part of Q1. The auction amounts stood reduced substantially to Rs.2,000 Cr for 91 Day T-Bill and Rs.1,000 Cr for both 182 Day and 364 Day T-bill auctions.



Further in a bid to ease liquidity pressures, the Government announced the buyback of soon to mature securities to the tune of Rs.20,000 Cr in two tranches.

## **VI. What lies ahead:**

Given the sheer size of the current fiscal year's market borrowing, viz. Rs.4,57,143 Cr, additional revenues from the 3G auctions come as a boon to the markets. Most market participants have started factoring in a lower Government borrowing. Comments from several Officials stating that the borrowing for the first half of the fiscal would not be altered lead to indications for a reduced borrowing in the second half. A borrowing of Rs.2,87,000 Cr pegged for the first half of the fiscal leaves the market with a borrowing of around Rs.1,70,000 Cr for the second half of the year.

Given the fact that the Government has earned an additional Rs.71,000 Cr from these telecom auctions, it leads to optimism that the second half borrowing would be reduced significantly.

|                        | 2009-10   | 2010-11   |
|------------------------|-----------|-----------|
| GDP (Rs.Cr)            | 61,64,178 | 69,34,700 |
| Fiscal Deficit (Rs.Cr) | 4,14,041  | 3,81,408  |
| FD/GDP (%)             | 6.7       | 5.5       |

**Borrowing to reduce in the second half of fiscal**

**- Reduction in the range Rs.25,000-Rs.30,000 Cr**

As seen in the table the Government has pegged its fiscal deficit at 5.5% of the GDP. However, the fiscal deficit may be negatively impacted by increased oil subsidies (budgeted at a mere Rs.3,108 Cr). Any increase in crude oil prices could lead to oil subsidies to the tune of around Rs.40,000-Rs.50,000 Cr. Keeping other projected parameters constant the revised fiscal deficit post consideration of higher oil subsidies and higher 3G revenues would be around Rs.3,50,000-Rs.3,60,000 Cr. At the given projected rate of GDP growth in the Budget this would imply a fiscal deficit to GDP ratio of around 5.2%. It would be the Government's endeavor to reduce this ratio to the extent possible. Bearing in mind the uncertainty with regards to the oil subsidies we expect the Government to lower its borrowing to the tune of Rs.25,000-Rs.30,000 Cr in the second half of the fiscal.

Apart from the implications for the fixed income market, there could be implications on the macro-economic front. The support given by banks to fund these telecom players could in the long run probably lead to a higher than anticipated credit off-take. To meet higher credit requirements we could witness a sell-off in the G-Sec market, an easy option for banks with excess SLR. In addition, the infrastructure



required for these telecom operations would mandate capital spending from the telecom players which would boost the GDP.

**Conclusion:**

While the 3G and BWA auctions have eminently proved salutary for the Government, for the financial markets they get along with them a mixed bag. While benefits to the macro-economy are plausible, its percolation into the financial markets may mark different repercussions. These surplus revenues could trigger a lower borrowing (cheer for the G-Sec market), at the same time could mean higher GDP, higher credit off-take (a dampener for G-Sec market sentiment).

We expect the fiscal deficit to come down in the range of around Rs.3,50,000-Rs.3,60,000 Cr tracking the improved revenues from the 3G auctions. The same would mean a reduction in the gross market borrowing for the second half of the fiscal. We expect a reduction to the tune of Rs.25,000-Rs.30,000 Cr in the Government's borrowing. On the path of normalization rate hikes remain imperative for the quarters to come. We expect both inflation and IIP to come down in the year ahead. Apart from the rate tightening process, we expect the market to be poised for a bullish sentiment. The 10 year G-Sec yield can be expected to trade in the range of 7.30-7.75% in the quarter to come.



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