INTEREST RATE OUTLOOK

30 September 2020

Centre sticks to its borrowing calendar

Centre has maintained its borrowing plan of Rs 12tn implying gross and net borrowing of Rs 4.25tn and Rs 3.37tn in H2. Issuance pattern remains skewed towards 10Y and above (55% of issuances) which to some extent justifies term premium/steep yield curve. State borrowings will also pick-up pace in Q3 and Q4. In addition, Centre may look at issuing longer dated securities to refinance some of the T-Bills outstanding. The above backdrop suggests gross borrowing of dated securities will be higher thus implying 10Y in the range of 6-6.25%.

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Centre's borrowing calendar unchanged at Rs 12tn: Centre has not changed its borrowing calendar for FY21. With Rs 7.66tn already borrowed in H1 (Rs 4.25tn in H1FY20), borrowing in H2 has been pegged at Rs 4.34tn (Rs 2.85tn last year). Net borrowing in H2 is estimated at Rs 3.37tn compared with Rs 1.33tn last year. Apart from dated securities, Centre has borrowed additional Rs 5.6tn by way of T-Bills in H1 compared with Rs 1.25tn last year. This has helped it to meet the gap between revenues and expenditure which increased to Rs 8.7tn during Apr-Aug compared with Rs 5.5tn last year.

Maturity pattern skewed towards long-end: Issuance pattern is skewed towards higher maturity bucket of 10-year and above at 55% in H2FY21 compared with 35% in H2FY20. This to some extent justifies the term premium between short-end and long-end bonds. Issuances in 1-5-year category is now kept at 23% in H2FY21 compared with 25% in H2FY20. FRB issuances are pegged at Rs 240bn (5.5% of overall issuance).

Consolidated deficit estimated at 12% of GDP: Driven by sharp decline in centre's net revenue receipts (40% in FYTD21) and steady growth in spending (6.2% in FYTD21) centre's fiscal deficit has already reached 6.5% of GDP in Aug'20 (12MMA basis). We expect the deficit to increase to 7.5% of GDP backed by the need to spend to support growth in H2. In addition, the Centre may issue dated securities to repay some of the outstanding T-Bills. The uncertainty over the extent of issuances implies term premium will remain elevated. In addition, fiscal deficit of states is estimated at 4.5% of GDP which implies borrowing of ~Rs 8tn by states in FY21 out of which states have already borrowed Rs 3.05tn in H1 and plan to issue another Rs 2.02tn in Q3. While banks have been large buyers of dated securities, MFs have bought T-Bills. We expect 10Y yield to remain in 6-6.25% range in the near-term.

KEY HIGHLIGHTS

- Gross borrowing in FY21 unchanged at Rs 12tn, H2 borrowing at Rs4.34tn.
- States to borrow Rs 2.02tn in Q3 after issuing Rs 3.05tn SDLs in H1.
- Centre's fiscal deficit estimated at 7.5% (of GDP).

FIG 1 – BORROWING PLAN KEPT UNCHANGED

(Rs bn)	FY17	FY18	FY19	FY20RE	FY21BE	FY21 Revised	FY21 Actual
H1	3410	3570	2760	4250	4880	6980	7660
H2	2420	2310	2950	2850	2920	5020	4340
Gross borrowing	5830	5880	5710	7100	7800	12000	12000
Repayments	(1748)	(1373)	(1483)	(2360)	(2351)	(2351)	(2351)
Net borrowing	4082	4507	4227	4740	5449	9649	9649

Source: Budget Documents, Bank of Baroda Research

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