

## INTEREST RATE OUTLOOK

28 September 2021

### Borrowing program unchanged

Centre maintained its gross borrowing plan of Rs 12tn with Rs 5.03tn expected to be raised in H2 against Rs 7.02tn in H1. This factors in GST shortfall. Net borrowing in H2 will be at Rs 3.8tn. Issuances remain heavily skewed towards 10Y and above (75% of issuances) which justifies term premium/steep yield curve. We expect 10Y yield to remain in the range of 6.1-6.4% in the near term, with upside risks from higher international oil prices. Centre's buoyant revenue collections will lend support.

Dipanwita Mazumdar

dipanwita.mazumdar@bankofbaroda.com

Sonal Badhan

sonal.badhan@bankofbaroda.com

**Centre's borrowing unchanged at Rs 12.05tn:** Centre has not changed its borrowing calendar for FY22. With Rs 7.02tn already borrowed in H1 (Rs 7.36tn in H1FY21), borrowing in H2 has been pegged at Rs 5.03tn (Rs 6.10tn last year). Net borrowing in H2 is estimated at Rs 3.78tn compared with Rs 5.18tn last year. Apart from dated securities, Centre has borrowed additional Rs 8.4tn by way of T-Bills in H1 compared with Rs 10.7tn last year. The H2 borrowing estimate includes requirements for releasing money to states as back-to-back loans in lieu of shortfall in GST compensation cess. This in turn implies that overall borrowing for financing centre's own deficit will be lower than budgeted. Higher than estimated revenue growth so far has allowed government to reduce its reliance on market borrowings.

**Maturity pattern skewed towards long-end:** Issuance pattern is skewed towards higher maturity bucket of 10-year and above as its issuance rose to 75.3% in H2FY22 compared with 68.6% in H1FY22 and 61.9% in H2FY21. This justifies the term premium between short-end and long-end bonds. The gap between 10Y G-sec and 1Y T-Bill also validated the same currently at 262bps against 231bps in FY21. Issuances in 1-5-year category is now kept at 15.9% in H2FY22 compared with 24.7% in H1FY22 and 32.4% in H2FY21. FRB issuances are pegged at Rs 440bn (8.7% of overall issuance against 6.6% in H1FY22 and 5.2% in H2FY21).

**Centre's fiscal deficit revised lower:** Driven by sharp increase in centre's net revenue receipts (75% over 2-year horizon) and only marginal increase in spending (6% over 2-year horizon) centre's fiscal deficit has already narrowed to 6.2% of GDP in Jul'21 (12MMA basis) from 9.3% in FY21. We expect the deficit to settle at 6.3% of GDP backed by robust revenue collections. We estimate centre's net revenue collections to overshoot the budgeted target by ~Rs 1.3tn, owing to higher direct and indirect tax collections. In addition, fiscal deficit of states is also projected at 3.5% of GDP versus 4.2% of GDP in FY21 (RE). This implies borrowing of ~Rs 7.8tn by states in FY22 out of which states have already borrowed Rs 3tn in FYTD22. We thus expect 10Y yield to remain in 6.1-6.4% range in the near-term, with upside risks emerging from higher international oil prices.

#### Key highlights

- Gross borrowing in H2FY22 at Rs 5.03tn against Rs 7.02tn in H1.
- Borrowing factors in GST shortfall.
- Centre's fiscal deficit estimated lower at 6.3% (of GDP) versus BE of 6.8%.
- 10Y yield to remain in the range of 6.1-6.4%.



**Fig 1 – H2FY22 borrowing at Rs 5.03tn**

(Rs bn)	FY17	FY18	FY19	FY20	FY21	FY22 BE	FY22 (Actual)
H1	3,410	3,570	2,760	4,250	7,360	7,240	7,020
H2	2,420	2,310	2,950	2,850	6,101	4,181	5,030
Gross borrowing	5,830	5,880	5,710	7,100	13,461	12,050	12,050
Repayments	(1,748)	(1,373)	(1,483)	(2,360)	(2,272)	(2,808)	(2,808)
Net borrowing	4,082	4,507	4,227	4,740	11,189	9,247	9,247

Source: Budget Documents, Bank of Baroda Research

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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](mailto:chief.economist@bankofbaroda.com)