

INTEREST RATE OUTLOOK

31 March 2021

Government borrowing skewed towards long-end

Centre's borrowing in H1FY22 is pegged at Rs 7.2tn compared with Rs 7.4tn in H1FY21. The share of greater than 30 year maturity has increased to 27% from 22% last year. Share of 10 year and 14 year maturity has declined to 41% from 47%. Government has also reduced interest rates on small saving schemes of different maturities ranging from 0.4% to 0.9% from 1 April 2021. This is positive for interest rate transmission and sentiment. But rising global yields, inflation and issuance pattern suggests upward momentum in yields to sustain.

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Centre's borrowing for H1 at Rs 7.2tn: Gross borrowing for H1FY22 has been kept at Rs 7.2tn as against Rs 7.4tn in H1FY21. Net borrowing is estimated at Rs 5.9tn in H1FY22 compared with Rs 6tn in H1FY21. Given the overall borrowing of Rs 12.05tn in FY22, H1 borrowing works out to be 60% of annual borrowing. This implies gross borrowing will be sharply lower in H2FY22 at Rs 4.8tn. However, state government borrowings are likely to remain elevated in FY22. In FY21, states have borrowed Rs 7.8tn. Out of this, 57% was borrowed in H2.

Maturity pattern skewed towards long-end: Out of the total issuance, 7% is through FRBs (6% in H1FY21). The 2-year and 5-year buckets account for 25% of total issuance in H1FY22 (25% in H1FY21). While 10 and 14 year issuance is at 41% of H1 borrowing (47% in H1FY21), greater than 30 year bucket stands at 27%, much higher than last year's 22%. The overwhelming presence of such high dated maturities should put upward pressure on yields at the longer end of the curve.

Outlook on interest rates: Global yields have been increasing this year with 10 year yield in US rising by 79bps followed by UK at 62bps and Germany by 28bps in CYTD21. Compared to this, India's 10 year yield has increased by 28bps. EM bond yields are up by 51bps. After the announcement of borrowing calendar, the government also announced sharp reduction in small saving rates ranging from 0.4% to 0.9% across different maturities. While this bodes well for decline in domestic interest rates, the size of Centre and State gross borrowing of Rs 20tn in FY22 along with upward pressure on inflation on account of rising commodity prices implies 10Y yields is likely to be in the range of 6.2-6.5% in most of FY22.

KEY HIGHLIGHTS

- Gross borrowing in H1FY22 at Rs 7.24tn.
- Issuance calendar skewed towards long-end with more than 30 year maturity at 27% of issuances.
- Long-end yields likely to see upward pressure in the year.



FIG 1 – BORROWING PLAN FOR H1FY22 AT RS 7.2TN

| (Rs bn) | FY17 | FY18 | FY19 | FY20 | FY21RE | FY22BE |
|----------------------------|-------------|-------------|-------------|-------------|--------------|--------------|
| H1 | 3410 | 3570 | 2760 | 4250 | 7360 | 7240 |
| H2 | 2420 | 2310 | 2950 | 2850 | 6101 | 4815 |
| Gross borrowing | 5830 | 5880 | 5710 | 7100 | 13461* | 12055 |
| Repayments | -1748 | -1373 | -1483 | -2360 | -2272 | -2808 |
| Net borrowing | 4082 | 4507 | 4227 | 4740 | 11189 | 9247 |
| Buyback | -597 | -416 | 0 | 0 | 0 | 0 |
| Net Switching | 11 | 11 | 5 | 0 | 0 | 0 |
| Short-term borrowing | 55 | 449 | 69 | 1501 | 2250 | 500 |
| NSSF | 674 | 1026 | 1250 | 2400 | 4806 | 3919 |
| State provident funds | 177 | 158 | 161 | 116 | 180 | 200 |
| Others | 861 | 54 | 740 | 443 | 391 | 543 |
| External debt | 180 | 79 | 55 | 87 | 545 | 15 |
| Drawdown of cash | -89 | 41 | -13 | 50 | -214 | 644 |
| Total debt receipts | 5356 | 5911 | 6494 | 9337 | 19148 | 15068 |

Source: Budget Documents, Bank of Baroda Research *Actual borrowing against budgeted Rs 12.8tn

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