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Govt cuts gross borrowings by ₹700 billion

Move may ease bond yields and pressure on liquidity; govt may meet fiscal deficit target

ARUP ROYCHOUDHURY & ANUP ROY
New Delhi/Mumbai, 28 September

Armed with augmented resources from small savings, the government will cut gross market borrowings by ₹700 billion for 2018-19 to finance its fiscal deficit, which is expected to remain within the targeted 3.3 per cent of gross domestic product (GDP).

The move, along with measures of the Reserve Bank of India (RBI), is expected to ease pressure on bond yields and liquidity. For the second half, the government will mop up ₹2.47 trillion as market borrowings, which will include issuances of inflation-linked bonds. While the target of net market borrowing will be retained, that for buybacks will be reduced.

Also, small savings will give additional resources to the government, after raising interest rates on them.

"The gross borrowing programme for the second half is now only ₹2.47 trillion. In the first half, our borrowing programme was ₹2.88 trillion," Economic Affairs Secretary Subhash Garg told reporters after fixing the calendar for the second half after consultation with the RBI. The government had budgeted mopping up ₹6.06 trillion in FY19, but will now raise ₹5.35 trillion (₹2.88 trillion in the first half and ₹2.47 trillion in the second half). Reduced buyback and increased resources from small savings will make up for the lower market borrowing. "Since our fiscal deficit is not being affected, we have decided to continue with the net borrowing programme as it is. However, we had some re-think on the buyback programme. Also, we expect some more funds to flow from small savings," Garg said. Earlier, the government had said it would reduce buyback by ₹250 billion and raise an additional ₹250 billion from small savings in FY19. This had been raised by ₹200 billion, for the whole of which the buyback would be reduced further, sources said. Icra Chief Economist Aditi Nayar said the 10-year bond yield was expected to range between 8.0 and 8.1 per cent in the near term. Currently, it is in the range 8.02-8.03 per cent.

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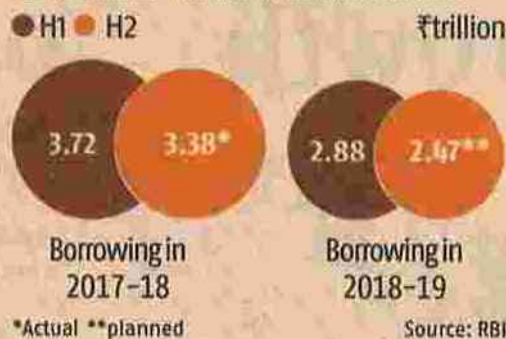
EASING THE PRESSURE



*Actual **planned
Source: RBI

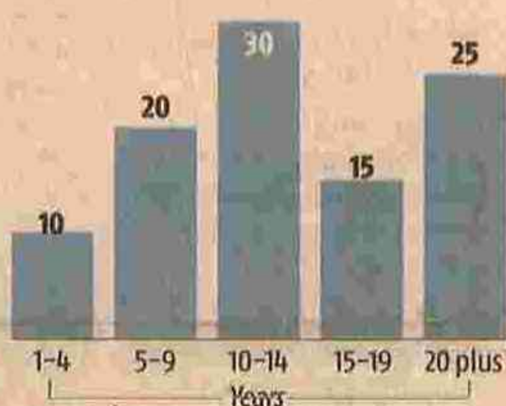
WEEKLY ISSUANCES OF G-SECs

₹110 bn a week: October 1 to November 2 (5 weeks)

₹120 bn a week: November 12 to February 22 (14 weeks)

₹170 bn Treasury bills

AS PERCENTAGE OF TOTAL G-SEC ISSUANCES IN OCT-FEB



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"With uncertainty regarding the size of H2 market borrowings out of the way, the outlook for inflation risks such as crude oil prices, rupee value, the pipeline of open market operations as well as emerging information on the balance of various fiscal risks would guide bond yields," she said. The government will borrow ₹110 billion a week until the start of November. "And thereafter, we will borrow ₹120 billion as was the case in the first half. We will end the year's borrowing programme on March 8," Garg said.

There will be 21 auctions. The government will introduce inflation-indexed bonds during the second half this year. "Since this is a new instrument, we expect one or two issues to be made in the current half year," Garg said. The government is not looking at financing the fiscal deficit from any source other than net market borrowings, buybacks and small savings. As such, either there will be no cash management bills or they may be for a very short time, Garg said.

"Our borrowing programme is sufficient for our fiscal needs. We also decided that ways and means advances would be ₹350 billion only in the second half. And in March, it will be kept only at ₹250 billion," the economic affairs secretary said.

The bond market is surprised at the cut in borrowing because it was expecting a reduction of ₹500 billion for the full year, as announced by Garg in March. "The borrowing number of ₹2.47 billion is positive. This reflects the government's comfort with revenues," said Harihar Krishnamurthy, head of treasury, First Rand Bank.

Jayesh Mehta, head of treasury, Bank of America Merrill Lynch, said the market would rally on Monday but it would also be cautious as the RBI monetary policy is scheduled next week. "If the rate hike is only 25 basis points, the market will be bullish and sustain 7.75 per cent," said Mehta. The bond market has not much reason to complain because the government is sticking to its fiscal deficit target, and the RBI is infusing liquidity of at least ₹2 trillion into the system. "The RBI move to ease liquidity via LCR (liquidity coverage ratio) easing, two successive OMOs, and the resumption of government spending have eased market liquidity considerably," Krishnamurthy said, adding he expected the 10-year bond yields to test and breach of 8 per cent on Monday. The 10-year bond yields closed at 8.02 per cent on Friday.

The weekly borrowing reduction of ₹110 billion from ₹120 billion should be able to bring some cheer in the market, but this wouldn't matter in the long term because the calendar would be stretched. Borrowing in the second half typically ends in January. This time borrowing will continue till the first week of March, the calendar showed. Bond dealers say it is unlikely that the inflation-indexed bond, introduced in the second half of the fiscal year, will be accepted widely if the spread is not good enough.

The central bank aims to keep the consumer price-based inflation rate anchored around 4 per cent, whereas the three-month treasury bill is yielding 7.5-7.6 per cent and the 10-year bond yields are quoting 8 per cent plus.