Ecowrap

GOVERNMENT BORROWING & REDEMPTION MATCHED TILL MAY: RBI MONETISATION OF FISCAL DEFICIT A MUST

Issue No. 01, FY21
Date: 03 April 2020

We welcome the RBI decision to curtail the market timings. Meanwhile, the Government is planning to borrow 62.6% of its total borrowing of the current fiscal in H1 FY21. But this has been the trend with the historical data showing that except for FY12 and FY19 the borrowing in the first half has always been above 60%. Interestingly, Ways and Means Advance (WMA) Limit (ceiling on its temporary loan facility with RBI) has been raised to Rs 1.2 lakh crore from Rs 75000 crore, (60% increase) for the Centre. When we look at the past WMA limits for the Centre such a huge amount was seen only in FY19 which was an election year in which the Government expenditure generally witnesses an increase. Furthermore, for States/UTs also, the WMA limit has been increased by 30% from the existing limit of Rs 32,225 crore to Rs 41,892 crore for all states. **We however believe the States require more support from the Centre as their finances are significantly stressed given that they are the last mile of COVID19 deliveries and also because the possibility of large slippage in Central Government finances is now a reality.**

Coming to borrowing in Q1 FY21, considering the long term borrowing demand of Rs 80,000 crore from insurance companies, the borrowing amount of Rs 2.35 lakh crore would only be slightly higher than the redemption value (Rs 1.38 lakh crore) and is nearly matched till the 3rd week of May. Furthermore, the short term money market rates have declined with call money rate at 4.29% and CBLO rate at 0.55% at end-Mar'20. Hence, the 10-year yield is likely to move down to 5.5-5.75% range, with the spread over repo rate around 120-135 bps. However, it will start ratcheting up once the picture becomes clear and the Government knows how much fiscal expansion will happen post COVID19.

However, we believe in the current scenario when market appetite is already low it seems difficult how such a huge amount of borrowing will be raised. Thus, it is imperative that the Government may use the clause given in FRBM act and monetize its deficit with RBI subscribing to the primary issues of the Central Government Securities and fulfill the supply-demand gap in FY21. In FY20, total borrowing by the Centre and States were at Rs 13.5 lakh crore (Centre at Rs 7.1 lakh crores and States at Rs 6.4 lakh crore). **Given at least estimated 4% slippage in GDP / Rs 8 lakh crore, we expect the Centre and States could borrow conservatively close to Rs 20 lakh crore in FY21. Thus it is a must that RBI monetizes the deficit, using the national calamity clause given the stressed market absorption capacity. This number must be anywhere between 2.5-3% of GDP and shown separately as an off balance sheet item in budget like a "COVID BOND". This will give a good signal to market that we have to resort to unprecedented move in this difficult times, but that will be temporary. There exists a misplaced concern in policy circles that monetisation of the fiscal deficit is bound to be inflationary per se. However, with the economy facing demand destruction, it is foolhardy to believe such now. Also, with cash withdrawals at record levels now with people holding them for precautionary motive (at Rs 96100 million for the week ended Mar'20) and even retailers shunning digital transactions because of uncertainty will depress the money multiplier thus negating any adverse impact on secondary creation of money supply that is more than desired.**

The other option is through small savings. However, with reduction in small savings rate the NSSF will come under pressure. **For example, the recent fiscal package of Rs 1.7 lakh crore has led to additional procurement burden of Rs 45,000 crore on FCI, that is likely to be financed from NSSF (over and above Rs 68,200 crore).** However, one can say that sharp revision in small savings (SS) rate by Government for Q1 FY21 is timely and appropriate. Government can achieve plethora of objectives through this move. First, we can expect a better transmission & coordinated policy actions as small savings rates have been reduced in the range of 80-140 bps. This move will reduce the divergence between bank and small savings rates. Second, we believe that this significant decline in SS rates might be a precursor / necessary nudge to migrate people from old tax regime to new tax regime as the incentive to save in PPF and other tax-savings instruments might diminish. Our estimates show that less than 10% of the total taxpayers are expected to migrate in new tax regime as they are the only ones who will be benefited.

However, the segment that will be negatively impacted by this rate reduction is senior citizens. As per our estimates, there are around 4.1 crore Senior Citizens term deposits accounts in the country with total deposit of Rs 14 lakh crore. Hence it is imperative that the Government exempts interest income from taxes particularly for Senior Citizen Savings Scheme (SCSS) for which the Government has reduced interest rate from 8.6% to 7.4%, a whopping 120 bps decline.

SMALL SAVINGS (SS) RATES REDUCTION WILL IMPROVE TRANSMISSION BUT THE TIME WAS NOT PERFECT

- In the last couple of months, all the key rates, including bank's deposit & lending rates, have been declining significantly. However, Government has not reduced the small savings rates from a long time to protect the small depositors.
- For a better transmission & coordinated policy actions, Government has now reduced all the small savings rates in the range of 80-140 bps across different maturities. As the SS rates are benchmarked with the 10-Yr G-sec, the change in rates was imperative (which we have highlighted in our '*Ecowrap*' dated 11 March 2020). This will reduce the divergence between bank and small savings rates. In FY19, the incremental Small savings deposits was 24% of incremental ASCB deposits. However, the time of cut is not good, as all the residents are facing COVID-19
- If we compare the interest rates on small savings schemes with the same brackets of bank deposits rate, the SS rates are still higher and give comparatively better returns to depositors. Further, the lower small saving rates also reduce the cost of deficit financing for the Central Government as majority of National Small Savings Fund corpus is used to finance the gap.

Small Savings Rates: Actual vs Formula Based Rates

Instruments	Govt. Announced Rates		Difference	SBI*	HDFC Bank*	ICICI Bank*
	Q4FY20	Q1FY21	(Q4FY19 minus Q1FY21)			
Savings Deposits	4.0	4.0	0.00	3.00	3.50	3.50
PPF	7.9	7.1	-0.80	-	-	-
5 year Recurring Deposit	7.2	5.8	-1.40	5.70	6.15	6.40
1-Yr Term Deposit	6.9	5.5	-1.40	5.00	6.15	6.20
2-Yr Term Deposit	6.9	5.5	-1.40	5.70	6.25	6.30
3-Yr Term Deposit	6.9	5.5	-1.40		6.25	6.40
5-Yr Term Deposit	7.7	6.7	-1.00		6.15	6.40
Sr. Citizen Savings Scheme	8.6	7.4	-1.20	TD Rate Plus 0.5%		
Post Office Monthly Income Scheme	7.6	6.6	-1.00	-		
KVP	7.6	6.9	-0.70			
NSC	7.9	6.8	-1.10			
Sukanya Samriddhi A/C	8.4	7.6	-0.80			

Source: SBI Research * Pre revised Rates before RBI Repo Rate Cut

- Further, we believe that this significant decline in SS rates will provide necessary nudge to migrate people from old tax regime to new tax regime, as we had estimated that less than 10% of the total taxpayers are expected to migrate in new tax regime.

IMPACT ON SENIOR CITIZENS

- Though it will help Government in terms of fiscal cost, it has huge impact on senior citizens savings, as their regular income will drop.
- We assess that there are around 4.1 crore Senior Citizens term deposits accounts in the country with total deposit of Rs 14-lakh crore. The average deposits size per account is around Rs 3.3 lakh and interest income from such deposits forms 5.5% of Private Final Consumption Expenditure in FY19.
- We suggest that in the present scenario, it is imperative that the Government should exempt interest income from taxes particularly for Senior Citizen Savings Scheme (SCSS) for which Government has reduced interest rate from 8.6% to 7.4%, a whopping 120 bps decline, The interest income under SCSS is fully taxable (the interest amount for Rs 1 lakh deposit for 5 years is around Rs 40,000 which is taxable).

SBI YEARLY COMPOSITE INDEX DECLINED BELOW THE COMFORT LEVEL IN MARCH 2020

- The yearly SBI Composite Index for March declined significantly to 46.3 (Moderate Decline) compared to 51.1 (Low Growth) in Mar'20. Also, the monthly SBI Composite index declined significantly to 48.2 (Low Decline) in March compared to 50.2 (Low Growth) in Feb'2020.
- The SBI Composite Index, a leading indicator for manufacturing activities in the Indian Economy aims to foresee the periods of contraction and expansion. The Composite Index has mainly two indices i.e. SBI Monthly Composite Index and SBI Yearly Composite Index. We believe IIP may come to positive territory in February and will be in negative 1.0-1.5% in March 2020.
- What would be the impact on India's GDP because of such a lockdown? Estimate shows that over a 60-year period, global GDP declined only once annually in 2009 by 1.7%. Even if we assume on a most conservative basis that global GDP declines at nearly similar rate in 2020 (although independent estimates suggest a significant contraction of as much as 4%) and given India's share in global GDP currently at 3.5% a contraction of 2% of real GDP in FY21 is possible purely because of India's integration with global economy through trade channel and social consumption channel. We estimate another 1.7% impact on real GDP because of 21 day lockdown in FY21 resulting in at least 70% of economy at a standstill. We thus peg our FY21 GDP estimate at 2.6%, with a clear downward bias, with Q1FY21 GDP numbers witnessing a contraction. FY20 GDP estimates could also see a downward revision from 5% to 4.5% with Q4GDP growth at 2.5%. The total cost of the lockdown is at least Rs 8.2 lakh crore in nominal terms / output loss of at least 4%. However, the economy could recover potentially faster the quickly the stimulus programme is in place.

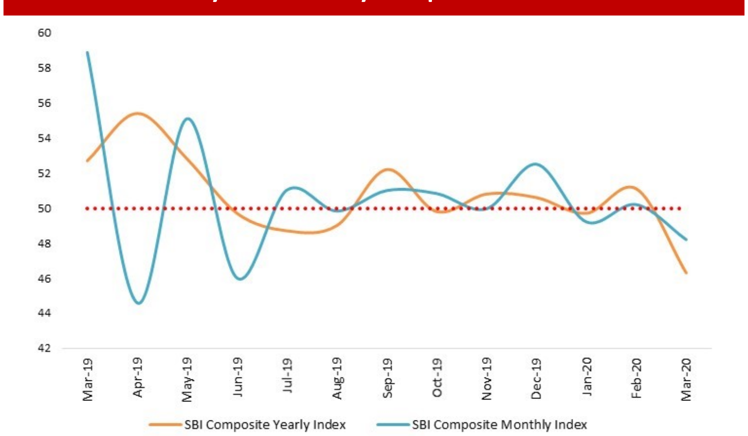
PPF Rate vs Bank Interest Rate

Source: SBI Research

Estimated Term Deposits with Senior Citizens			
Size of Term Deposits	Number of Accounts (in Million)	Amount (in Rs Billion)	Average Amount per Account (in Rs)
Less than 25,000	2	34	18916
25,000 to 1 Lakh	10	638	62088
1 Lakh to 15 Lakh	28	9153	3.3 lakhs
15 Lakh to 1 Crore	1	3495	29.5 lakhs
1 Crore and above	0.03	405	154.20 lakhs
Total	**41**	**13724**	**334243**

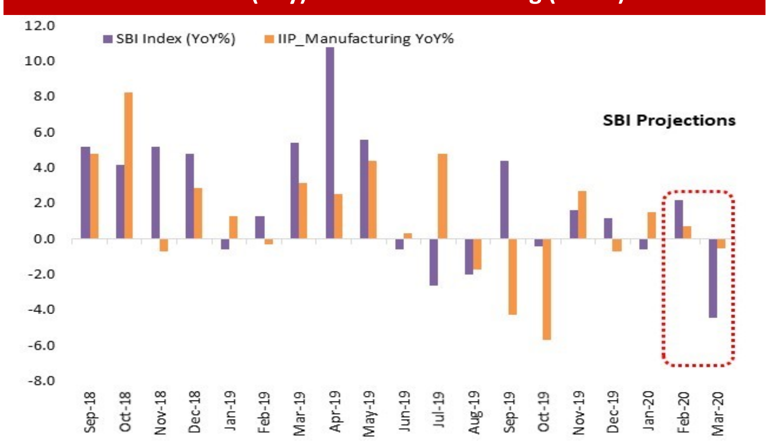
How to Read SBI Composite Index	
Index Value	**Read as**
Less than 42	Large Decline
42 to 46	Moderate Decline
46 to 50	Low Decline
50 to 52	Low Growth
52 to 55	Moderate Growth
55 & Above	High Growth
Source: SBI Research	

SBI Yearly and Monthly Composite Index Trend



Source: SBI Research

SBI Index (Yoy) vs IIP Manufacturing (YoY%)



Source: SBI Research

BORROWING FOR FY21: FRONTLOADING IN H1 WITH 62.6% OF OVERALL BORROWING

- The Government has come out with its borrowing calendar for FY21. It has been proposed to borrow Rs 4.88 lakh crore (62.6% of BE of Rs 7.8 lakh crore) in H1 FY21 and the rest in H2. According to the ministry, the borrowing plan factors in necessary stimulus required due to COVID-19.
- Though the market is assuming frontloading of borrowing in the first half of the year owing to the current circumstances of increase in COVID -19 pandemic, looking at the historical data it can be seen that except for FY12 and FY19 the borrowing in the first half has always been above 60%.
- As per the detailed issuance calendar, the maximum amount will be raised through 10-year paper (26.43% of total), followed by 5-year (21.52%) and 40 year (15.37%). Compared to H1 FY20, there has been an increase in the share of very long-term papers (25Y and above) in the overall borrowing requirement. The share has increased from 23.5% in H1 FY20 to slightly more than 30% in H1 FY21.
- The Centre also plans to issue the debt exchange traded fund (ETF) comprising of government securities to widen the base of investors. However, the volume is not so large to have some meaningful impact for market.
- The Government has also announced switches and buybacks worth Rs 2.7 lakh crore in FY21, with switch to be held every 3rd Monday of the month.
- Interestingly, Ways and Means Advance (WMA) Limit (ceiling on its temporary loan facility with RBI) has been raised to Rs 1.2 lakh crore from Rs 75000 crore, (60% increase) to tide over the cash flow mismatch in FY21 expected from higher spending to combat the spread of COVID-19. When we look at the past WMA limits for the Centre such a huge amount was seen only in FY19 which was an election year in which the Government expenditure generally witnesses an increase.
- Furthermore, for States/UTs also, the WMA limit has been increased by 30% from the existing limit. The revised limits will come into force with effect from 1 Apr'20 and will be valid till 30 Sep'20. WMA from RBI by States amounted to Rs 32,225 crore in FY20, thereby implying a further enhanced limit of Rs 41,892 crore for all states.
- The increase in WMA limit this year comes at an unprecedented time when the Centre and the States need greater flexibility to raise funds from RBI without borrowing them from the market, amidst higher medical and other expenditure related to the pandemic.
- If we look at the Q1 FY21 borrowing calendar, total borrowing amounts to Rs 2.35 lakh crore while redemption for Q1 is Rs 1.38 lakh crore. If we assume the long term borrowing demand of Rs 80,000 from insurance companies, the borrowing amount would only be slightly higher than the redemption value. Furthermore, the short term money market rates have declined with call money rate at 4.29% and CBLO rate at 0.55% at end-Mar'20.
- Hence, the 10-year yield is likely to move down to 5.5-5.75% range, as the spread over repo rate has been around 120-135 bps. However, it will start ratcheting up once the picture becomes clear and the Government knows how much fiscal expansion will happen post COVID19.

MONETISATION OF DEFICIT

- The total net borrowing requirement of the Centre and the States for FY21 is around Rs 11 lakh crore. This number is based on old estimates before the COVID-19 pandemic. Of this, demand of securities from banks will be around Rs 3.8 lakh crore (assuming 10% growth in NDTL and 27% SLR). The insurance sector could subscribe upto Rs 3.5 lakh crore. The rest of the amount will be borrowed from PDs (Rs 21,000 crore), Mutual Funds (Rs 64,000 crore), FPI (Rs 64,000 crore) and others. However, in the current scenario when market appetite is already low it seems difficult how such a huge amount will be raised. Thus, it seems that RBI will have to aggressively monetize to fulfil the supply-demand gap in FY21 and also do OMO purchases.

Gross Government Borrowing (Rs lakh crore)

Year	Full year	H1 Borrowing (% to Full Year)
FY12	5.10	49.0%
FY13	5.58	66.3%
FY14	5.64	61.9%
FY15	5.90	62.3%
FY16	5.85	61.5%
FY17	5.82	61.0%
FY18	5.88	63.3%
FY19	5.71	50.4%
FY20	7.10	62.3%
FY21	7.80	62.6%

Source: SB Research, RBI

Issuance Calendar for Marketable Dated Securities (Rs Crore)

Week	2Y	5Y	10Y	14Y	30Y	40Y	FRB	TOTAL
1	3000		10000			6000		19000
2		9000		5000	6000			20000
3	3000		9000			5000	4000	21000
4		9000		4000	6000			19000
5	3000		10000			6000		19000
6		9000		4000	6000			19000
7	3000		10000			6000		19000
8		8000		3000	6000		4000	21000
9	3000		10000			6000		19000
10		9000		4000	6000			19000
11	3000		10000			6000		19000
12		8000		3000	6000		4000	21000
13	3000		10000			6000		19000
14		9000		4000	6000			19000
15	3000		10000			6000		19000
16		8000		3000	6000		4000	21000
17	3000		10000			6000		19000
18		9000		4000	6000			19000
19	3000		10000			6000		19000
20		9000		4000	6000			19000
21	2000		10000			5000	4000	21000
22		9000		4000	6000			19000
23	3000		10000			6000		19000
24		9000		4000	6000			19000
25	2000		10000			5000	4000	21000
Sum	**37000**	**105000**	**129000**	**46000**	**72000**	**75000**	**24000**	**488000**
% to total	**7.58**	**21.52**	**26.43**	**9.43**	**14.75**	**15.37**	**4.92**	**100.00**

Source: SBI Research, RBI

WMA Limit (Rs crore)

Year	Amount	Year	Amount
H1FY15	35000	H1FY19*	130000
H2FY15	20000	H2FY19**	60000
H1FY16	45000	H1FY20	75000
H2FY16	20000	H2FY20	35000
H1FY17	50000	H1FY21	120000
H2FY17	25000		
H1FY18	60000		
H2FY18	25000		

Source: SBI Research, RBI, * announced separately for Q1 (Rs 60,000 cr) & Q2 (Rs 70,000 cr), ** Oct'18-Feb'19 Rs 35,000 cr & Mar'19 -Rs 25,000 cr)

- *The FRBM Act clearly states under 'Borrowing from Reserve Bank' section that RBI may subscribe to the primary issues of the Central Government Securities in case the Government breaches the fiscal deficit target on account of 'national security, act of war, national calamity, collapse of agriculture severely affecting farm output and incomes, structural reforms in the economy with unanticipated fiscal implications, decline in real output growth of a quarter by at least three per cent points below its average of the previous four quarters'.*
- Thus, in the given situation of pandemic when the Government has to provide additional fiscal stimulus it may use this provision and monetise the deficit. RBI can monetise deficit to the extent of 2.5-3% of GDP.

FISCAL SITUATION

- The Government has already announced a fiscal package of Rs 1.7 lakh crore amidst the ongoing spread of COVID-19 and more is expected to come. This in turn is going to impact its fiscal situation in FY20 and FY21. As per the CGA data, the Government's fiscal deficit touched 135.2% of the full-year target at end-Feb'20 (compared to 134.2% of FY19 BE in the corresponding period last year) mainly due to slower pace of revenue collections. The revenue receipts were Rs 13.77 lakh crore or 74.5% of the FY20 RE, while total expenditure was 91.4% of RE or Rs 24.65 lakh crore. The Government has also missed the revised disinvestment target of Rs 65,000 crore by Rs 14,700 crore. In case of tax collection also it is falling far behind on its targets. Net tax revenue in the 11 months of FY20 was 74.1% of the budgeted estimate. To meet its full-year target, the Government would need to have collected Rs 3.9 lakh crore rupees in taxes in the last month.
- If we look at GST collections, the full year GST collections have grown by 4% over the last year's GST revenue. The Government can comfortably meet the GST target, as it has unallocated IGST at its disposal. However, the problem will be mainly on the other heads of revenue, the combined shortfall of which could be around Rs 2.0 lakh crore. This could push this year's fiscal deficit well over 4.0% of GDP as GDP data is also be revised downwards.
- For FY21, The Centre has projected a fiscal deficit of 3.5% of GDP. However, the Government spending is likely to increase than their earlier estimates on account of additional healthcare expenditure, to provide for daily wage earners whose livelihood has been impacted due to lockdown and also for stimulus to be provided for certain sectors like aviation and hospitality which are hurt due to COVID-19 spread.
- The Government had budgeted capital expenditure increase of 21% for FY21 and has earlier stated that a significant part of the borrowings for FY21 would go towards it. However, given the current situation it remains to be seen how much can be spared for this. Thus the fiscal deficit of the Centre is likely to exceed the budgeted 3.5% by a large extent.
- Furthermore, for states if we take the FY19 GSDP data and assume that states spend 1% of this GSDP extra or Rs 1.6 lakh crore as well as take into account reduced GDP growth and tax collections, their fiscal deficit will increase from budgeted 2.06% to 3.5% of GSDP, unless backed up by capital expenditure cuts.

INCREASED RELIANCE ON SMALL SAVINGS: CAN IT SUSTAIN?

- Over the past two years, the Government has increased its reliance on small savings for financing its deficit. In FY20 small savings accounted for 31.3% (Rs 2.4 lakh crore) of overall fiscal deficit and it has been budgeted at 30% for FY21. This was less than 20% in the previous two fiscal years.
- The Government has projected a net increase in NSSF collection of Rs 2.95 lakh crore in FY21 from the revised estimate of Rs 2.76 lakh crore in FY20. It is observed that a significant amount in FY21 is allocated to Food Corporation of India. In FY20, around 76.1% of the additional investment of the fund in public agencies went to FCI. This has increased to 96.5% in FY21. Gross amount of Rs 1.36 lakh crore is budgeted to be invested in FCI and considering the repayments of Rs 68,400 crore, the net amount of investment in FCI stands at Rs 68,200 crore. It seems that a large proportion of food subsidy bill (reduced by Rs 75,532 crore in FY20 RE when compared to FY20 BE) is getting shifted to next year to be funded through NSSF.
- However, with reduction in small savings rate, the NSSF will come under pressure and thus the efficacy of small savings for financing fiscal deficit becomes questionable.
- This in turn will impair the investment in FCI through NSSF. Furthermore, the recent fiscal package of Rs 1.7 lakh crore has led to additional procurement burden of Rs 45,000 crore on FCI. How this would be financed also needs to be looked into.

NSSF Fund Allocation (Rs crore)

	FY19	FY20 RE	FY21 BE
Net Collection during the year	212,004	276,588	295,936
Net additional allocation during the year	198,597	311,548	286,577
Special Central Government Securities	73,450	177,438	157,878
Special State Government Securities -	-36,039	-26,570	-26,570
Reinnvestment in Central Government Special Securitie	51,550	62,562	82,122
Public Agencies	109,636	98,118	73,147
FCI	70,000	63,600	68,200
NHAI	20,000	10,000	0
Air India	-364	0	0
BMTPC	0	15,000	0
IRFC	7,500	0	0
PFC	7,500	0	0
REC	5,000	5,000	0
RCF	0	1,805	0
MMTC	0	1,310	0
Other Public Agencies	0	1,403	4,947

SBI Research, Budget Documents

*****

Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
:@kantisoumya