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GOVERNMENT OF INDIA FINANCES

No major deviation seen in GoI's fiscal deficit relative to FY2022 RE and FY2023 BE; borrowings more front-loaded than expected

April 2022

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OUTLOOK

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The fiscal deficit of the GoI in FY2022 and FY2023 is assessed to be similar to the RE and BE, respectively

The GoI plans to borrow Rs. 8.45 trillion from the market in H1 FY2023 (~59% of the FY2023 BE for gross market borrowings), a sharp 20.4% higher than the amount raised in H1 FY2022

With interest rates on small savings schemes remaining unchanged for Q1 FY2023, we expect continued inflow of funds, amid healthy spreads over Bank deposit rates

We expect the new benchmark 10-year G-sec yield to range between 6.8-7.4% in H1 FY2023

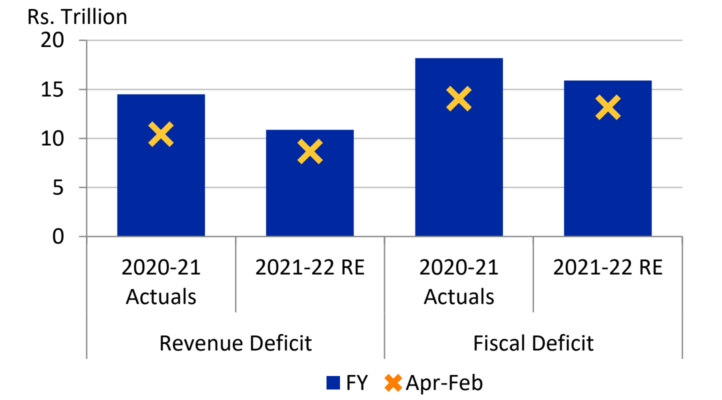
An upside to Government of India's (GoI's) tax and non-tax revenues in FY2022 and a likely undershooting of the capex target may absorb the shortfall in the disinvestment proceeds and higher expenditure included in the third supplementary demand for grants, and prevent its fiscal deficit from exceeding the revised estimate (RE) of Rs. 15.9 trillion. Similarly, our current analysis of the expected outcomes for revenues and expenditures suggests that the fiscal deficit of the GoI in FY2023 may print similar to the BE of Rs. 16.6 trillion. The market borrowing calendar for H1 FY2023 has pencilled in borrowing of Rs. 8.45 trillion from the market in this six-month period, a sharp 20.4% higher than the amount raised in H1 FY2022 (Rs. 7.02 trillion). The issuance calendar for H1 FY2023 is also slightly more front loaded than what we had anticipated (~55%), with ~59% of the FY2023 BE for gross market borrowings to be raised in H1 FY2023. Accordingly, we expect the 10-year G-sec yield to cross 7.0% over the next few weeks, and rise to as much as 7.4% over the course of H1 FY2023. While the GoI has retained the interest rates on small savings schemes for Q1 FY2023, at the levels prevailing in Q4 FY2022, we expect the same to rise going ahead, mirroring the anticipated 50 bps of repo rate hikes seen over Aug-Sep 2022.

- **Gross tax revenues of the GoI in FY2022 to overshoot the RE by Rs. 2.25 trillion:** Based on the additional tax devolved to the states in Feb-March 2022 (excluding arrears pertaining to earlier years), we have assessed that the gross tax revenues of the GoI likely overshot the RE of Rs. 27.6 trillion by a considerable Rs. 2.25 trillion.
- **FY2022 fiscal deficit seen similar to the revised target of Rs. 15.9 trillion:** Netting off the upside to the GoI's tax and non-tax revenues in FY2022 compared to their RE levels, and the likely miss on disinvestment, suggests a cushion of ~Rs. 500 billion. Additionally, we expect capex may undershoot the FY2022 RE by ~Rs. 600 billion. This suggests a total cushion of Rs. 1.1 trillion for higher revex, which is equivalent to the size of the third supplementary demand for grants.
- **The fiscal deficit of the GoI in FY2023 may be similar to the BE of Rs. 16.6 trillion:** The expected overshooting of the GoI's gross and net tax revenues for FY2023, relative to BE is likely to entirely absorb the key risks related to additional spending that are evolving at the current juncture, namely, higher fertiliser and food subsidies as well as a potential cut on excise duty on fuels. Consequently, the fiscal deficit of the GoI in FY2023 may remain similar to the BE of Rs. 16.6 trillion.
- **10-year G-sec yield to rise to 7.4% over H1 FY2023:** According to the market borrowing calendar for H1 FY2023, the GoI plans to borrow Rs. 8.45 trillion (~59% of the FY2023 BE for gross market borrowings) from the market, by conducting 26 weekly auctions with a size varying between Rs. 320 billion – Rs. 330 billion, and with tenures ranging from two to 40 years. The amount to be raised through dated borrowings in H1 FY2023 is a sharp 20.4% higher than the amount raised in H1 FY2022 (Rs. 7.02 trillion). Once the borrowing calendar for FY2023 kicks off, we expect the G-sec yields to harden in line with the global trends, even though the repo rate may not be hiked till August 2022. We expect the 10-year G-sec yield to range between 6.8-7.4% over the course of H1 FY2023.

GoI's fiscal trends in April-February FY2022: The provisional data released by the Controller General of Accounts (CGA) indicates that the GoI's fiscal deficit eased to Rs. 13.2 trillion (82.7% of FY2022 RE) in April-February or 11M FY2022 from Rs. 14.1 trillion (77.3% of FY2021 Actuals) in 11M FY2021, with a sharp 30.7% YoY growth in revenue receipts, a moderate 10.2% rise in revenue expenditure and a 19.7% expansion in capital expenditure (refer Exhibits 1 and 2).

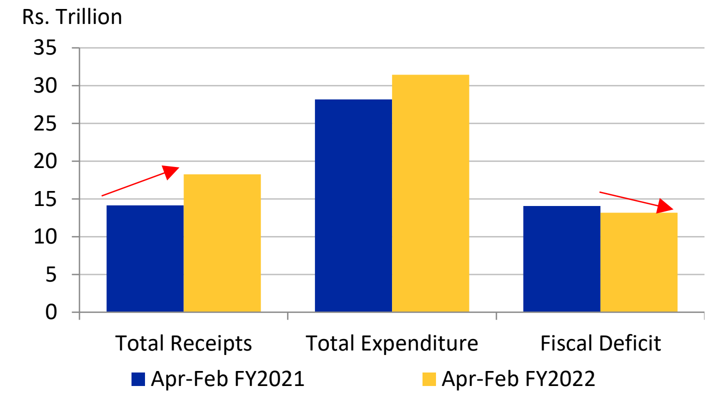
The GoI's fiscal deficit eased to Rs. 13.2 trillion in 11M FY2022 from Rs. 14.1 trillion in 11M FY2021, with a sharp 30.7% YoY growth in revenue receipts, a moderate 10.2% rise in revex and a 19.7% expansion in capex

EXHIBIT 1: GoI's Revenue Deficit and Fiscal Deficit



***Source**: CGA, Ministry of Finance, GoI; CEIC; ICRA Research*

EXHIBIT 2: Fiscal trends in April-February FY2022



***Source**: CGA, Ministry of Finance, GoI; CEIC; ICRA Research*

The revenue receipts of the GoI expanded by 30.7% YoY to Rs. 17.9 trillion in 11M FY2022 (86.2% of the FY2022 RE) from Rs. 13.7 trillion in 11M FY2021 (83.9% of FY2021 Actuals). Moreover, the collections are a healthy 30.0% higher than 11M FY2020, predominantly led by net tax revenues (+32.9%).

The GoI's gross tax revenues surged by 36.6% YoY to Rs. 22.7 trillion during 11M FY2022 from Rs. 16.7 trillion in 11M FY2021, and accounted for a sizeable 90.4% of the FY2022 RE (vs. 82.2% of FY2021 Actuals). This was driven by direct tax collections (+53.3% YoY; 88.6% of the FY2022 RE), as well as CGST (+32.1%; 92.6%) and customs duty inflows (+46.6%; 87.4%). Moreover, gross tax revenues in 11M FY2022 were 35.6% higher than 11M FY2020 (Rs. 16.8 trillion).

As per the CGA data available upto Feb 2022, the amount of central tax devolution (CTD) to the states in 11M FY2022 shot up by 77.4% to Rs. 7.9 trillion, relative to Rs. 4.4 trillion in 11M FY2021 (Rs. 4.4 trillion). In monthly terms, the GoI has devolved Rs. 2.4 trillion to the states in February 2022, by far the largest monthly release, a part of which entailed the payment of Rs. 431.7 billion towards net devolution arrears that were due to states for the period FY1997-FY2018. Subsequently, as per the press release provided by the Ministry of Finance, the Centre has transferred an additional Rs. 950.8 billion as CTD to states in March 2022 (refer Exhibit 4). Accordingly, the actual tax devolution to the state governments in FY2022 stood at Rs. 8.8 trillion, a considerable 18.5% or Rs. 1.4 trillion higher than the RE (Rs. 7.4 trillion). In other terms, the Centre has released two additional CTD instalments during FY2022, over and above the regular 14 instalments.

After removing the payment related to arrears for past years, aggregate CTD to States in FY2022 has overshot the RE level by ~Rs. 0.95 trillion. This implies that Centre's gross tax revenues have exceeded the RE level in FY2022. Assuming the additional tax devolution, net of arrears, of Rs. 0.95 trillion is equivalent to 42% of the upside to the Centre, suggests that the gross tax revenues of the GoI overshot the RE of Rs. 25.2 trillion by a considerable Rs. 2.25 trillion (refer Exhibit 3). This latter is higher than what we were earlier pencilling in.

We estimate the net tax revenues (net of devolution to States) in FY2022 at Rs. 18.6 trillion, a robust ~Rs. 0.9 trillion higher than the RE (Rs. 17.7 trillion)

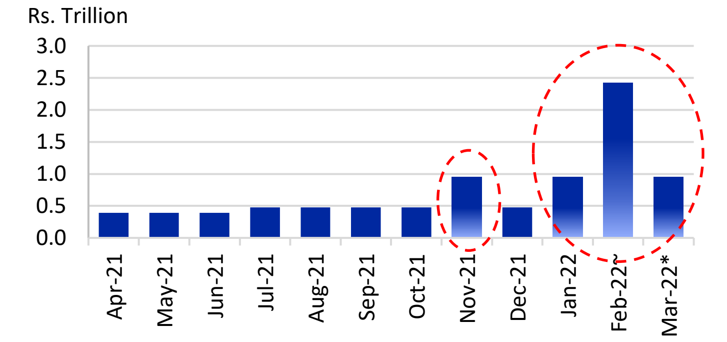
The upside in gross taxes in FY2022 over the RE, is likely to have been led by the CGST and customs duty (rebound in gold imports in Feb 2022 post third wave) collections as well as direct taxes. Note that CGST inflows during Apr-Feb FY2022 have already reached ~93% of FY2022 RE, according to the CGA data, and GST collections in March 2022, as per the Ministry of Finance, GoI, have risen to a fresh-all time high of Rs. 1.42 trillion, given the rebound in generation of GST e-way bills in February 2022 and continuing anti-evasion activities. **As a result, we estimate the net tax revenues (net of devolution to States) in FY2022 at Rs. 18.6 trillion, a robust ~Rs. 0.9 trillion higher than the RE (Rs. 17.7 trillion).**

EXHIBIT 3: Trends and estimates for Central Tax Devolution and Gross Tax Revenues

Rs. Trillion	FY2022 RE (1)	Apr-Feb FY2022	FY2022 Estimates (2)	(2) – (1)
Central Tax Devolution (A)	7.4	7.9	8.4*	0.95
Gross Tax Revenues (B)	25.2	22.7	27.4^	2.25
Net Tax Revenues (B-A)	17.7	14.8	18.6	0.9

*Excluding payment related to arrears of Rs. 431.7 billion for FY1997-FY2018, for GTR calculation; *As per PR released by Ministry of Finance on April 1, 2022; ^Based on ICRA's projections for FY2022;* ***Source****: CGA, Ministry of Finance, GoI; CEIC; ICRA Research*

EXHIBIT 4: Monthly trends in Central Tax Devolution



*Note - Data for Nov 2021, Jan 2022 and Mar 2022 includes one additional CTD tranche; ~Data for Feb 2022 is inclusive of two additional CTD tranches and additional arrears of Rs. 431.7 billion for FY1997-FY2018 released on Feb 25, 2022; *Data for Mar 2022 is based on PR released by Ministry of Finance;* ***Source:*** *CGA; Ministry of Finance, GoI; ICRA Research*

Non-tax revenues stood at Rs. 3.1 trillion in 11M FY2022 and accounted for 98.8% of the RE for FY2022. This implies a decline in non-tax revenues to Rs. 0.04 trillion in Mar 2022 to stay within the FY2022 RE, from Rs. 0.53 trillion in Mar 2021, suggesting a mild upside relative to the RE given the recent dividend pay-outs of some PSUs to the GoI. In addition, **the non-tax revenues from telecom may modestly exceed the FY2022 RE by around Rs. 90-100 billion, given the prepayment by certain telecom operators, such as Bharti Airtel. Including this, aggregate non-tax revenues of the Centre could exceed the FY2022 RE of Rs. 3.1 trillion by atleast Rs. 200 billion, after considering the dividend pay-outs.**

According to the CGA data, miscellaneous capital receipts fell by 47.4% on a YoY basis to Rs. 135.1 billion in 11M FY2022, and were equivalent to a low 17.3% of the FY2022 RE, comprising inflows of Rs. 84.8 billion from disinvestment of GoI's equity holdings and proceeds of Rs. 10.1 billion from monetisation of National Highways. Moreover, as per the data provided by the Department of Investment and Public Asset Management, Ministry of Finance, GoI, the total receipts from disinvestment of the GoI's equity holdings stood at Rs. 135.3 billion as on March 31, 2022. **We expect the disinvestments receipts to be limited under Rs. 0.17 trillion in FY2022, ~22% of the FY2022 RE level, following the delay in the LIC IPO.**

We expect disinvestment inflows to be limited under Rs. 0.17 trillion in FY2022, ~22% of the FY2022 RE level, largely due to delay in LIC IPO

On the expenditure front, the GoI's revenue spending grew by 12.7% in the month of February 2022, whereas capital spending was contained at Rs. 0.43 trillion, a mild 0.8% higher than February 2021. With a large Rs. 1.2 trillion left to be spent in March 2022 (refer Exhibit 5), it appears unlikely that the capex target of Rs. 6.0 trillion included in the FY2022 RE will be met. The headroom of Rs. 5.1 trillion left for revenue expenditure is much lower than the Rs. 6.7 trillion recorded in March 2021, and the FY2022 RE for revenue spending is likely to be achieved, or even modestly exceeded, **with a back-ended release of funds towards items included in the second and third (net cash outgo of Rs. 1.1 trillion, announced on March 14, 2022) supplementary demand for grants for FY2022.**

However, the implied number for March 2022 for capital expenditure is quite high compared to the average monthly spending of 441.1 billion during 11M FY2022; we expect capital expenditure to undershoot the FY2022 RE by ~Rs. 600 billion despite the relaxations announced regarding capital-related spending for the Ministries/Departments for Q4 FY2022.

EXHIBIT 5: Trends and headroom available for Revenue Expenditure

Rs. Trillion	FY2022 RE	Apr-Feb FY2022	Implicit amount left to meet FY2022 RE	Growth over FY2021 (%)
Revenue Expenditure	31.7	26.6	5.1	-24.1%
Interest Payments	8.1	6.7	1.4	19.0%
Subsidies	4.3	3.8	5.1	-85.1%
Non-interest Non-subsidy Revenue Expenditure	19.2	16.1	3.1	51.4%

Source: CGA; ICRA Research

Netting off the upside to the GoI's tax and non-tax revenues in FY2022 compared to their RE levels, and the likely miss on disinvestment, suggests a cushion of ~Rs. 500 billion

Additionally, we expect capex may undershoot the FY2022 RE by ~Rs. 600 billion

This suggests a total cushion of Rs. 1.1 trillion for higher revex, which is equivalent to the size of the third supplementary demand for grants

Overall, we expect the fiscal deficit of the GoI for FY2022 to be broadly similar to the revised target of Rs. 15.9 trillion

Netting off the upside to the GoI's tax and non-tax revenues in FY2022 compared to their RE levels, and the likely miss on disinvestment, suggests a cushion of ~Rs. 500 billion (refer Exhibit 6). Additionally, we expect capex may undershoot the FY2022 RE by ~Rs. 600 billion. This suggests a total cushion of Rs. 1.1 trillion for higher revex, which is equivalent to the size of the net cash outgo in third supplementary demand for grants for FY2022 (announced on March 14, 2022). Moreover, the Ministry of Finance, GoI has recently modified the cash management guidelines to grant one time relaxation for facilitating revex and capex during end-March 2022 with immediate effect on March 21, 2022 (limited to FY2022 only). Overall, we expect the fiscal deficit of the GoI for FY2022 to be broadly similar to the revised target of Rs. 15.9 trillion.

EXHIBIT 6: ICRA's FY2022 forecast for GoI's revenues

Rs. trillion	FY2022 RE (1)	FY2022 ICRA P (2)	Change in FY2022 (2-1)
Non-excise GTR	21.2	23.5	2.25
Union Excise duty	3.9	3.9	0.0
Gross tax revenues	**25.2**	**27.4**	**2.25**
CTD	7.4	8.8	1.4
Net tax revenues - A	**17.7**	**18.6**	**0.9**
Non-tax revenues - B	3.1	3.3	>0.2
Disinvestment Proceeds - C	0.78	0.17	-0.6
Revenue receipts and Disinvestment proceeds (A+B+C)	**21.6**	**22.1**	**0.5**

Source: CGA; Union Budget; ICRA Research

FY2023 OUTLOOK: The GoI's budgeted fiscal deficit of Rs. 16.6 trillion or 6.4% of GDP for FY2023 is likely to be adversely affected on account of potential excise duty cuts, high fertiliser and food subsidies, and compressed growth in direct taxes given squeezed corporates' profit margins. However, modest nominal GDP growth and tax buoyancy assumptions, and the spillover of the LIC IPO to FY2023 would provide some cushion.

The nominal GDP for FY2023 assumed in the FY2023 Union Budget (Rs. 258.0 trillion) is only 9.1% higher than the NSO's 2nd Advance Estimate for FY2022 (Rs. 236.4 trillion). We expect the nominal GDP to expand by 14% YoY in FY2023, after taking into account the ongoing inflationary pressures amid geopolitical conflict and its impact on deflator.

Our forecast of the sizeable upside to GoI's gross tax revenues in FY2022 is entirely stemming from non-excise flows. Accordingly, if we assume 14% YoY growth in the GoI's non-excise tax revenues (in line with the growth in FY2023 BE, relative to FY2022 RE), in gross terms, these inflows in FY2023 are estimated to rise to Rs. 26.8 trillion from the expected Rs. 23.5 trillion in FY2022. Even if we remove the potential loss of Rs. 920 billion from the budget estimate of union excise collections for FY2023, if excise duties on petrol and diesel are scaled back to pre-pandemic levels, the gross tax revenues of the Centre in FY2023 may end up overshooting the BE of Rs. 27.6 trillion by a robust Rs. 1.6 trillion. After taking into account the CTD adjustment, net tax revenues in FY2023 could be Rs. 1.0 trillion higher than the BE. **Overall, we expect revenue and disinvestment receipts of the GoI in FY2023, at present, can exceed the BE by Rs. 1.35 trillion, inclusive of spillover of inflows from LIC IPO to FY2023 (refer Exhibit 7).**

On the expenditure side, given the ongoing Russia-Ukraine conflict and the resultant surge in input costs, the fertiliser subsidy requirements are expected to rise, we expect the subsidy outgo of the GoI to overshoot the FY2023 BE of Rs. 1.1 trillion by Rs. 500-550 billion. Moreover, the free foodgrain extension under the Pradhan Mantri Garib Kalyan Ann Yojana (PMGKAY) until Sep 2022 will cost Rs. 800 billion to the GoI, pushing up the outgo for food subsidy for FY2023. **At present, the upside risks to the GoI's total expenditure in FY2023 over the BE level is likely to be around Rs. 1.30-1.35 trillion.**

The GoI is expected to borrow Rs. 8.45 trillion from the market in H1 FY2023 (~59% of the FY2023 BE for gross market borrowings), 20.4% higher than the amount raised in H1 FY2022

EXHIBIT 7: ICRA's FY2023 forecast for GoI's revenues

Rs. Trillion	FY2023 BE (1)	FY2023 ICRA P (2)	Change in FY2023 (2-1)
Non-excise GTR	24.2	26.8	2.5
Union Excise duty	3.4	2.4	-0.9
Gross tax revenues	**27.6**	**29.2**	**1.6**
CTD	8.2	8.8	0.7
Net tax revenues – A	**19.3**	**20.3**	**1.0**
Non-tax revenues – B	2.7	2.7	0.0
Disinvestment Proceeds - C	0.65	1*	0.35
Revenue receipts and Disinvestment proceeds (A+B+C)	**22.6**	**24.0**	**1.35**

**Inclusive of spillover of inflows from LIC IPO to FY2023; Source: CGA; Union Budget; ICRA Research*

On balance, the expected overshooting of the GoI's gross and net tax revenues for FY2023, relative to BE are likely to entirely absorb the key risks related to additional spending that are evolving at the current juncture, namely, higher fertiliser and food subsidies as well as the potential cut on excise duty on fuels. Consequently, the fiscal deficit of the GoI in FY2023 may remain similar to the BE of Rs. 16.6 trillion, based on the current analysis of expected outcome for revenues and expenditures.

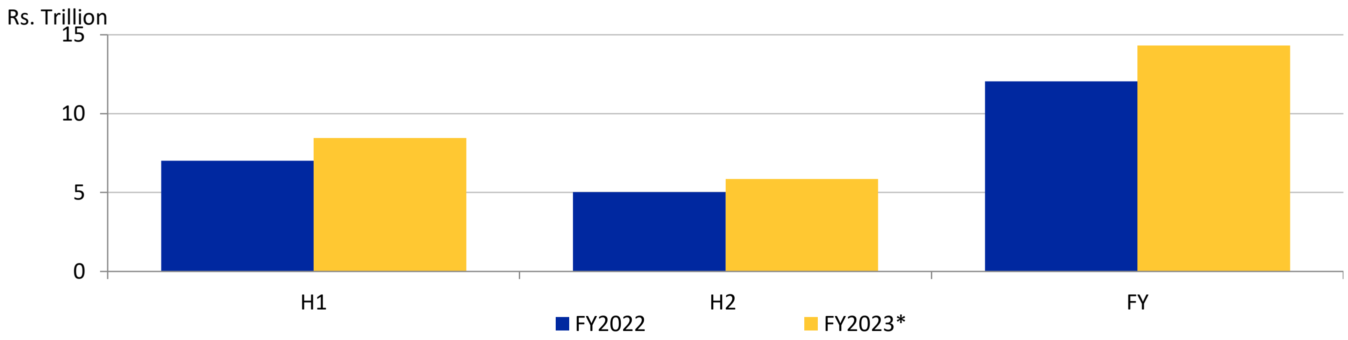
We believe that the GoI may issue seven additional tranches of Rs. 140 billion each of 6.54 GS 2032 by July 8, 2022, after which a new benchmark 10-year security may be issued.

Borrowing programme of the GoI in FY2023: The Union Budget for FY2023 had pegged the gross and net market borrowings at higher-than-expected Rs. 15.0 trillion and Rs. 11.2 trillion, respectively, in FY2023 BE (refer Exhibit 8) translating to a considerable YoY expansion of 42.9% and 44.2%, respectively, relative to FY2022 RE. However, adjusting for the switch/conversion of the G-secs of Rs. 0.63 trillion, which was undertaken by the RBI on January 31, 2022, the gross borrowing for FY2023 would be a lower Rs. 14.3 trillion, nevertheless exceeding the FY2022 RE level by a significant ~19%.

According to the recently released market borrowing calendar, the GoI is expected to borrow Rs. 8.45 trillion (~59% of the FY2023 BE for gross market borrowings) from the market in H1 FY2023, by conducting 26 weekly auctions with a size varying between Rs. 320 billion – Rs. 330 billion, and with tenures ranging from two to 40 years. The amount to be raised through dated borrowings in H1 FY2023 is 20.4% higher than the amount raised in H1 FY2022 (Rs. 7.02 trillion). The share of borrowing under different maturities will be: 2-year (6.2%), 5-year (13.9%), 7-year (10.8%), 10-year (20.0%), 14-year (16.0%), 30-year (13.3%), 40-year (13.9%) and FRBs (6.2%). Additionally, the GoI has announced that it would borrow a lower Rs. 4.32 trillion worth T-bills in Q1 FY2023, compared to Rs. 5.37 trillion in Q1 FY2022.

The issuance calendar for H1 FY2023 (of Rs. 8.45 trillion) is slightly more front loaded than what we had anticipated, with ~59% of the FY2023 BE for gross market borrowings to be raised in H1 FY2023. We had expected the GoI's market borrowing calendar to target raising of Rs. 7.9 trillion gross G-sec in H1 FY2023, 55% of the adjusted budgeted total for FY2023. Our expectations were based on the assumption that the GoI would borrow a slightly larger amount in H2 FY2023 in anticipation of the possibility of Indian bonds getting included in the global bond indices in the second half of the year. This would have allowed for the larger supply in H2 to get absorbed by the market, based on which we had pencilled in relatively less front-loading in H1 FY2023.

EXHIBIT 8: GoI's Market Borrowing Programme in FY2022 (Actual) and FY2023 (Planned)



Adjusting for switch of G-sec of Rs. 0.63 trillion on January 31, 2022, the gross borrowing would be Rs. 14.3 trillion in FY2023; **Source: GoI; RBI; ICRA Research*

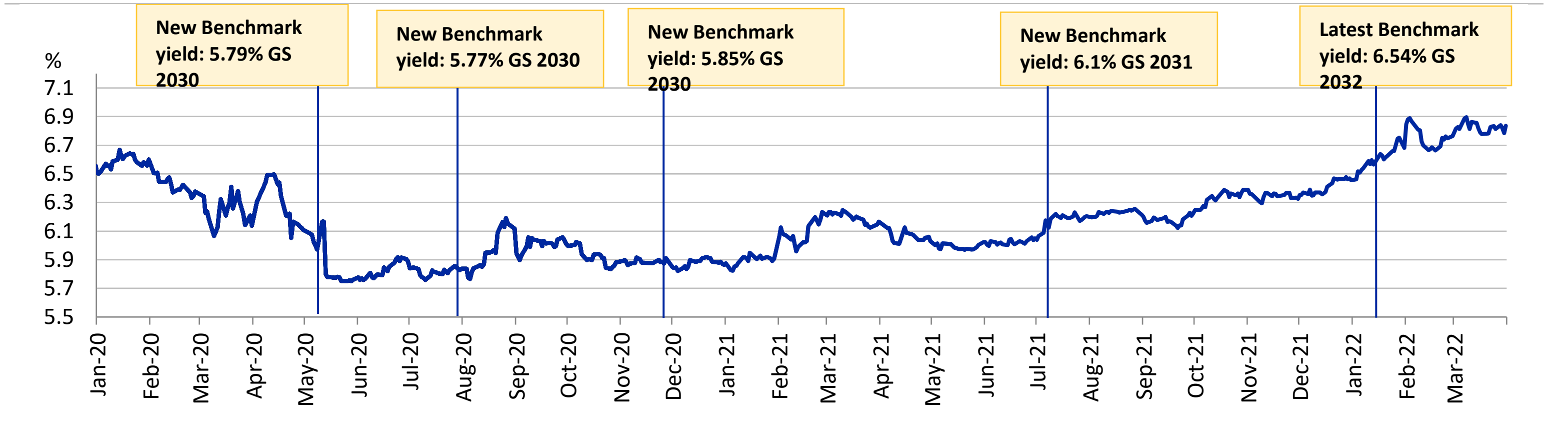
We expect the 10-year G-sec yield to cross 7.0% over the next few weeks, and rise to as much as 7.4% over the course of H1 FY2023

Nevertheless, the announced borrowing for H1 FY2023 is slightly less front-loaded than H1 FY2022, in which 62% of the total FY2022 borrowing was raised, even though the amount is higher in absolute terms vis-a-vis H1 FY2022 levels (Rs. 7.02 trillion). Adjusting for redemptions of Rs. 2.27 trillion included in H1 FY2023 (Rs. 1.39 trillion in H1 FY2022), the net market borrowings had been estimated at Rs. 6.18 trillion for H1 FY2023, higher than Rs. 5.63 trillion for H1 FY2022.

The amount of borrowing planned in the 10-year segment in H1 FY2023 has been pegged at Rs. 1.69 trillion, in 13 tranches of Rs. 130 billion each. This is higher than the maximum amount outstanding in any security, which at present is Rs. 1.5 trillion (in 5.63 GS 2026, 6.10 GS 2031 and 6.67 GS 2050). As on 31st March 2022, Rs. 390 billion has been issued in the current benchmark 6.54 GS 2032. **Therefore, we believe that the GoI may issue seven additional tranches of Rs. 140 billion each of 6.54 GS 2032, taking the total to Rs. 1.4 trillion. This may be completed by July 8, 2022, after which a new benchmark 10-year security may be issued.**

G-sec yields expected to rise in H1 FY2023: The RBI issued a new 10-year G-Sec (6.54% GS 2032) at the auction on January 14, 2022. Following the issuance, with some amount of devolvement to the primary dealers for the first time ever at the time of new issuance, the yield rose and crossed the 6.60% mark on January 19, 2022. Subsequently, it surged by 15 bps to a multi-month high of 6.75% on January 27, 2022 ahead of the presentation of the Union Budget for FY2023 in the backdrop of a considerable rebound in crude oil prices, following easing concerns of Omicron on global demand. On the Union Budget day i.e. February 1, 2022, the G-sec yield rose sharply to 6.85%, as the budgeted gross and net market borrowings for FY2023 were much higher than expectations, at Rs. 15.0 trillion and Rs. 11.2 trillion, respectively, amidst the absence of any steps in the budget to facilitate India’s inclusion in the Global Bond Indices. However, after having peaked at 6.87% on February 4, 2022, the 10-year G-sec yield cooled off to pre-budget levels and stood at 6.66% on February 18, 2022.

EXHIBIT 9: Movement in 10-year benchmark G-sec Yield



***Source**: Bloomberg; CEIC; ICRA Research*

The GoI retained the interest rates on small savings schemes for Q1 FY2023, at the levels prevailing in Q4 FY2022, in contrast with the movements seen in the average month-end G-Sec yields of various maturities, during the trailing three-month period, to which such rates are linked

Subsequently, the retention of the weekly G-sec auction held on February 25, 2022, after two cancellations, caused yields to rise, magnified by the impact of elevated crude oil prices. Thereafter, the rapid escalation of geopolitical tensions between Russia and Ukraine pushed the international crude oil price of Indian basket above $100/barrel on February 24, 2022, which caused the benchmark G-sec yields to rise to 6.75% on February 28, 2022. The 10-year yield rose further to 6.90% on March 8, 2022 (highest level since June 28, 2019), after the crude oil prices touched US$130/bbl (a 14-year high) on March 7, 2022. The average 10-year G-sec yield increased to 6.83% in March 2022 from 6.75% in Feb 2022 and 6.60% in Jan 2022.

In our view, G-sec yields are likely to have an upward bias in the near term given the large GoI borrowings budgeted for FY2023. As discussed previously, the fiscal deficit of the GoI in FY2023 may remain similar to the BE of Rs. 16.6 trillion.

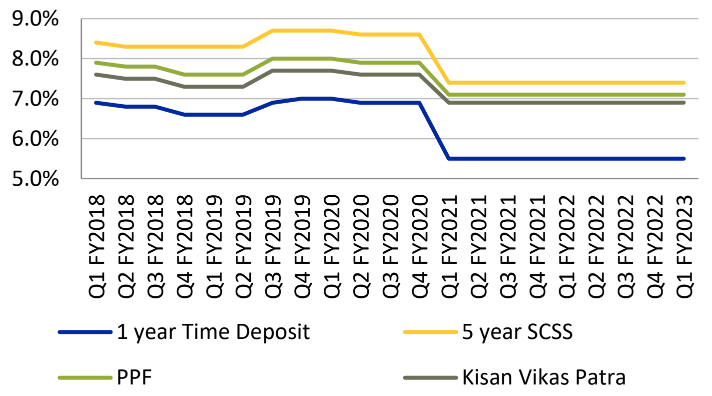
Besides, we expect the CPI inflation to average at 5.6% in FY2023, well above the Monetary Policy Committee's (MPC) projection of 4.5%, with a likely reading of over 6.0% in Q1 FY2023. While we expect only a shallow rate hike cycle in FY2023, with two repo hikes of 25 bps each in August-September 2022, G-sec yields are likely to rise ahead of repo rate hikes, mirroring the trend in global rates.

Once the borrowing calendar for FY2023 kicks off, we expect the G-sec yields to start hardening in line with the global trends, even though the repo rate may not be hiked till August 2022. We expect the 10-year G-sec yield to cross 7.0% over the next few weeks, and rise to as much as 7.4% over the course of H1 FY2023.

Interest rates on small savings schemes in Q1 FY2023: Vide a notification released by the Ministry of Finance March 31, 2022, the GoI retained the interest rates on small savings schemes[1] for Q1 FY2023, at the levels prevailing in Q4 FY2022 (refer Exhibits 9, 10 and 11). This is in contrast with the movements seen in the average month-end G-Sec yields of various maturities, during the trailing three-month period, to which such rates are linked. For instance, the average month-end G-Sec yields for one-year, two-year and 5-year bonds increased substantially (40 bps, 36 bps and 30 bps, respectively) in Dec 2021-Feb 2022 relative to the average month-end yields during Sep 2021-Nov 2021. The last revision in small savings rates had been undertaken for the quarter starting April 1, 2020.

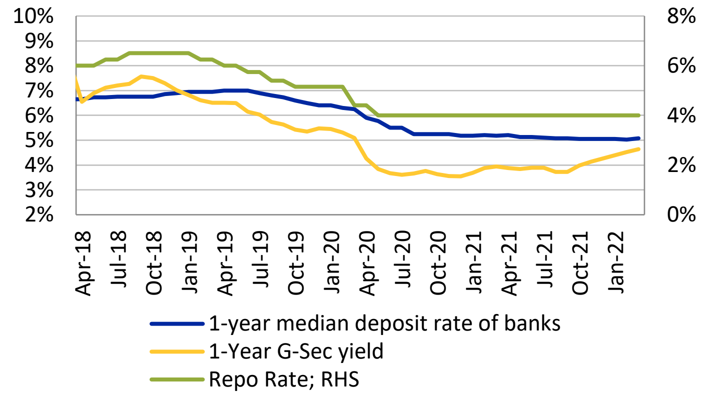
The RBI is likely to gradually absorb the surplus liquidity infused post-Covid, which coupled with weak foreign inflows, could keep the incremental deposit growth in FY2023 muted, and we estimate the same to be 7.3-7.9% in FY2023 (Rs. 12.0-13.0 trillion)

EXHIBIT 10: Trends in Interest Rates on Selected Small Savings Schemes



***Source**: Ministry of Finance, GoI; RBI; CCIL; CEIC; ICRA Research*

EXHIBIT 11: Trends in Repo Rate, 1-year G-sec Yield and 1-year Median Deposit Rate



***Source**: Ministry of Finance, GoI; RBI; CCIL; CEIC; ICRA Research*

Banks have reduced their deposit rates by up to 13 bps in FY2022 (till March 14, 2022), after a sharp 80-135 bps reduction over the entire fiscal year in FY2021, across various maturities, in the backdrop of moderate credit growth amid the unfolding pandemic, the repo rate cuts of 115 bps since late-March 2020, and surplus liquidity in the system. Partly on account of the significant cut in deposit and savings rates, as well as a high base, bank deposits growth has eased in the past six quarters, to 8.8% on March 11, 2022 from 12.1% on March 12, 2021. Moreover, incremental deposits have decreased by ~16.2% to Rs. 11.6 trillion in the same period, from Rs. 13.9 trillion in the corresponding period of the last year (refer Exhibits 12-15). The incremental deposit growth for FY2022 is likely to be within our estimates of Rs. 12.0-14.0 trillion for FY2022, likely closer to Rs. 13.0 trillion, implying a YoY deposit growth of 8.6% (11.4% for FY2021). **The RBI is likely to gradually absorb the surplus liquidity infused**

post-Covid, which coupled with weak foreign inflows, could keep the incremental deposit growth in FY2023 muted; we estimate the same to be Rs. 12.0-13.0 trillion. This will translate in a YoY deposit growth of 7.3-7.9% in FY2023.

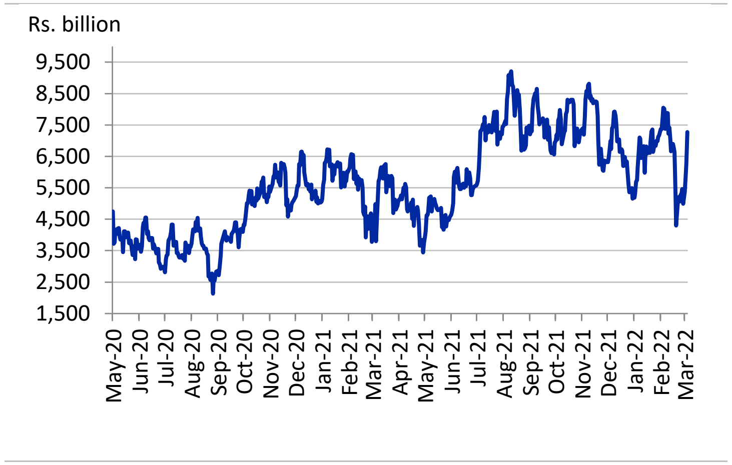
Based on the FY2022 RE, the inflows into savings deposits and certificates, and PPF, are implicitly projected to increase by ~33% to Rs. 1.2 trillion in March 2022 from Rs. 0.9 trillion in March 2021

EXHIBIT 12: Interest rate on Small Saving Schemes for Q1 FY2023

Instruments	Q1 FY2023 (%)
Savings Deposit	4.0%
1 year Time Deposit	5.5%
2 year Time Deposit	5.5%
3 year Time Deposit	5.5%
5 year Time Deposit	6.7%
5 year Recurring Deposit	5.8%
Senior Citizen Savings Scheme	7.4%
Monthly Income Account	6.6%
National Savings Certificate	6.8%
Public Provident Fund	7.1%
Kisan Vikas Patra	6.9%
Sukanya Samriddhi Account Scheme	7.6%

Source: *Ministry of Finance, GoI; ICRA Research*

EXHIBIT 13: Daily LAF outstanding



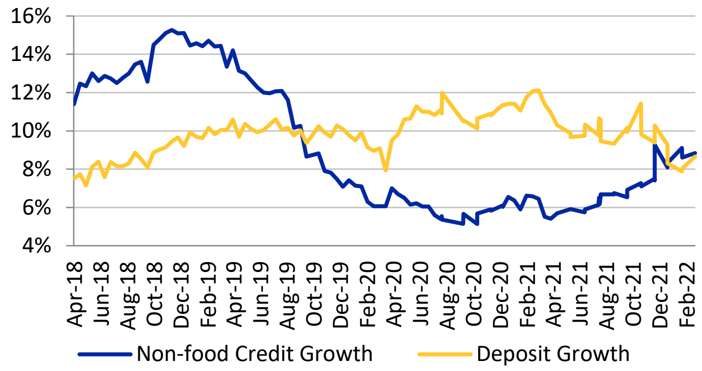
Source*: RBI; CEIC; ICRA Research*

The GoI had revised upwards the estimated net amount from small savings to fund its fiscal deficit for FY2022 by Rs. 2.0 trillion to Rs. 5.9 trillion in FY2022 RE, sharply higher than Rs. 4.8 trillion raised in FY2021. The provisional data released by the CGA indicates that inflows into savings deposits and certificates, and PPF, had risen by a healthy 9.7% to Rs. 2.4 trillion in 11M FY2022 from Rs. 2.2 trillion in 11M FY2021 (refer Exhibit 16). This is slightly higher than the growth displayed by Bank deposits (8.8% YoY on March 11, 2022). **Based on the FY2022 RE, the inflows into savings deposits and certificates, and PPF, are implicitly projected to rise by ~33% to Rs. 1.2 trillion in March 2022 from Rs. 0.9 trillion in March 2021.**

We expect continued inflow of funds into small saving schemes in the ongoing quarter, with some stabilisation in the economic activity, and healthy spreads relative to bank deposits for schemes with longer maturities

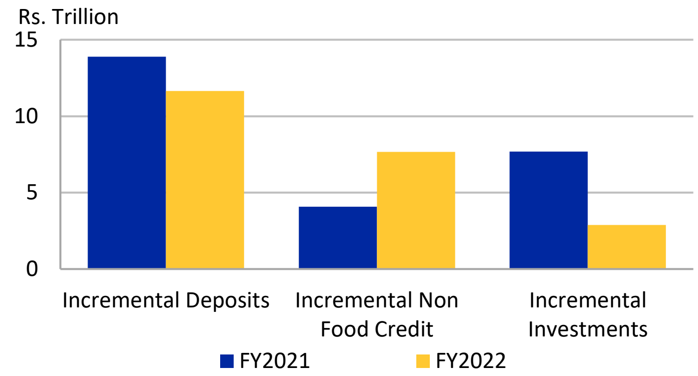
With the GoI's decision to keep the rates unchanged for Q1 FY2023, the interest rate offered by the one-year and three-year time deposit small savings schemes (5.5% each) have a modest spread of 20-42 bps over median deposits rates (one-year: 5.1%; three-year: 5.3%) offered by banks for respective maturities (refer Exhibit 17). However, the interest rates on small saving schemes with higher maturities such as five-year SCSS and National Savings Certificate have a substantial spread of ~140 bps over bank deposits rates of corresponding maturities (five-year: 5.4%). **We expect continued inflow of funds into small saving schemes in the ongoing quarter, with some stabilisation in the economic activity, and healthy spreads relative to bank deposits for schemes with longer maturities. We expect a shallow rate hike cycle to commence in mid-2022, with 50 bps of repo hikes over August-September 2022, which may subsequently be mirrored in small savings rates being hiked.**

EXHIBIT 14: YoY growth of Non-Food Bank Credit and Bank Deposits



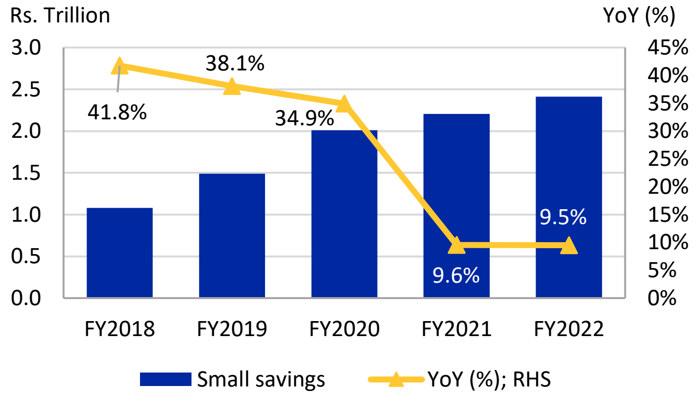
*Data available till March 11, 2022; **Source**: RBI; ICRA Research*

EXHIBIT 15: Incremental change in credit, deposit, investment in G-Sec^



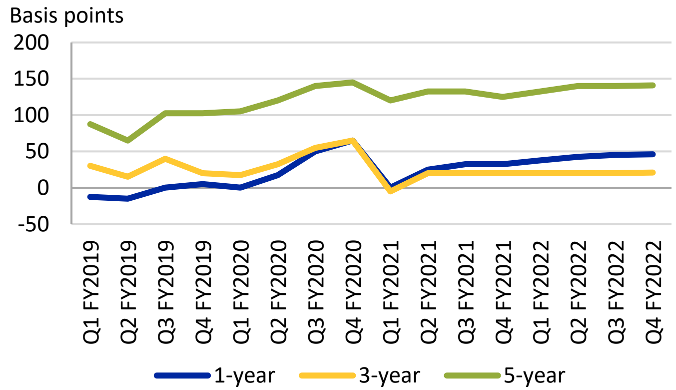
Outstanding data for reporting fortnight ending March 11, 2022
*^YTD change since March 26, 2021 for FY2022; **Source**: RBI; ICRA Research*

EXHIBIT 16: Trends in savings deposit and certificates and PPF during April-February in the past few years



***Source**: CGA; ICRA Research*

EXHIBIT 17: Spread between interest rate offered by small savings schemes and median bank deposit rates



***Source**: Ministry of Finance, GoI; ICRA Research*

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