

Summary

The Finance Minister presented the Union Budget 2011 – 12 today. Key highlights are captured in the table below

	Budget Estimates 2011 - 12	Revised Estimates 2010 - 11	Year on Year Growth (%)
Revenue Receipts	789,892	783,833	0.8%
Tax Revenue (Net)	664,457	563,685	17.9%
Non-Tax Revenue	125,435	220,148	-43.0%
Non-Debt Capital Receipts	55,020	31,745	73.3%
Total Receipts	844,912	815,578	3.6%
Non-Plan Expenditure	816,182	821,552	-0.7%
Plan Expenditure	441,547	395,024	11.8%
Total Expenditure	1,257,729	1,216,576	3.4%
Fiscal Deficit	412,817	400,998	2.9%

Fiscal deficit as a % of market GDP has been pegged at 5.1% for FY 11 and 4.6% for FY 12.

Takeaways

After the recent release of GDP figures for FY 11 by the Central Statistical Organization (CSO), market GDP for the year had been substantially revised upwards thereby providing ample room for the GOI to better fiscal deficit %ages both for the current year and the next. Using this advantage, the fiscal deficit for the current year has been pegged at 5.1% from 5.5% projected earlier even though the absolute deficit amount has actually been revised upward by almost INR 20,000 crores. The same advantage is evident in the fiscal deficit target of 4.6% for FY 12 as well. However, to be fair, the absolute growth projected in fiscal deficit target is also extremely small at INR 12,000 crores. As a result, the net market borrowing has been projected at INR 3,43,000 crores for FY 12 versus INR 3,35,414 crores for the current year. This compares with market expectation of INR 3,70,000 – 3,80,000 crores. The positive surprise has had a near term positive impact on bond yields.

Most of the revenue side assumptions seem appropriate, with the one caveat that the assumed 9% real GDP growth rate for the year ahead seems to be too optimistic. However, the larger area of concern pertains to the projections with regard to non plan expenditure. The finance minister has projected an actual reduction in non plan expenditure for FY 12 over revised estimates of FY 11. Within these, items like subsidies are showing a lower projected amount versus revised estimates for FY 11. Unless the government is planning significant reforms on decontrol, which seems unlikely in a year of key state

elections, it is hard to see how these numbers will be achieved especially in an environment of rising commodity prices.

View Forward

The projected fiscal deficit and net borrowing numbers come as a positive surprise for the market and have translated into near term bullish sentiment. This sentiment may keep bond prices supported into end of financial year especially since there is hardly any supply due from here till March 31st. Also, robust deposit accretion should ensure support from SLR demand as well. However, given that the supply calendar is typically front loaded, starting April it is likely that weekly auctions of INR 12,000 – 13,000 crores will re-start. As we have seen historically, it becomes very difficult for bond yields not to rise in the face of such steady supply. Additionally, the curve is extremely flat currently with 10 over 1 spreads at hardly 45 bps. Thus there is little to be said about attractiveness of government bond yields at current levels.

We reiterate our view that the curve should begin to steepen starting April. This will be especially true for the corporate bond curve which is currently inverted. Triggers for the same would be improvement in system liquidity on the back of accelerated government spending from here towards fiscal end as well as lesser pressure on banks to continue to raise deposits starting the new financial year. The best place to play the trade would be the ‘front end’ of the corporate curve (up to 1 year).

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