Union Budget, 2012-13: Credible roadmap for fiscal consolidation awaited

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The Union Budget for 2012-13 is to be presented on March 16, 2012 in the midst of deteriorating Government finances as well as a challenging domestic macroeconomic environment. While economic growth, investment spending and business confidence have weakened during 2011-12, interest rates remain high and concerns regarding inflationary pressures are yet to be eliminated. Recently, the Reserve Bank of India (RBI) indicated that it may be constrained from lowering the policy rate to respond to the slowing economic growth in the absence of credible fiscal consolidation. This has heightened the expectations from the Union Budget for 2012-13 to provide a realistic roadmap for fiscal correction, through a combination of augmenting tax revenues and restricting the growth of revenue expenditure (particularly subsidies). At the same time, it is expected that the Budget may increase outlays and announce policy measures to boost infrastructure spending, which would ease supply constraints and raise the potential growth rate of the Indian economy.

The Budget for 2011-12 set an ambitious target to rein in the fiscal deficit to 4.6% of GDP in 2011-12 from 4.8% of GDP in 2010-11 (according to Provisional Accounts), despite the expected decline in non-tax revenues following the one-time inflow of funds from the telecom auctions held in 2010-11. However, the fiscal situation of Government of India (GoI) has displayed considerable signs of stress in the current fiscal year, on account of factors such as a slower than anticipated economic growth, unfavourable equity market conditions and a widening of fuel subsidies.

Table 1: Trends in Fiscal Indicators

	As a Percentage of GDP (Estimates released by CSO in February 2012)				April-January as a Percentage of BE	
	2009-10	2010-11 RE	2010-11 Prov.	2011-12 BE	2010-11	2011-12
Revenue Receipts	8.9%	10.0%	10.4%	8.9%	92.2	69.5
Revenue Expenditures	14.1%	13.4%	13.5%	12.3%	81.8	80.5
Revenue Balance	**-5.2%**	**-3.4%**	**-3.2%**	**-3.4%**	**56.3**	**108.8**
Capital Receipts	0.4%	0.3%	0.3%	0.4%	56.9	6.9
Capital Exp, Net Lending	1.6%	2.0%	1.9%	1.6%	61.6	71.0
Fiscal Deficit	**-6.5%**	**-5.1%**	**-4.8%**	**-4.6%**	**58.3**	**105.4**

Note: BE: Budget Estimate; RE: Revised Estimate, Prov.: Provisional Accounts
Source: GoI Budget Documents; Controller General of Accounts (CGA), Ministry of Finance, GoI; ICRA Analysis

As compared to the 16%[1] growth envisioned in the Budget Estimates (BE) for 2011-12, GoI's net tax collections[2] expanded by 7.5% in April 2011-January 2012 relative to the same period in 2010-11, whereas disinvestment proceeds fell considerably short of the budgeted Rs. 40,000 crore. Moreover, total expenditure expanded by 13.4% in April 2011-January 2012 relative to the same period in 2010-11, substantially higher than the modest 5% growth forecast by the BE for 2011-12.

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[1] Relative to the Provisional Accounts for 2010-11
[2] Data released by the Controller General of Accounts (CGA). Net of devolution to States, net of refunds.

Reflecting these trends, GoI's fiscal deficit for the ten months ending January 2012, stood at 105% of the budgeted level for the entire fiscal year. ICRA expects the fiscal deficit to worsen to around 5.5% of GDP in the current fiscal year, substantially exceeding the BE for 2011-12 of 4.6%. Additionally, if compensation to the oil marketing companies (OMCs) overshoots the Budget and Supplementary Estimates for fuel subsidies, the fiscal deficit may widen to around 5.8% of GDP in 2011-12.

In the baseline scenario (refer ICRA's publication *Outlook for the Indian Economy: Growth expected to remain moderate in 2012-13 unless substantive policy measures are undertaken to boost investment sentiments* published in March 2012), Indian GDP growth is expected to remain around 6.9%-7.0% in 2012-13 (at factor cost, constant prices). Accordingly, direct and indirect tax collections are likely to display a moderate expansion in the coming fiscal year, unless measures are undertaken to increase tax rates and significantly widen the tax net. However, such measures would need to be cautiously calibrated to avoid fuelling inflationary pressures and dampening growth impulses. Auction of 2G spectrum (to reallocate the 122 licences recently cancelled by the Supreme Court) and disinvestment proceeds may boost GoI's non-tax revenues to an extent in 2012-13. Nevertheless, the magnitude of such inflows would critically depend on industry and market sentiments and would remain small relative to the size of the fiscal deficit.

In addition to a widening of the tax base, a credible and sustainable roadmap for fiscal consolidation must involve a rationalisation of expenditure. However, it is critical that GoI present realistic estimates of its expenditures, in order to avoid substantial upward revision over the course of the year. To a large extent, growth of expenditures towards salaries, pensions, interest payments and defence is likely to be inflexible. In addition, food subsidies are proposed to be enhanced under the National Food Security Bill. Accordingly, it is crucial that GoI undertake steps towards curtailing subsidies towards other items, for instance through a substantial upward revision in the retail price of diesel, and restrain growth of non plan revenue expenditure, in order to create space for additional infrastructure spending. Overall, ICRA expects GoI's fiscal deficit to ease somewhat from around 5.5-5.8% of GDP in 2011-12 to 5.0-5.5% of GDP in 2012-13, exceeding the rolling target of 4.1% of GDP for 2012-13 published previously by GoI.

The current fiscal situation does not afford much space for providing a direct stimulus to growth, through lower taxes or substantially higher spending in the event of a deeper-than-expected domestic slowdown or an external crisis. Accordingly, prioritising additional expenditure towards infrastructure spending would ease structural bottlenecks and buffer economic growth from any externally driven economic slowdown in the coming year. In particular, GoI may need to raise the rates of excise duty and service tax and widen the tax net in the forthcoming Budget to support fiscal consolidation, cap the Central Government's borrowing programme and prevent crowding out of private investment. Moreover, a credible roadmap for fiscal consolidation may prompt the RBI to embark on monetary easing in early 2012-13.[3] In addition, policy measures (which may or may not be announced during the Budget) would go a long way in restoring business confidence and support the pace of growth of the Indian economy (refer ICRA's publication *Outlook for the Indian Economy: Growth expected to remain moderate in 2012-13 unless substantive policy measures are undertaken to boost investment sentiments* published in March 2012).

Direct tax collections likely to fall short of the BE for 2011-12 with moderating economic growth; forthcoming Budget likely to enhance income tax deduction limit

The Union Budget for 2011-12 forecast a 20% expansion of corporation tax collections relative to the Provisional Accounts for 2010-11, based on an optimistic assumption of 9% economic growth and other measures such as an increase in the rate of minimum alternate tax (MAT) to 18.5% of book profits from 18%, while the surcharge on domestic companies was reduced to 5% from 7.5%. Contrastingly, gross corporation tax collections have risen by a modest 12% in April 2011-January 2012 according to data released by GoI, partly reflecting the slower economic growth in 2011-12 (6.9% in April-December 2011, according to data released by the CSO). At the same time, elevated input prices, higher interest rates and a weaker rupee have compressed the margins of producers, thus dampening growth of corporation tax. Even though the exemption limit for tax payers was increased from Rs. 160,000 to Rs. 180,000, GoI had estimated that income tax collections would expand by a robust 24% in 2011-12. However, data released by GoI indicates that gross personal income tax collections have expanded by a slower, albeit healthy, 20% in April 2011-January 2012.

While gross direct tax collections expanded by around 15% between April 2011 and January 2012, refunds of direct taxes rose by 46% as compared to the same months of 2010-11. Accordingly, GoI's net direct tax

[3] In its Third Quarter Review of Monetary Policy, the Central Bank had indicated that in the absence of credible fiscal consolidation, it would be constrained from lowering the policy rate in response to decelerating private consumption and investment spending and that the timing and magnitude of future rate actions would depend on a number of factors, including clear signs of fiscal consolidation to create fiscal space for infrastructure spending.

collections stood at Rs. 3.5 lakh crore between April 2011 and January 2012, an increase of 9% over the same months in 2010-11. With the Indian economy expected to record a sub-7% expansion in Q4, 2011-12, ICRA expects direct tax collections to fall short of the BE for 2011-12 of Rs. 5.3 lakh crore.

ICRA expects the Union Budget for 2012-13 to increase the exemption limit for personal income tax in line with rising income levels, which would provide a limited boost to consumption spending. Additionally, GoI may consider enhancing the limit for deductions with regard to income tax to encourage higher investment in infrastructure bonds as well as interest on housing loans. Minimal changes are expected with regard to corporation tax, pending the implementation of the Direct Taxes Code on April 1, 2012. With economic growth unlikely to rebound sharply in 2012-13, direct tax collections are likely to display a moderate growth in the coming fiscal year.

Indirect tax collections likely to meet BE for 2011-12 with robust growth of service tax offsetting low growth of excise duty; increase in rates and widening of tax base would support fiscal consolidation going forward

The Union Budget for 2011-12 reduced the number of items exempted from central excise duty by imposing a levy of 1% on 130 items and increased the rate of central excise duty to 5% from 4% on certain other items, even as the peak rate was maintained at 10%. Moreover, the coverage of service tax was widened, although with the rate was retained at 10%. GoI forecast that customs duty, excise collections and service tax collections would expand by 11%, 19% and 15%, respectively, in 2011-12 relative to the Provisional Accounts for 2010-11.

According to data released by the CGA, excise collections have displayed a modest 7% growth in April 2011-January 2012 relative to the same months in 2010-11, considerably slower than the 19% growth envisioned in the BE for 2011-12. Growth of excise collections has been dampened by the sluggish 3.4% growth of the manufacturing sector (as indicated by data released by CSO) during April-December 2011. Moreover, in June 2011, GoI reduced the excise duty on diesel to Rs. 2 per litre from Rs. 4.60 per litre; removed the 5% customs duty on crude oil; and reduced the customs duty on all petroleum products by 5%. Despite these changes, customs duty collections expanded by 15% in April 2011-January 2012 relative to the same months in 2010-11, faster than the 11% growth envisioned in the BE for 2011-12. Customs duty collections have been boosted in the current fiscal by the healthy growth of imports, 34% in rupee terms in April 2011-January 2012, which partly reflects the depreciation of the Indian rupee relative to various major currencies. In January 2012, GoI imposed *ad valorem* rates of customs duty on gold and silver, as opposed to the prevailing practice of duty based on the weight of the metal being imported, which is likely to boost customs duty collections to an extent going forward.

Service tax collections have displayed a robust 37% growth in April 2011-January 2012 relative to the same months in 2010-11, substantially higher than the 15% growth envisioned in the BE for 2011-12, aided by the wider coverage of service tax. ICRA expects collections of indirect taxes in 2011-12 to be largely in line with the BE for 2011-12 of Rs. 3.9 lakh crore.

The Union Budget for 2012-13 may reduce the annual turnover threshold for exemption from paying excise duty to widen the tax net, shift items to a higher excise duty bracket (for example from 1% to 2% or 5%) and prune excise exemptions further to align the same with the proposed Goods and Services Tax (GST). Given the pressing need for fiscal consolidation, a key revenue enhancement measure that GoI may adopt is the introduction of a negative list of services for the imposition of service tax. This would substantially widen the base for service tax from the present 119 services and augment indirect tax revenues. Additionally, GoI may consider raising the peak rate of central excise duty and the rate of service tax above 10% in the forthcoming Budget, carrying forward the process of unwinding the stimulus measures instituted in 2008-09. In the absence of such measures, the pace of growth of indirect tax collections is expected to remain moderate in 2012-13, with the pace of expansion of economic activity unlikely to revive sharply in the coming fiscal year.

Non-tax revenues decline sharply in 2011-12; expected to improve in 2012-13

GoI's non-tax revenues were boosted in 2010-11 on account of the receipts from the auction of 3G and BWA spectrum, which exceeded Rs. 1 lakh crore. In contrast, GoI has not been able to raise the targeted Rs. 13,000 crore from BWA auction so far in 2011-12. Accordingly, GoI's non-tax revenue receipts contracted by around 55% in the first ten months of 2011-12, as compared to the same months in the previous fiscal. This also resulted in a 13% de-growth of GoI's revenue receipts in April 2011-January 2012 relative to April 2010-January 2011. However, higher revenues through dividends and profits from some PSUs may aid GoI in meeting it's BE for 2011-12 for non-tax revenues. In 2012-13, auction of 2G spectrum following the cancellation of 122 licences by the Supreme Court may enhance GoI's non-tax revenues to an extent.

Disinvestment proceeds in April 2011-Janaury 2012 (around Rs. 1,150 crore through the FPO of Power Finance Corporation) have been small as compared to the BE for 2011-12 of Rs. 40,000 crore. Although the improved equity market conditions since January 2012 may prompt GoI to raise funds through a few issues in March 2012, it is likely that actual inflows will fall substantially short of the BE for 2011-12. With a pipeline of prospective issues in place, GoI may set a similar target of Rs. 40,000 crore capital receipts in the coming fiscal year. Nevertheless, the magnitude of disinvestment proceeds would depend upon the timing of issues, valuation levels and market sentiment. Moreover, the volume of funds raised through disinvestment would remain small relative to the size of the fiscal deficit at an absolute level.

Revenue expenditure likely to surpass BE for 2011-12 led by higher subsidies outgo; fuel subsidies should be curtailed going forward to counter higher proposed food subsidy outlay

GoI's BE for 2011-12[5] forecast a low 5% growth of total expenditure in 2011-12. Subsequently, GoI laid two Supplementary Demands for Grants before the Parliament in 2011-12, entailing a net cash outgo of over Rs. 56,000 crore[6], largely led by additional revenue expenditure. Data released by the CGA indicates that total expenditure rose by a substantially steeper 13% in April 2011-Janaury 2012 relative to the same months in 2010-11.

Table 2: Expenditure Growth

	April-Jan 2010-11	April-Jan 2011-12	BE 2011-12
Revenue Expenditure	11%	13%	6%
o/w Plan	21%	8%	16%
o/w Non Plan (less Interest)	7%	15%	1%
o/w Interest	9%	19%	14%
Capital Expenditure[4]	32%	20%	0%

Source: CGA, Ministry of Finance, GoI

As compared to the 6% growth envisioned by the BE for 2011-12, revenue expenditure expanded by 13% in the first ten months of 2011-12. This was led by non-plan revenue expenditure, which the Budget for 2011-12 had attempted to restrain. Subsequently, GoI had to make additional allocations for fuel, fertiliser and food subsidies in the supplementary demands for grants, which boosted the growth of non-plan revenue expenditure. In 2011-12, fuel subsidies have risen substantially relative to the budgeted level, following the rise in the price of crude oil, depreciation of the rupee and incomplete adjustment of retail prices of regulated fuels. Moreover, an enhanced rate of Dearness Allowance (DA) following the elevated inflation levels likely exerted pressure on salaries and pensions, a large portion of which would be covered under non-plan revenue expenditure. Additionally, interest payments accelerated and growth exceeded the budgeted forecasts by a considerable margin. This partly reflects the hardening of yields at which debt was contracted in the current fiscal up to mid-November 2011, on account of the monetary tightening undertaken by the RBI as well as the enhancement of GoI's borrowing programme for 2011-12.

Plan revenue expenditure expanded by 8% in April 2011-January 2012, slower than the 21% growth in the corresponding period in 2010-11 as well as the 16% growth envisioned in the BE for 2011-12. Data released by the CGA indicates that certain departments have spent less than 66% of their budgetary plan allocations in the first three quarters of the fiscal year. Given the stipulation that not more than 33% of the BE may be spent in Q4 (not more than 15% to be spent in March) to avoid a concentration of expenditure at the end of each fiscal year, there may be some savings with respect to the BE for plan expenditure.

Capital expenditure recorded a healthy 20% growth in April 2011-January 2012, substantially faster than the budgeted pace of growth. Notably, 17% of the additional expenditure undertaken in April 2011-January 2012 relative to the same months in 2010-11 was towards the capital account, which is favourable. Overall, GoI's expenditure is likely to surpass the BE for 2011-12.

Growth of salaries and pensions on account of the rise in DA may be limited in 2012-13, given that inflation is expected to stabilise to an extent in the coming fiscal year, although rising crude oil prices on the back of geopolitical concerns remain an imminent risk. In spite of the expected monetary easing, interest payments would continue to rise, reflecting the considerable net accretion to the debt stock. This highlights the inherent need to undertake fiscal consolidation to contain the growth of the debt stock and avoid a deterioration of debt affordability indicators such as interest payments as a proportion of revenue receipts. Existing schemes and programmes of GoI that are intended to promote inclusive growth would require

[4] Capital expenditure includes capital outlay and gross loans and advances extended by GoI
[5] Relative to the Provisional Accounts for 2010-11
[6] The First Supplementary Demand for Grants (August 2011) involved a net cash outgo of Rs. 9,016; however, GoI indicated that this would be offset through savings related to other expenditure. The Second Supplementary Demand for Grants (November 2011) entailed an additional net cash outgo of Rs. 56,848 crore, dominated by additional subsidies towards fuel (Rs. 30,000 crore), fertilisers (Rs. 13,779 crore) and food (Rs. 2,298 crore).

enhanced funding. For example, the outlay towards Mahatma Gandhi Rural Employment Guarantee Scheme (MGREGS) would need to be raised as wages under this scheme have been indexed to inflation. The outlay towards food subsidies is likely to increase significantly based on the entitlements proposed under the National Food Security Bill and the anticipated increases in the Minimum Support Prices (MSP) to incentivise larger production. While this Bill has been cleared by the Union Cabinet, it is yet to be enacted. Moreover, the identification of beneficiaries through the Socio Economic and Caste Census is yet to be completed. It is likely that the enhanced entitlements may not be introduced in H1, 2012-13, thereby limiting the increase in food subsidies in 2012-13. Nevertheless, food subsidies are set to expand substantially in the near-to-medium term. Rationalising subsidies by eliminating leakages and improving targeting may not be feasible in the near term, until the unique identification project covers substantial portions of the population. Accordingly, the rise in food subsidy expenditure should be funded through an offsetting reduction in other subsidies, particularly fertiliser and fuel subsidies. While reducing subsidies towards kerosene, LPG and diesel in one go may prove to be politically challenging, the Union Budget for 2012-13 could initiate a substantial upward revision of the retail price of diesel to reduce the under-recoveries of the Oil Marketing Companies (OMCs). This would limit the magnitude of subsidies to be borne by GoI and also reduce the price differential between petrol and diesel, dampening the demand for diesel-fuelled passenger vehicles. In addition, GoI may consider increasing the excise duty on diesel cars.

Additionally, the Twelfth Plan Period commences in 2012-13, and GoI may introduce a limited number of new schemes in the forthcoming Budget. However, incremental outlays must be prioritised towards schemes that focus on removing infrastructural bottlenecks and create a supportive environment for economic growth. At the same time, existing schemes should be rationalised, to avoid duplication and save administrative costs.

Restraint on revenue expenditure growth would be critical to ensure that fiscal consolidation is sustainable, and not excessively dependent on revenue augmentation. Besides, controlled expansion of revenue expenditure would create fiscal space for augmenting capital expenditure, aid in capping GoI's borrowing programme and prevent crowding out of private investment, given that boosting investment demand will be instrumental towards achieving a growth in excess of 7% in 2012-13. Even as the expectations are high for GoI to display fiscal tightening through low expenditure growth in the forthcoming Budget, it is equally desirable that GoI present realistic estimates of its expenditures, in order to avoid substantial upward revision over the course of the year.

Fiscal Balances likely to worsen at an absolute level in 2012-13

The Thirteenth Finance Commission (ThFC) had suggested a revised roadmap entailing annual targets for the revenue and fiscal deficit of GoI (please refer *Table 3*). However, the BE for 2011-12 and rolling targets for 2012-13 and 2013-14 (please refer *Table 3*) included in the Medium Term Fiscal Policy (MTFP) Statement in the Union Budget for 2011-12 differed from the roadmap suggested by the ThFC, particularly in the case of the target for the revenue deficit. GoI's rolling targets for 2013-14 indicate a revenue deficit of 2.1% and a fiscal deficit of 3.5%, higher than the targets set by the ThFC, with considerably lower fiscal space for incurring capital expenditure as compared to what was envisioned by the ThFC.

Table 3: Comparison of Fiscal Balance Targets (percentage of GDP)

ThFC's Fiscal Roadmap	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**
Revenue Deficit	3.2	2.3	1.2	0.0	-0.5
Fiscal Deficit	5.7	4.8	4.2	3.0	3.0
GoI's Rolling Targets	**2010-11 (prov.)**	**2011-12 BE**	**2012-13**	**2013-14**	**2014-15**
Revenue Deficit	3.2	3.4	2.7	2.1	NA
Fiscal Deficit	4.8	4.6	4.1	3.5	NA

Source: GoI Budget Documents, ThFC Report

Overall, the fiscal deficit in the first ten months of 2011-12 stood at 105% of the BE for the entire fiscal year, which pegged the deficit at 4.6% of GDP. Given the moderation in growth of tax revenues; low likelihood that GoI would meet its disinvestment target; and the additional expenditure proposed under the two Supplementary Demands for Grants, ICRA expects the fiscal deficit for 2011-12 to worsen to around 5.5% of GDP. If additional compensation is provided to the OMCs for their under-recoveries in H2, 2011-12, overall fuel subsidies are likely to overshoot the Budget and Supplementary Estimates, which may result in the fiscal deficit rising to 5.8% of GDP in 2011-12.

With economic growth unlikely to revive sharply in 2012-13, growth of indirect and direct tax collections is expected to be moderate in the coming fiscal year unless substantive measures are undertaken to augment tax revenues. However, such measures would need to be carefully calibrated to avoid stoking inflation and dampening economic growth. Given the likely enlargement of food subsidies and largely inflexible growth of outlays towards salaries, pensions, defence and interest payments, ICRA expects GoI's fiscal deficit to remain between 5.0-5.5% of GDP in 2012-13; two possible scenarios are outlined below.

Table 4: Likely Scenarios for GoI's Fiscal Balance in 2012-13 (percentage of GDP)

Baseline	**Favourable**
• GDP growth of 6.9-7.0%;	• Revival in GDP growth;
• Widening of the tax base, particularly coverage of service tax;	• Substantial widening of tax base and upward revision in excise and service tax;
• Rollout of higher food entitlements in Q2 2012-13;	• Rollout of higher food entitlements in Q3 2012-13;
• Limiting fuel subsidies to Rs. 50,000 crore in 2012-13.	• Limiting fuel subsidies to Rs. 35,000 crore in 2012-13.
Revenue Deficit: 4.1 % of GDP	**Revenue Deficit: 3.6% of GDP**
Fiscal Deficit: 5.5% of GDP	**Fiscal Deficit: 5.0% of GDP**

Source: ICRA Estimates

Overall, ICRA expects that GoI would be unable to meet the rolling targets for 2012-13 (restraining the revenue and fiscal deficit to 2.7% and 4.1% of GDP, respectively) and 2013-14 (restraining the revenue and fiscal deficit to 2.1% and 3.5% of GDP, respectively), set in the Union Budget for 2011-12. Accordingly, it may be prudent for GoI to announce a new fiscal correction path that is realistic, and incorporate the same in the new Fiscal Responsibility and Budget Management Act, which is to be brought out in the upcoming session of Parliament.

Magnitude of Government borrowing likely to remain substantial in 2012-13

The long-term market borrowing programme of GoI was initially estimated at Rs. 4.2 lakh crore for 2011-12, around 60% of which was to be completed in H1, 2011-12. GoI raised the intended Rs. 2.5 lakh crore in the first half of the current fiscal year, in a scenario of sluggish incremental credit off-take and substantial augmentation of the deposit base. Subsequently, GoI's market borrowing programme for H2, 2011-12 was enhanced twice, initially by Rs. 53,000 crore, largely to offset the shortfall in receipts from the National Small Savings Fund (NSSF), and subsequently by a further Rs. 40,000 crore. In order to arrest the depreciation of the rupee, the RBI intervened in the foreign exchange market removing rupee liquidity of around Rs, 65,000 crore though spot market transactions between September 2011 and December 2011. These factors contributed towards a sharp rise in the systemic liquidity deficit under the Liquidity Adjustment Facility (LAF). The latter has averaged nearly Rs. 120,000 crore since November 2011, substantially in excess of the RBI's stated comfort zone of +/-1% of net demand and time liabilities (NDTL).

Table 5: GoI's Long-Term Market Borrowings for 2011-12 (Rs. Crore)

Budget Estimates	417,128
Announced Borrowings	510,000
Borrowings Completed so far	486,000
Devolvement in H1, 2011-12	2,232
Devolvement in H2, 2011-12	9,881

Source: RBI, ICRA Estimates

While yields of Government securities (G-sec) rose in October-November 2011, a portion of the borrowings devolved on the primary dealers in six of the seven auctions held during those two months. Between late-November 2011 and February 2012, the RBI infused around Rs. 1.02 lakh crore of liquidity through purchase of G-sec, higher than the increase in GoI's borrowing programme for 2011-12 relative to the BE. Additionally, in the Third Quarter Review of Monetary Policy, the cash reserve ratio (CRR) was cut by 50 basis points (bps) to 5.5%, to infuse around Rs. 32,000 crore of primary liquidity.

While credit off-take in April 2011-January 2012 has remained lower than the levels seen in the corresponding period of 2010-11, the private sector also opted to fulfil a portion of its financing requirements through other sources through the year, such as external commercial borrowings, and issuance of bonds and commercial paper.

GoI's fiscal deficit is likely to expand at an absolute level in 2012-13 as compared to 2011-12. Based on this, ICRA expects the net long-term borrowings of the Central Government to increase to around Rs. 4.5 lakh crore in 2011-12; factoring in the repayments due in the coming fiscal year, the gross borrowing programme may rise to nearly Rs. 5.4 lakh crore.

While GoI's borrowing programme for 2011-12 would be completed shortly, advance tax payments would exert further stress on systemic liquidity in March 2012. The anticipated large Government borrowing programme in 2012-13 suggests that the liquidity deficit may remain in excess of the RBI's comfort zone of +/-1% of net demand and time liabilities (NDTL) of Commercial Banks. Accordingly, we expect the RBI may reduce the CRR by a further 50 bps in the forthcoming mid-quarter policy review. Additionally, the Central Bank is expected to embark on monetary easing from April 2012 onwards, which would result in a gradual moderation of bond yields.

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