

## ***Shobhana edit***

### ***Banks afraid to buy because of RBI's attitude, and govt needs to clearly explain how it got its deficit numbers***

That Thursday's Rs 11,000 crore auction of government securities had to be cancelled after bond yields spiked by nearly 20 basis points on Thursday is a matter of concern. This is the fourth auction cancelled by [RBI](#) in just over a month. The sharp sell-off in the bond markets on Thursday was driven by apprehensions that the government might once again slip on its deficit targets in 2018-19, as it has in 2017-18 and also that food inflation would trend up following the government's decision to support crop prices if farmers aren't able to get the MSP. The markets are nervous and unsure of what to expect even though the net borrowing for 2018-19 at Rs 4.62 lakh crore is projected to be quite similar to that in 2017-18.

Bond yields have risen 90 basis points in the last three months and 32 basis points since January 17 when Viral Acharya, deputy governor, RBI said the central bank was not in a position to bail banks out every time they suffered a loss on their portfolio. RBI may well feel forbearance will kill market discipline, but with banks facing massive NPA-related losses as well as bond-market losses, it does need to consider forbearance. Since it ruled this out, PSU banks have more or less decided to sit it out, afraid of taking more chances on bond market losses with yields rising so dramatically.

And now, it is the government that needs to be talking to banks to convince them its numbers for 2018-19 are credible. Right now, market players are justified in staying away from bond markets given that, apart from being inflationary, the promise to pay farmers 1.5 times the cost of production of the crop could turn out to be expensive for the government. As this paper has pointed out, the costs of subsidising the farmers depend on how the government chooses to calculate costs. And any uptrend in inflation will make RBI start tightening monetary policy, causing more bond-market losses.

That's not all since many find the revenue numbers, for 2017-18 and 2018-19 confusing. The budget assumes tax buoyancy—growth in taxes as a ratio to GDP growth—of 1.4 for 2018-19, slightly higher than the 1.3 in 2017-18 which, as is obvious, saw better direct tax revenues due to both demonetisation and GST. But 2018-19 buoyancy projections are lower than the 1.7 in 2016-17, the fact that there are more taxpayers due to DeMo and GST and the fact that buoyancy also rises as per capita incomes cross \$2,000—as India's have—suggests the numbers, while high, may just be achievable. GST projections, for 2017-18, however, are a bit more tricky.

Till December, the centre and state governments collected Rs 526,000 crore. Since the budget estimates they will collect Rs 889,262 crore in eight months of 2017-18, this means they have to collect an impossible Rs 363,000 crore in two months. If despite this, GST revenues are on track, it is because the centre has, for now, accounted for part of the undistributed IGST as its GST collections. This is not exactly incorrect since there will always be a certain amount of undistributed IGST, but why not explain this to the bond markets? If markets are not reassured through a dialogue, they could remain skittish. That would then hamper the government's borrowing programme, making it costlier; interest costs account for a fourth of government expenditure. More critically, rising interest rates would jeopardise the nascent recovery in the economy.