Budget 2000 and Fixed Income Markets*

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I must compliment the organisers for convening this Conference and thank them for inviting me to be here. Perhaps, you could not have chosen a better moment to have an inaugural meet of dealers in Fixed Income Markets. The latest Budget announced earlier this week is a landmark and, indeed a watershed, in heralding an enabling environment for the development of healthy Fixed Income Markets in India. The Budget ushers in the most comprehensive debt market reform in India. The main focus of today's address would, therefore, be on the impact of the latest Budget for Fixed Income Markets.

However, recognising the contemporary interest in the implications of the borrowing programme of Government as announced in the budget, I will spend a few minutes on it.

As per the latest estimates for 1999-2000, in the Budget, the future borrowing requirements of the Central Government till this month end are in the range of Rs. 4000 to Rs. 5000 crore. The Reserve Bank of India sees absolutely no reason as to why the borrowing needs of the Centre or States should not be met as smoothly in this month as it has been until now.

There have also been speculations that all this remaining borrowing needs of the Central Government in the current fiscal year will be raised through auction only, thus excluding any element of private placement. The Reserve Bank sees no basis for such assumptions, when the actual requirements of Government of India as well as instruments and methods are yet to be firmed up.

On the borrowing programme for next year, i.e., 2000-2001, the net borrowing is marginally less than the current year, though the gross amount to be raised is somewhat higher. Given the recent experience of significant slippages in the budgeted programme, the first issue that arises relates to how realistic the estimate is. Both, in the previous and current year, there have been political and economic uncertainties, be it in global or domestic scene – such as elections, Asian crisis, sanctions, Kargil, etc. There is now reason to believe that such uncertainties are behind us. We observe that some analysts have already described the next year's borrowing programme as based on realistic estimates. Operationally, therefore, the tasks could be less daunting in the future than it has been so far.

Further, since the Reserve Bank has equipped itself with several innovative instruments and institutional arrangements, the functioning of Government Securities Market should be far more efficient and smoother than it has been so far, especially, if there are no unforeseen uncertainties.

As mentioned, at the beginning of this address, there are several reasons as to why this budget is a landmark for fixed income market dealers. These are worth exploring since their significance is perhaps, yet to be fully appreciated.

The Finance Minister has expressed that “in the fast changing world of modern finance it has become necessary to accord greater operational flexibility to the Reserve Bank for conduct of monetary policy and regulation of the financial system”. In this context, he said that he intended to bring to Parliament proposals for amending the relevant legislation. The Reserve Bank had already set up an Internal Group to identify the legislative changes that are desirable at this stage of economic reform. You will recall that a few months back, in a forex Assembly at Kathmandu, I had stated that the Reserve Bank intends to move towards the statutory minimum with reference to CRR in the medium term as also bring amendments to lower the statutory minimum itself in respect of both CRR and SLR. Naturally, this will be one of the legislative changes that will be sought. Other major recommendations of the Working Group include empowering the

Reserve Bank to define constitution of demand and time liabilities rather than defining it in terms of exclusion of items; vesting with the Reserve Bank the power to declare securities eligible for SLR purpose; making of enabling provision for a future separation of monetary and debt management functions and empowering the Reserve Bank to notify institutions for inclusion in the banking system for computation of liabilities of a banking company/cooperative bank.

The Budget has also indicated the replacement of the old Public Debt Act, 1944 with a Government Securities Act. The proposal seeks to recognise electronic mode of transfer of title of Government Securities. It would also facilitate pledging of securities without actual transfer. In other words, the proposal seeks to be consistent with modern trading practices and technological development including RTGS (Real Time Gross Settlement). Substantial work has already been completed on this front. In the light of discussions with State Finance Secretaries, we expect the Bill to be passed in the Parliament soon.

Though not strictly a part of the Budget, you are aware of day before yesterday’s announcement regarding the repeal of the 1969 Notification, which had banned forward trading. I had referred to this issue a number of times in the past. The Government had recently amended the Securities Contract Regulation Act and it has now issued a statement delineating the areas of responsibility between the Reserve Bank and the SEBI. Follow-up notifications by the Reserve Bank and the SEBI have already been issued yesterday. These developments have paved the way for introduction of when-issued market for PDs in the near future. We should be in a position to issue detailed guidelines on some of these matters very soon.

The Budget made a reference to Credit Information Bureau. This is based on the recommendations of a Working Group set up by the Reserve Bank. There are already reports of interest from some banks and institutions to set up such a Bureau and the Reserve Bank also had informal soundings on the subject. The Bureau will improve the transparency regarding the creditworthiness of market participants and thus facilitate healthy financial markets.

The Finance Minister also stated that a portion of disinvestments proceeds would be earmarked for retiring Government debt. The modalities of this proposal are yet to be worked out in detail, and possible link with a proposal for Sinking Fund is yet to be examined. In any event, this is a noteworthy development.

The withdrawals of interest tax in this Budget is also a significant measure as it leads to reduction in the transaction cost of banks, and the price, to the extent the tax is passed on to borrowers through interest rates. The Government has foregone a revenue of over Rs.1,000 crore as a result of this measure. Gains to the financial system as a consequence would be significantly higher than Rs.1,000 crore because of savings on account of transaction and compliance costs.

Clarification regarding Stamp Duty on dematerialised debt instruments has been long overdue and is reported to have been fully resolved in the latest Finance Bill introduced with the Budget. Such a clarification is bound to give a fillip to secondary market debt trading.

Now, a word on Fiscal Responsibility Act (FRA). A statement of paramount importance in the Budget is 'For medium term management of the fiscal deficit we also need the support of a strong institutional mechanism embodied in a Fiscal Responsibility Act'. The Working Group on FRA met in the Reserve Bank, day before yesterday, to discuss the draft legislation. The matter is likely to be considered in a couple of weeks by Dr. Sarma Committee – the Committee to which Finance Minister made a reference in the Budget speech. We should expect high priority and expeditious processing of this matter.

In brief, the Reserve Bank has reason to be highly appreciative of the Budget initiatives on financial markets and we propose to complete submission of all necessary draft legislative proposals, as a follow-up of the Budget within six to eight weeks to enable early enactments in the Parliament. Hence, it will be deeply appreciated if market participants may please make suggestions as soon as possible.

In this background, let me briefly mention what we in the Reserve Bank expect to benefit from this Conference.

First, we could establish an effective fora for interaction through this, and prepare modalities for future annual conferences.

Second, of immediate significance, we seek your views on budget related issues that I have mentioned, in particular, the contemplated legislative changes and appropriate regulatory notifications from the Reserve Bank. These may be deliberated here and views communicated to us soon.

Third, several policy changes concerning Liquidity Adjustment Facility; institutional arrangements such as clearing and settlement systems; changes in debt market operations of the Reserve Bank such as two way quotes; and procedural aspects of repo market; etc. are under contemplation and we need your inputs on all these.

Fourth, and the most significant, relates to retailing of Government Securities on which we are still groping.

We value your views on all these matters.

The next monetary policy statement is due in April, 2000. Obviously, while we are not in a position to state what it would be like, you are in a position to advice and we are willing to listen. I hope this Conference will give an opportunity to exchange views - informal, well informed and in a professional manner.

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* **Inaugural address by Dr. Y.V.Reddy, Deputy Governor, Reserve Bank of India, at the First Annual Conference – Action Plan 2000 – organised by FIMMDA and PDAI at Goa on March 4, 2000.**

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