Press Release

Fiscal Stimulus equivalent to 4.8% of GDP desirable: Acuité

Rs.3.0 Lakh Cr of government guarantees for COVID loans to MSMES and corporates can address banks' risk aversion

29 April, 2020

Acuité considers the repair and revival of the economy through public expenditure a priority in today's scenario where the slowdown in the economy has been further hit by the Covid-19 lockdown. It recommends that the government consider a stimulus package of Rs. 11.2 Lakh Cr (USD 150 billion), the economic loss that it had estimated for the current lockdown period which will tantamount to 4.8% of FY20 GDP. Although the need for a large government stimulus is acknowledged for a quick revival of the economy by H2FY21, it will also be important to ensure that it is fiscally efficient and well targeted given the constraint of resources.

The central government had announced a Rs. 1.7 Lakh Cr stimulus package to address the basic needs of the vulnerable segments of the population. While the next phase of stimulus from the government for vulnerable businesses is awaited, RBI continues to play a key role in the current crisis; apart from a generous infusion of liquidity in the banks since March 2020, it has also effected additional cut in CRR and reverse repo rate and deployed the LTRO and the refinancing programmes through financial institutions, all of which is expected to encourage bank lending and provide liquidity to the corporate and the NBFC sector; however, such percolation of liquidity is significantly constrained today by the increased risk aversion in the banking system.

Says Sankar Chakraborti, MD & CEO, Acuité Ratings & Research **"Timely funding support from banks or others sources may avoid permanent impairment of businesses and loss of employment particularly in the MSME segment, thereby arresting any longer term damage to the economy. The banks therefore, need to be encouraged to provide additional working capital up to a certain proportion of the existing limits with a backstop guarantee from the government, any of the government institutions or a SPV/fund set up for the purpose by the government with an upfront capital contribution. Acuité Ratings estimates that an amount of Rs.1.8 Lakh Cr additional working capital funds will be required by MSMEs and another Rs.1.2 Lakh Cr by corporates in relatively more vulnerable sectors which aggregate to Rs.3.0 lakh Cr."** There can be different funds or SPVs for different sectors or segments like MSMEs, NBFCs and MFIs which will not only provide guarantees for bank or NBFC loans but also infuse equity or subordinate debt, if necessary. The upfront fund infusion from the government will only be fraction of the guarantee amount although some provisions for these guarantees, nevertheless, will have to be made in the budget over the medium term.

There are significant downside risks of a debt funded large stimulus package; even if the additional borrowings are curtailed to 8.0 Lakh Cr, it will take the fiscal deficit beyond the permissible limits of stakeholders such as the rating agencies, to reach almost 7.0% of GDP as compared to the budgetary estimate of 3.5%. This will further lead to a sudden spike in borrowing rates and substantially offset the lower interest rate regime that has been brought about by an accommodative monetary policy of RBI. Adds Suman Chowdhury, Chief Analytical Officer, Acuité Ratings **"We believe there is adequate justification to finance the deficit directly from RBI at this juncture; the feasibility of a special one-time issuance of special**

zero coupon securities to RBI can be explored. However, it has to be within moderate limits since the downside risk to the deficit financing model is an unavoidable expansion of the RBI balance sheet, 60% of which (based on empirical estimates) will have to go to the currency in circulation (M1), thereby triggering a spurt in inflation which will need to be controlled". Given the debt burden of a large stimulus package, it may also be a good idea to ask the states to share 50% of the additional borrowings if they are to be raised from the market. A few relatively stronger states with lower fiscal deficit levels may take up around Rs. 3 Lakh Cr of additional borrowings with the rest of the requirement raised from the remaining states based on their economic fundamentals and fiscal position. It goes without saying that such a debt sharing mechanism among the central and state governments can only work when there is consensus and close coordination among them.

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 8,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in BKC, Mumbai.

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