State Government Finances

Fiscal deficit of 20 state governments increased by 8.3% YoY in H1 FY2019, led by healthy rise in capital outlay

December 2018

HIGHLIGHTS

- ***Un-audited monthly provisional data available from the Comptroller and Auditor General of India (CAG) for 20 Indian states, reveals that their combined revenue receipts increased by 13.7% on a year-on-year (YoY) basis in H1 FY2019, slightly higher than the 13.3% rise indicated in the budget estimates (BE) for FY2019.***
- ***During H1 FY2019, the pace of growth of tax revenues (11.3%), comprising the Central tax devolution (CTD) and the states' own tax revenues (SOTR) lagged the growth budgeted for FY2019 (14.7%). In contrast, the pace of growth of non-tax revenues (22.5%), comprising states' own non-tax revenues (SONTR) and grants from the Centre exceeded the budgeted growth (2.8%) by a wide margin.***
- ***ICRA expects a shortfall in indirect tax revenues of the Government of India (GoI) in FY2019 relative to the budgeted level, driven by lower-than-budgeted Central Goods and Services Tax (CGST) and excise collections. This may lead to a downward adjustment in the CTD to the states in FY2019 relative to the level budgeted by the GoI, which has emerged as a risk to the achievement of the FY2019 BE for the revenue receipts of the state governments.***
- ***Moreover, the cut in the rate of VAT levied on fuels by several states in the recent months and the recent fall in prices of fuels, may dampen the growth in the revenues from such items in H2 FY2019, notwithstanding a favourable base effect.***
- ***However, the trend of State GST (SGST) collections, so far, suggests that the aggregate SGST collections of all states may modestly exceed the combined FY2019 BE. The SGST collections have partly benefitted from the provisional apportionment of Rs. 920.0 billion of unsettled Integrated GST (IGST) collections between the Centre and the states during April - October FY2019.***
- ***In contrast to the ~1% contraction budgeted by the 20 states in FY2019, the aggregate grants from the Centre to these states expanded by 21.6% in H1 FY2019, which may have partly benefitted from the receipt of GST compensation. Additionally, the higher collections of the GST compensation cess relative to the compensation required by the states in H1 FY2019, suggests that such revenues may be shared with the state governments in the coming months. This would ease the cash flows and augment the revenues of the state governments.***
- ***The revenue expenditure of the 20 states during H1 FY2019 expanded by 12.5%, higher than the 10.8% expansion indicated in the BE for FY2019. This could partly be on account of the pre-election spending by some of the states. In ICRA's view, apart from pre-election spending, the outgo related to drought/flood relief work by some of the states may lead to the aggregate revenue expenditure of the 20 states exceeding the budgeted level in FY2019.***
- ***Moreover, the capital outlay of the 20 states expanded by a healthy 16.8% during H1 FY2019, sharply higher than the 9.9% growth indicated in the BE for FY2019.***
- ***While the revenue deficit of the 20 state governments narrowed to Rs. 232.5 billion in H1 FY2019 from Rs. 307.7 billion in H1 FY2018, the fiscal deficit of the 20 state governments widened somewhat to Rs. 1.6 trillion during H1 FY2019 from Rs. 1.5 trillion in H1 FY2018 following the sharp increase in capital outlay.***

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Unaudited provisional fiscal data for H1 FY2019 is available for 20 of the 29 Indian states, from the CAG. These states are Bihar, Chhattisgarh, Gujarat, Haryana, Himachal Pradesh (HP), Jharkhand, Karnataka, Kerala, Madhya Pradesh (MP), Maharashtra, Nagaland, Odisha, Punjab, Rajasthan, Sikkim, Tamil Nadu (TN), Telangana, Uttar Pradesh (UP), Uttarakhand and West Bengal (WB). The combined revenue receipts and revenue expenditure of these states comprised a sizeable ~87% and ~88% of the revenue receipts and revenue expenditure, respectively, of all the 29 states in the BE for FY2019 (source: Reserve Bank of India; RBI).

This note compares the growth of key fiscal aggregates of the aforesaid sub-set of 20 state governments in H1 FY2019 relative to the trends in H1 FY2018, as well as with the pace of expansion of such aggregates in the BE for FY2019, and highlights some of the plausible reasons for the trends observed in the current fiscal.

Revenue Receipts[1]: In aggregate, the revenue receipts of the 20 state governments rose to Rs. 9.6 trillion in H1 FY2019 from Rs. 8.4 trillion in H1 FY2018 (refer Exhibit 1). Their revenue receipts during H1 FY2019 stood at 39.3% of the FY2019 BE (Rs. 24.4 trillion), similar to the trend during H1 FY2018 (39.1% of FY2018 RE). The pace of expansion of the aggregate revenue receipts of the 20 states improved marginally to 13.7% on a YoY basis in H1 FY2019 from 13.4% in H1 FY2018 (refer Exhibit 2). Moreover, the growth in revenue receipts of the 20 states during H1 FY2019 was slightly higher than the 13.3% expansion indicated in the BE for FY2019 relative to the RE for FY2018, led by the trend displayed by 10 out of the 20 states during this period (refer Exhibit 3).

During H1 FY2019, tax revenues (Rs. 7.4 trillion) accounted for more than three-fourth of the total revenue receipts of the 20 states (Rs.9.6 trillion), with the balance comprising non-tax revenues (Rs. 2.2 trillion). Additionally, tax revenue and non-tax revenue accounted for ~65% and ~35%, respectively, of the incremental revenue receipts in H1 FY2019, relative to H1 FY2018. The pace of growth of the aggregate tax revenues of the 20 states moderated to 11.3% in H1 FY2019 from 13.9% in H1 FY2018, which was offset by a robust improvement in the growth of non-tax revenues to 22.5% from 11.7%, in the same time period. Moreover, during H1 FY2019, the pace of growth of tax revenues lagged the growth budgeted for FY2019 (14.7%). In contrast, the pace of growth of non-tax revenues, exceeded the budgeted growth (2.8%) by a wide margin.

Exhibit 1: Combined key fiscal aggregates of the 20 states in H1 FY2018 and H1 FY2019

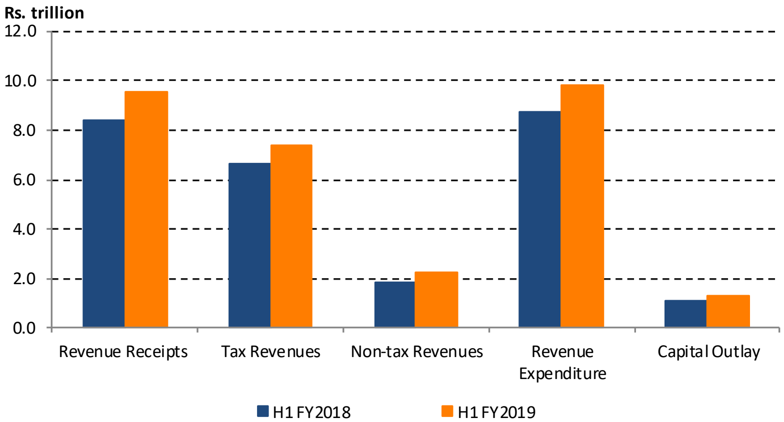
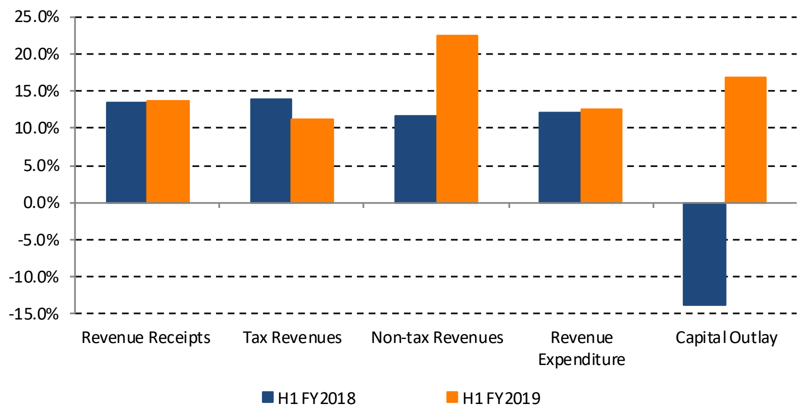


Exhibit 2: Combined YoY growth of key fiscal aggregates of the 20 states in H1 FY2018 and H1 FY2019



Source: CAG; RBI; ICRA research

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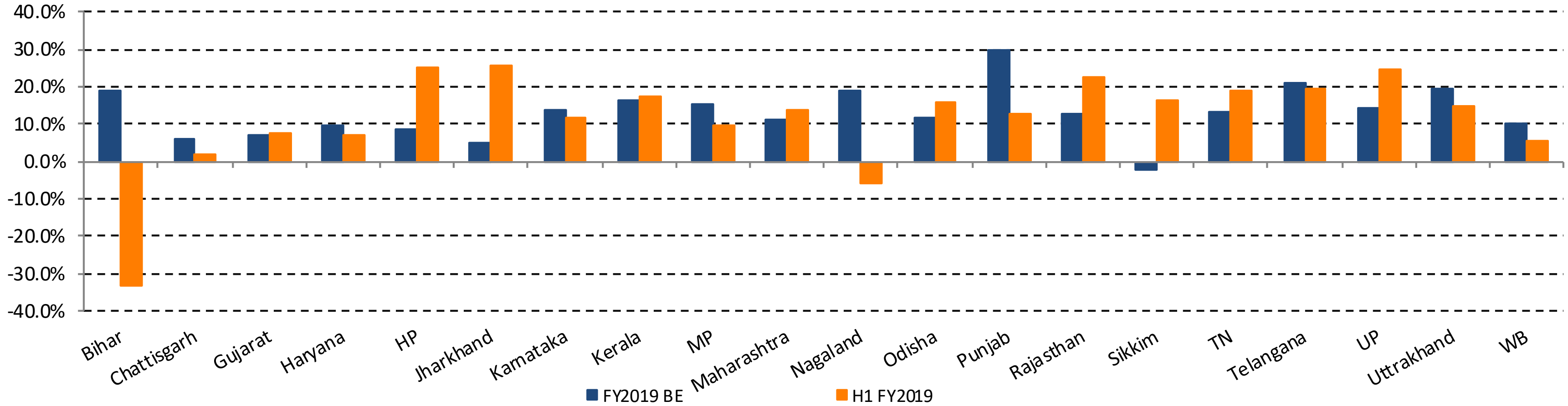
[1] *The revenue receipts of the Indian state governments can be classified as tax and non-tax revenues. Tax revenues comprise states' own tax revenues (SOTR) and states' share in Central taxes or Central tax devolution (CTD). The non-tax revenue comprises, states own non-tax revenues (SONTR) and grants from the Centre.*

Exhibit 3: Growth in revenue receipts budgeted by each of the 20 states for FY2019 and YoY growth in H1 FY2019



Source: CAG; RBI; ICRA research

CTD: The GoI transfers a portion of its shareable tax collections, comprising direct taxes and indirect taxes, as CTD to the state governments, based on the recommendations of the successive Finance Commissions (FC)[2]. From FY2018 onwards, the CGST collected by the GoI is being shared with the state governments as part of the CTD. A portion of IGST, which is collected on all inter-state trade, is transferred from the IGST account to the CGST/SGST account, whenever the collected IGST credit is used for payment of CGST/SGST. Out of the IGST that remains unsettled at the end of the fiscal, 42% is being devolved to the state governments as part of CTD.

Data released by the Controller General of Accounts (CGA) indicates that the CTD to all 29 states rose to Rs. 3.2 trillion in H1 FY2019 from Rs. 2.9 trillion in H1 FY2018. The CTD to all states displayed a YoY growth of 11.4% in H1 FY2019, sharply lower than the 18.3% expansion in H1 FY2018 and the 17.1% growth budgeted by the GoI for FY2019 (refer Exhibit 4).

Moreover, the CTD in H1 FY2019 stood at 40.9% of the FY2019 BE, lower than the level in H1 FY2018 (42.9% of FY2018 BE). Until early FY2018, the GoI typically used to transfer 7.1% of the BE for CTD to the states in each month in the first three quarters of the fiscal, irrespective of the actual collections of the GoI. Adjustments, if any, reflecting the actual trend in the GoI's tax collections used to be made in Q4 of the fiscal. The CGA data for FY2019 reveals that the CTD released in only two out of the six months in H1 FY2019 (April and May 2018) was equivalent to 7.1% of the budgeted CTD of Rs. 7.9 trillion, in line with the practice followed till FY2018. Out of the remaining four months of H1 FY2019, the CTD was less than 6% in June 2018 and modestly lower than 7.0% each of the budgeted CTD in July-September 2018 (as well as October 2018; refer Exhibit 5). ***As a result, the pace of growth of CTD in H1 FY2019 was lower than the budgeted level of 17.1%. However, the reasons for the change in the monthly pattern of disbursal of CTD in H1 FY2019 are not clear.***

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[2]The share of each state government in the CTD is based on the inter-se share of a state as recommended by the FC. Since FY2016, the GoI has been transferring 42% of its sharable taxes as CTD to the state governments based on the Fourteenth Finance Commission's (award period FY2016 to FY2020) recommendations.

Exhibit 4: Combined YoY growth of CTD of the 20 states in H1 FY2018, H1 FY2019 and growth of CTD to all states budgeted by the GoI for FY2019

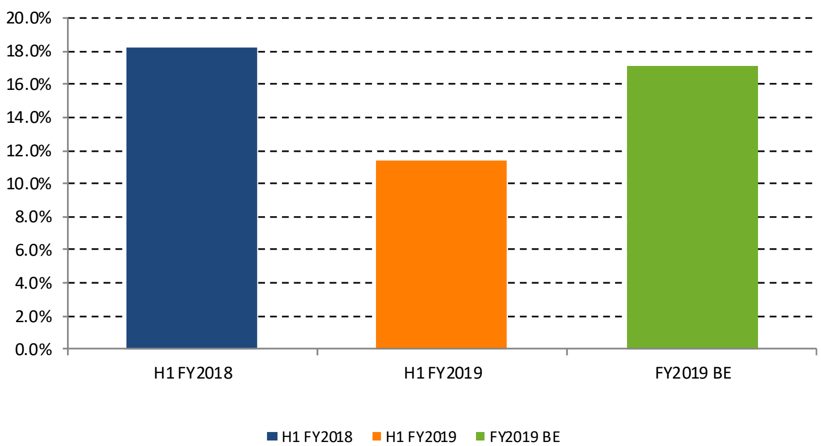
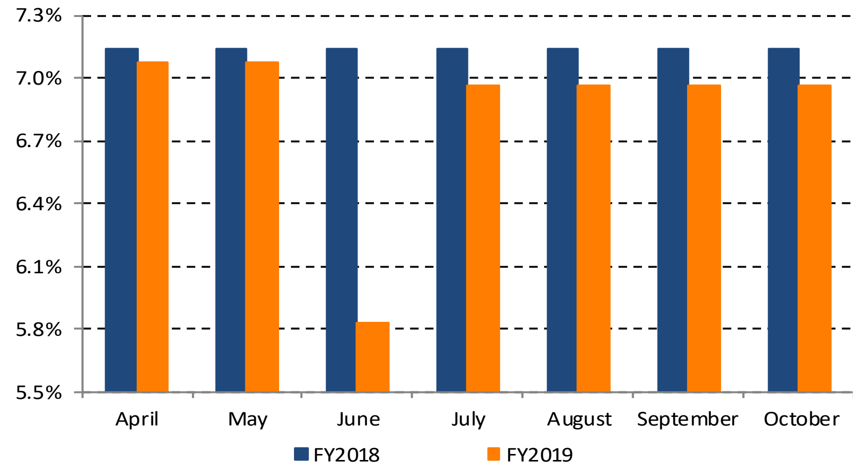


Exhibit 5: Month-wise CTD as a percentage of budgeted CTD transferred to all states in H1 FY2018 and H1 FY2019



Source: CGA; GoI Budget FY2019; ICRA research

The aggregate inter se share of these 20 states in the CTD for all 29 states, is 86.4% for the Fourteenth FC's award period. Assuming that these states have received 86.4% of the total tax devolution to the states in both H1 FY2018 and H1 FY2019, ICRA estimates that the CTD to the 20 states rose to Rs. 2.8 trillion in H1 FY2019 (11.4% YoY growth) from Rs. 2.5 trillion in H1 FY2018 (18.3% YoY growth).

Moreover, the provisional data released by the CGA indicates that the GoI's tax revenues (net of refunds, gross of devolution to states) rose by a modest 6.7% to Rs. 10.4 trillion in April-October FY2019, considerably lower than 18.3% growth included in FY2019 BE. The lower-than-budgeted growth in the GoI's tax revenues mainly reflects a contraction of 4.9% in the indirect taxes (customs duty, excise duty, service tax, CGST, IGST and Union Territory Goods and Services Tax or UTGST) in April-October FY2019, in sharp contrast to the 21.3% expansion included in FY2019 BE[3]. In particular, the CGST collections stood at Rs. 2.6 trillion in April-October FY2019, equivalent to a modest 43.5% of the BE (Rs. 6.0 trillion), which is a cause for concern. However, the GoI's direct taxes rose by 16.4% in April-October FY2019, nearly in line with the growth of 17.4% included in FY2019 BE.

Notwithstanding concerns related to the inflows from the long-term capital gains tax, we do not expect a meaningful shortfall in the GoI's direct tax collections relative to the BE for FY2019. However, we expect a shortfall in indirect tax revenues in FY2019 relative to the budgeted level, driven by lower-than-budgeted CGST and excise collections. The GoI cut excise duty on petrol and diesel by Rs. 1.5/litre each in October 2018, with a revenue implication of Rs. 105.0 billion, which would dampen indirect tax revenues in H2 FY2019. Moreover, the GoI had indicated in the Lok Sabha that the reduction in the GST rates recommended by the GST Council in its 28th meeting in July 2018, would have a revenue implication of about Rs. 100.0 billion in FY2019. ***Additionally, a recent press release of the Ministry of Finance, GoI, reveals that the headline GST collections slipped to Rs. 976.4 billion in November 2018 from Rs. 1.0 trillion in October 2018, despite the onset of the festive season. Based on various press releases of the GoI, the aggregate CGST collections (inclusive of regular settlement of IGST and provisional***

[3]*For detailed note refer ICRA's publication, Government of India's fiscal deficit rises by 19.2% YoY to Rs. 5.9 trillion in H1 FY2019, stands at 95.3% of budget estimates of FY2019 (November 2018) available on ICRA's website www.icra.in*

apportionment of unsettled IGST) during the first eight months of FY2019, are estimated by ICRA at Rs. 3.0 trillion. This is equivalent to a relatively moderate 50.1% of the FY2019 BE for CGST of Rs. 6.0 trillion included by the GoI, which suggests an impending shortfall relative to the level budgeted for this fiscal.

As of now, it appears that there would be a shortfall in the tax revenues of the GoI relative to the budgeted targets for FY2019, which is likely to lead to a downward adjustment in the CTD to the states in the ongoing fiscal. This has emerged as one of the risks to the achievement of the budgeted level of revenue receipts of the state governments.

Moreover, the monthly pattern of transfer of CTD in the remaining months of FY2019 remains unclear, i.e. whether roughly 7% of CTD would be transferred each month in Q3 FY2019, with adjustments to reflect the actual growth of the GoI's tax collections to be made in Q4 FY2019, or if some adjustments would be made in the last two months of Q3 FY2019 as well. The lack of clarity regarding the amount of monthly transfer of CTD may impart uncertainty to the cash-flows of the state governments, to an extent.

SOTR: The SOTR comprises (a) sales tax/VAT on petroleum and petroleum products and alcohol, (b) excise duty on alcoholic liquor for human consumption, (c) stamps and registrations duties, (d) electricity duties, (e) motor vehicles tax, (f) other taxes including taxes on professions, trades callings and employment and (g) SGST on all taxable goods and services consumed within the state other than the aforementioned items.

Based on the estimation of CTD as above for our sub set of 20 states, ICRA calculates that the balance (total tax revenues less CTD), i.e. the SOTR increased to Rs. 4.6 trillion in H1 FY2019 from Rs. 4.1 trillion in H1 FY2018 (refer Exhibit 6). This implies a YoY growth of 11.3% in the SOTR of the 20 states in H1 FY2019, similar to the growth in H1 FY2018. However, the estimated growth of SOTR of the 20 states in H1 FY2019 is lower than the 16.6% expansion budgeted by these states for FY2019. Additionally, the estimated SOTR of the 20 states in H1 FY2019 stood at 65.3% of the FY2019 BE (Rs. 7.0 trillion), lower than the trend during H1 FY2018 (68.4% of FY2018 RE). Encouragingly, the pace of growth of the estimated SOTR of the 20 states improved to 14.7% in Q2 FY2019 (13.4% in Q2 FY2018) from a modest 7.5% in Q1 FY2019 (9.2% in Q1 FY2018).

Exhibit 6: Estimated SOTR of the 20 states in H1 FY2018 and FY2019

(Amount in Rs. trillion)	Source	H1 FY2018	H1 FY2019	YoY Growth (%)
Total Tax Revenue of 20 States (A)	CAG	6.6	7.4	11.3%
Total Central Tax Devolution to 29 States (B)	CGA	2.9	3.2	11.4%
Estimated Share of 20 States in Total Central Tax Devolution (86.4% of B =C)		2.5	2.8	11.4%
Estimated SOTR (A-C= D)		4.1	4.6	11.3%
Budgeted SOTR (E)		6.0*	7.0	16.6%
D as a percentage of E		68.4%	65.3%	

**based on FY2018 RE*

Note: Difference, if any, is due to rounding off

Source: CAG; CGA; ICRA research

Sales tax/VAT on petroleum and petroleum products and SGST account for a bulk of the SOTR. The provisional data published by the Petroleum Planning and Analysis Cell (PPAC), indicates a sharp easing in the pace of YoY growth of sales tax/VAT on POL products of the 20 states to ~10% in H1 FY2019 from 19.3% in H1 FY2018. Following the uptick in global crude oil prices, the domestic retail prices of fuels also underwent a considerable rise in H1 FY2019 relative to H1 FY2018, which seems to have led to a slowdown in the pace of growth of consumption of POL products. For instance, the YoY growth of aggregate consumption of diesel and petrol eased to 4.2% in H1 FY2019 from 7.2% in H1 FY2018. This is likely to have contributed to the slowdown in the growth of states' revenues from fuels, despite the considerable YoY rise in fuel prices.

Reflecting the recent correction in the global crude oil prices, the average retail prices of diesel and petrol across the four metros (excluding tax changes) as on December 11, 2018, were lower by Rs. 13.8/litre and Rs. 10.7/litre, respectively, from their levels on the September 30, 2018, which may boost consumption growth in the immediate term. ***However, several states have cut the rate of VAT levied on fuels in the recent months, which may dampen the growth of revenues from such items in H2 FY2019, notwithstanding a favourable base effect related to the modest 3.4% YoY growth of sales tax/VAT on POL products of 20 states in H2 FY2018.***

Given that the GST was implemented from July 1, 2017, a YoY growth of the SGST collections in H1 FY2019 relative to H1 FY2018 is not meaningful. The press releases published by the GoI indicate that the aggregate SGST collections of all states declined to Rs. 645.1 billion in Q2 FY2019 from Rs. 694.1 billion in Q1 FY2019, partly reflecting the cut in the GST rates on several items in July 2018. However, after the regular settlement of IGST and provisional apportionment of unsettled IGST, the total SGST collections are estimated by ICRA[4] to have risen by a healthy 24.2% to around Rs. 1.4 trillion in Q2 FY2019 from Rs. 1.1 trillion in Q1 FY2019, leading to a rise in the estimated SOTR of the 20 states to Rs. 2.5 trillion in Q2 FY2019 from Rs. 2.1 trillion in Q1 FY2019. This sequential uptick in SGST collections may have supported the aforesaid pickup in the YoY growth of the estimated SOTR of the 20 states to 14.7% in Q2 FY2019 from 7.5% in Q1 FY2019.

Based on various press releases of the GoI, the aggregate SGST collections (inclusive of regular settlement of IGST and provisional apportionment of unsettled IGST) of all 29 states for the period April 2018 – November 2018, are estimated by ICRA at Rs. 3.4 trillion, constituting a healthy ~70% of the amount of Rs. 4.9 trillion budgeted by all the states for FY2019 (Source: RBI State Finances: A Study of Budgets). The trend so far suggests that the aggregate SGST collections of all states may well modestly exceed the combined FY2019 BE. In contrast, the CGST collections (inclusive of regular settlement of IGST and provisional apportionment of unsettled IGST) during April 2018 – November 2018, are estimated by ICRA at Rs. 3.0 trillion. This is equivalent to a relatively moderate 50.1% of the FY2019 BE for CGST of Rs. 6.0 trillion included by the GoI, which poses a risk to the magnitude of CTD to the states in FY2019, as highlighted previously.

The GoI had provisionally settled Rs. 500.0 billion of unsettled IGST equally between the Centre and the states in June 2018. In August 2018, the IGST (Amendment) Bill, 2018, was passed by the Lok Sabha, which provided that any unsettled amount of IGST shall be divided equally between the Centre and the states (with the pattern of the split between the states to be decided by the GST Council). Subsequently, in August 2018 and October 2018, Rs. 120.0 billion and Rs. 300.0 billion, respectively, were apportioned equally between the GoI and the states from the IGST pool. ***The provisional apportionment of unsettled IGST collections between the Centre and the states is likely to ease the cash flows of the state governments and would also boost their revenues in FY2019.***

Non-Tax Revenues: The growth of the combined SONTR of the 20 states improved to 24.3% during H1 FY2019 from 16.1% during H1 FY2018. Their SONTR during H1 FY2019 (Rs. 685.8 billion) stood at 34.2% of the FY2019 BE (Rs. 1.8 trillion), higher than the trend during H1 in FY2018 (30.8% of FY2018 RE). Moreover, the growth in SONTR of the 20 states during H1 FY2019 was considerably higher than the 12.0% expansion indicated in the BE for FY2019 relative to the RE for FY2018.

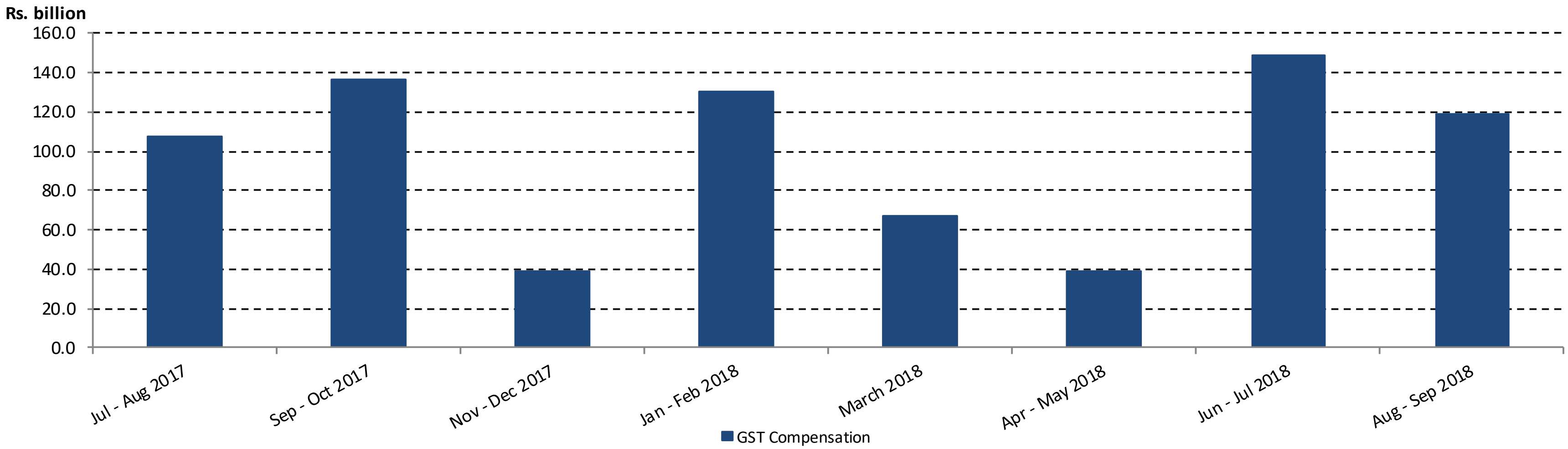
The pace of growth of the aggregate grants from the Centre to the 20 states more than doubled to 21.6% during H1 FY2019 from 9.7% during H1 FY2018. The grants received by these states from the Centre stood at Rs. 1.5 trillion during H1 FY2019, equivalent to 35.0% of the FY2019 BE of Rs. 4.4 trillion, higher than the trend during H1 in FY2018 (28.5% of FY2018 RE). Moreover, the YoY growth of 21.6% in aggregate grants received by the 20 states during H1 FY2019, was in sharp contrast to the budgeted contraction of 0.8% in aggregate grants in FY2019 relative to FY2018 RE.

The GoI shall provide compensation for losses, if any, on the revenues subsumed into the GST, to the states at a nominal growth rate of 14% (using FY2016 revenues as the base), for the initial period of five years after its introduction. The GoI has been providing the GST compensation to the state governments, typically on a bi-monthly basis, since September 2018.

[4] *The IGST amount split into CGST and SGST collections for July 2018 is estimated by ICRA.*

The total GST compensation released by the GoI to various states and Union Territories rose to Rs. 188.3 billion in H1 FY2019 (refer Exhibit 7) from Rs. 108.1 billion in H1 FY2018 (a further Rs. 119.0 billion was earmarked to the states for August-September 2018, which is likely to have been released in October 2018). Assuming[5] that the GST compensation inflows have been accounted for by the CAG in the grants from the Centre to the states, this pickup in release of the GST compensation is likely to be a key factor driving the aforesaid improvement in growth of the aggregate grants from the Centre to the 20 states in H1 FY2019.

Exhibit 7: GST compensation released for various months by the GoI to all states and union territories in FY2018 and for H1 FY2019



Source: Unstarred Questions, Lok Sabha; ICRA research

Additionally, in August 2018, the GST (Compensation to States) Amendment Bill, 2018, was passed by the Lok Sabha, which provides that 50% of the unutilised amount lying in the Compensation Fund at any point in a financial year during the transition period, can be distributed amongst the states in the ratio of their base year revenue. The remaining 50% of such unutilised funds will be transferred to the GoI. The monthly data released by the CGA, reveals that the GoI had collected GST compensation cess of Rs. 469.4 billion till September 2018, which is higher than Rs. 370.3 billion released as GST compensation to the states for April 2018 – September 2018 on a bi-monthly basis. It is unclear if any additional GST compensation has been released as yet to the states subsequent to the passing of the GST (Compensation to States) Amendment Bill, 2018. ***The higher collections of the GST compensation cess relative to the compensation required by the states so far in FY2019, suggests that such revenues may be shared with the state governments in the coming months, which would ease their cash flows and augment their revenues.***

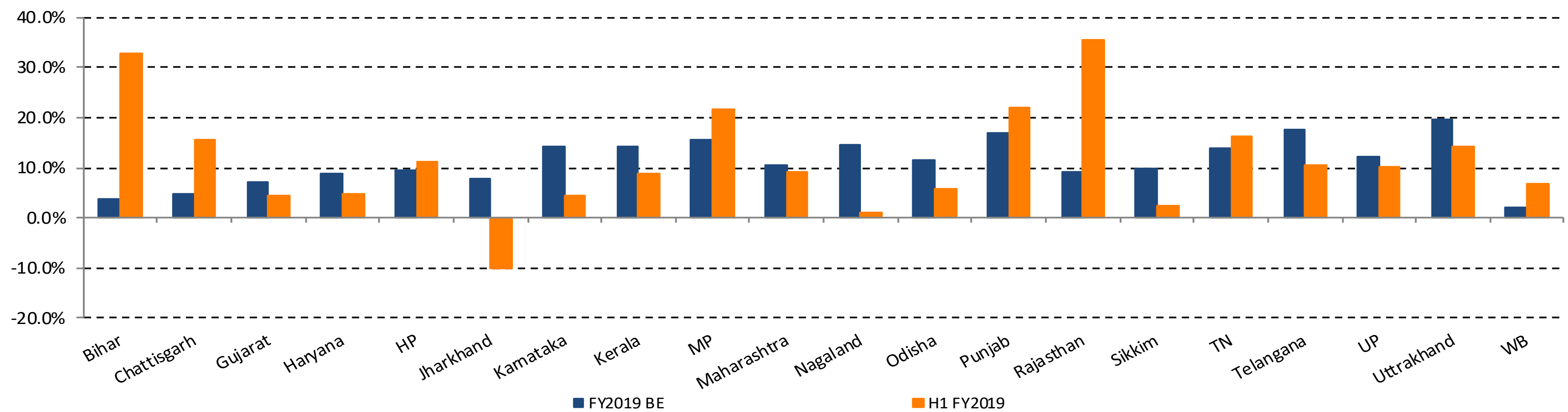
Based on data for earlier years, ICRA has observed that state governments tend to overestimate grants from the Centre. For instance, the variance analysis for FY2017 indicates that the actual grants released by the GoI to all states stood at Rs. 3.6 trillion in that year, 23.5% lower than Rs. 4.7 trillion estimated by these states in their RE for FY2017. The ~1% YoY contraction in the aggregate grants from the Centre budgeted by the 20 states for FY2019, could partly because of the

[5] *The FY2019 budgets of 12 (Gujarat, Haryana, Karnataka, Kerala, MP, Maharashtra, Punjab, Rajasthan, TN, Telangana, UP and WB) out of the 20 states in the sample analysed in detail by ICRA, indicate that five out of these 12 states have included GST compensation under grants from the Centre, three have included it under the SOTR, and four have not included the GST compensation in either FY2018 RE or FY2019 BE. In this note, we are assuming that the CAG would have universally accounted for GST compensation actually received by the states in FY2018 and FY2019, in grants from the Centre.*

over-estimation of grants in FY2018 RE. In ICRA's view, the grants from the Centre may continue to benefit from flows related to GST compensation in the remainder of FY2019.

Revenue Expenditure and Capital Outlay: In aggregate, the revenue expenditure of the 20 state governments rose to Rs. 9.8 trillion in H1 FY2019 from Rs. 8.7 trillion in H1 FY2018. Their revenue expenditure during H1 FY2019 stood at 40.1% of the FY2019 BE of Rs. 24.5 trillion, somewhat higher than the trend during H1 FY2018 (39.6% of FY2018 RE). The pace of growth of the revenue expenditure of these states rose marginally to 12.5% during H1 FY2019 from 12.1% during H1 FY2018. Moreover, the growth in revenue expenditure of the 20 states during H1 FY2019 was higher than the 10.8% expansion indicated in the BE for FY2019 relative to the RE for FY2018, led by Bihar, Chhattisgarh, HP, MP, Punjab, Rajasthan, TN and WB (refer Exhibit 8). Notably, the Assembly elections took place in Chhattisgarh in November 2018 and in Rajasthan and MP in December 2018. ***The higher-than-budgeted pace of growth of revenue expenditure in Chhattisgarh, Rajasthan and MP in H1 FY2019 could partly have been led by pre-election spending. Additionally, the massive flooding in Kerala and in parts of Karnataka in August 2018 and the cyclonic storm that hit TN in November 2018, may lead to these states incurring additional spending on rehabilitation work, which may push up the budgeted revenue expenditure of these states in FY2019. Some states may also incur expenditure on drought relief, given the deficient/large deficient rainfall recorded in 37% of all districts in India in the 2018 monsoon season.***

Exhibit 8: Growth in revenue expenditure budgeted by each of the 20 states for FY2019 and YoY growth in H1 FY2019

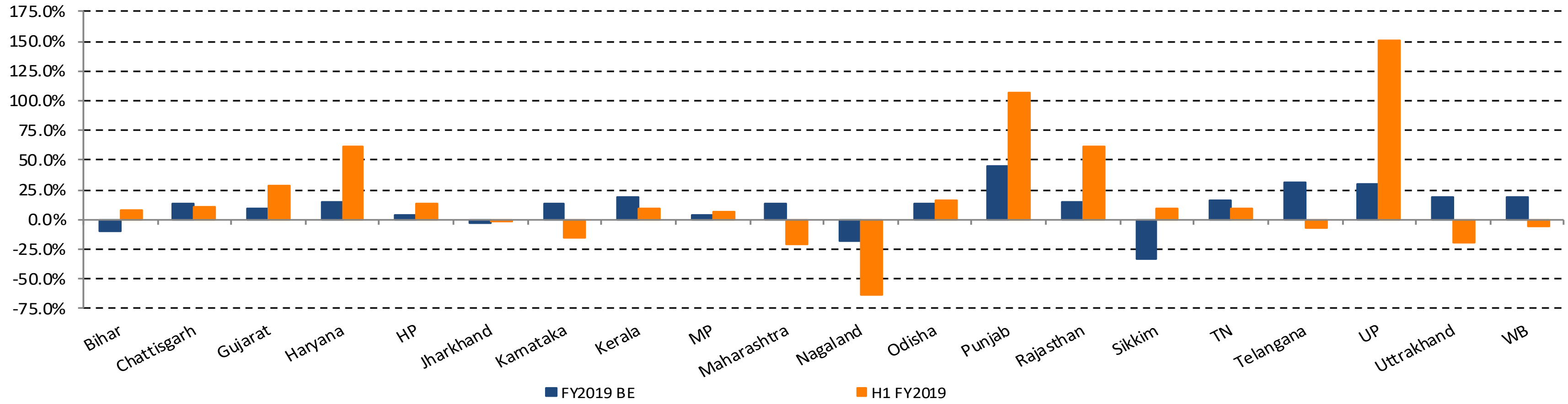


Source: CAG; RBI; ICRA research

Moreover, the capital outlay of the 20 states expanded by a healthy 16.8% during H1 FY2019, in contrast to the 13.8% contraction in H1 FY2018. While the capital outlay of these states rose appreciably to Rs. 1.3 trillion in H1 FY2019 (28.8% of FY2019 BE) from Rs. 1.1 trillion in H1 FY2018 (27.1% of FY2018 RE), it was only modestly higher than the spending of Rs. 1.29 trillion in H1 FY2017 (32.8% of FY2017 Actuals).

Additionally, the growth in the aggregate capital expenditure of the 20 states during H1 FY2019 sharply exceeded the 9.9% expansion indicated in the BE for FY2019, mainly led by Gujarat, Haryana, MP, Punjab, Rajasthan and UP (refer Exhibit 9). The sharp expansion in capital outlay in H1 FY2019 displayed by UP, Punjab and Haryana is partly on account of a rather small base of capital outlay in H1 FY2018 (equivalent to 12.7%, 14.1% and 23.8%, respectively, of FY2018 RE).

Exhibit 9: Growth in capital outlay budgeted by each of the 20 states for FY2019 and YoY growth in H1 FY2019



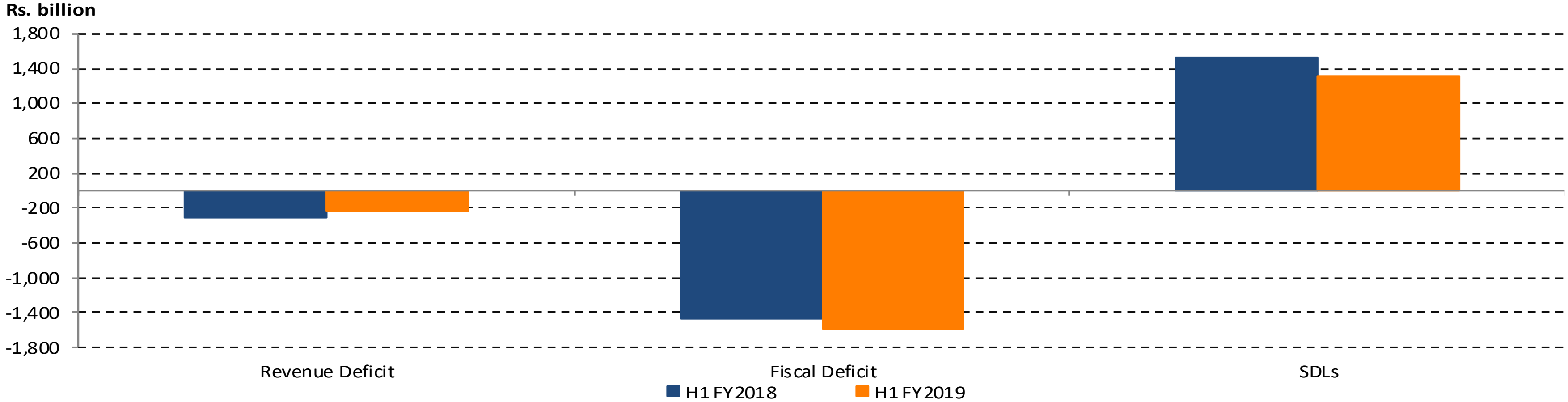
Source: CAG; RBI; ICRA research

Fiscal Balances: With the growth of revenue receipts outpacing that of revenue expenditure, the un-audited revenue deficit of the 20 state governments (refer Exhibit 10) narrowed to Rs. 232.5 billion in H1 FY2019 (Rs. 49.1 billion in FY2019 BE) from Rs. 307.7 billion in H1 FY2018 (Rs. 530.6 billion in FY2018 RE). However, following the sharp increase in capital outlay, the fiscal deficit of the 20 state governments widened somewhat to Rs. 1.6 trillion during H1 FY2019 (36.5% of FY2019 BE) from Rs. 1.5 trillion in H1 FY2018 (33.9% of FY2018 RE).

Despite this YoY increase in their aggregate fiscal deficit, the gross State Development Loans (SDLs) raised by these 20 state governments contracted by 14.5% to Rs. 1.3 trillion during H1 FY2019 from Rs. 1.5 trillion during H1 FY2018. The YoY decline in SDL issuances in H1 FY2019 was fairly broad-based; as many as 11 out of the 20 states in our sub-set issued lower gross SDLs in H1 FY2019 relative to H1 FY2018, while one state (Bihar) did not issue SDL in both H1 FY2018 and H1 FY2019,[6] (refer Exhibit 11). This contraction in SDL issuances in H1 FY2019 is likely to have partly been led by the impact of the hardening of the weighted-average 10-year SDL yields to 8.4% in H1 FY2019 from 7.4% in H1 FY2018. Subsequently, the combined SDL issuances of the 20 states have increased by a considerable 21.6% in during October 1, 2018 - December 11, 2018 relative to October 1, 2017 - December 12, 2017.

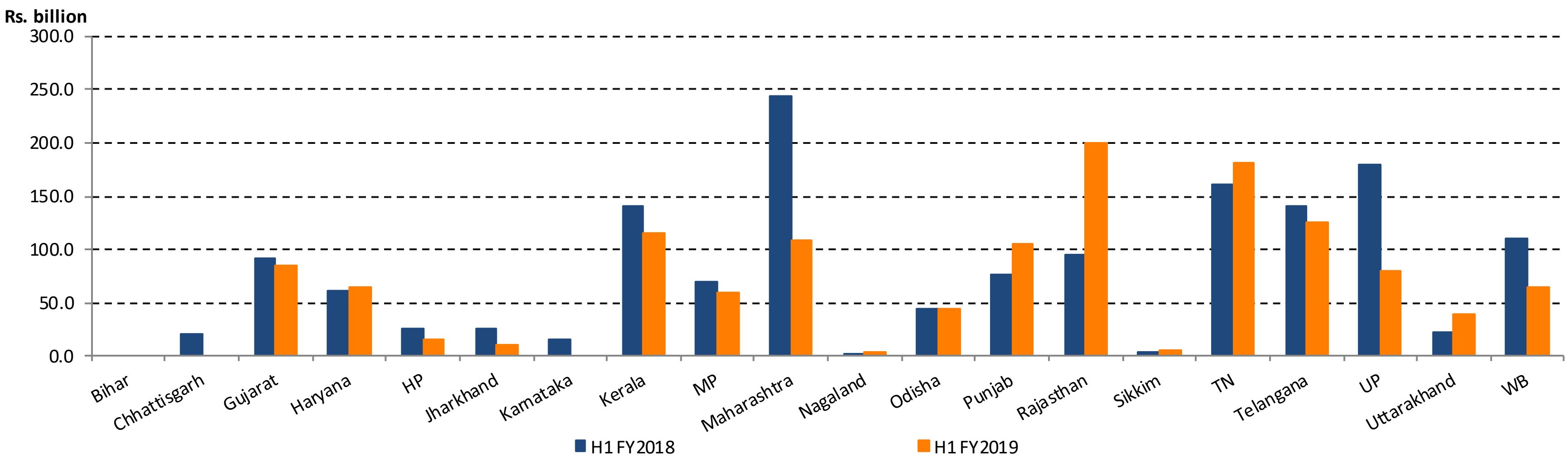
[6] *For detailed note refer ICRA's publication, Indicative SDL borrowing pegged at Rs. 1.2 trillion for Q3 FY2019; gross SDL issuance could rise to Rs. 4.9 trillion – Rs. 5.2 trillion in FY2019 from Rs. 4.2 trillion in FY2018 (October 2018) available on ICRA's website www.icra.in*

Exhibit 10: Combined revenue deficit, fiscal deficit and gross SDL issuances of the 20 states in H1 FY2018 and H1 FY2019



Source: CAG; RBI; ICRA research

Exhibit 11: SDL issuance of 20 states in H1 FY2018 and H1 FY2019



Source: RBI; ICRA research

The pace of growth of the CTD and SOTR of the 20 states in our sub-set in H1 FY2019 lagged the growth budgeted for FY2019 for these revenue streams, which is a cause for concern. Unless there is a sharp and sustained increase in the headline GST collections in the last four months of this fiscal, there may be a sizeable

shortfall of CGST relative to the amount budgeted by the GoI for FY2019 (Rs. 6.0 trillion). This, in conjunction with the cut in basic excise duty on petrol and diesel in October 2018, may result in lower-than-budgeted CTD to the state governments. Moreover, reflecting the cut in the rate of VAT levied on fuels by several states in the recent months, the growth of revenues from such items may ease in H2 FY2019, despite a favourable base effect. On the other hand, the healthy SGST collections (inclusive of regular settlement of IGST and provisional apportionment of unsettled IGST) of all 29 states for the period April – November 2018, suggest that the aggregate SGST collections may modestly exceed the combined FY2019 BE, partly offsetting the risk arising from the lower-than-budgeted growth of CTD.

The grants received by the states in FY2019 may benefit from the receipt of GST compensation. Moreover, the recent change in the GST (Compensation to States) Amendment Bill, 2018, which would allow for the distribution of the excess collections of the GST compensation cess compared to the compensation amount required to be released to the states, between the GoI and the states, would boost their revenues and ease their cash flows.

On the expenditure side, the pre-election spending and outgo related to drought/flood relief work by some of the states may lead to the aggregate revenue expenditure of the 20 states exceeding the budgeted level in FY2019, in ICRA's view. Notwithstanding the sharply higher-than-budgeted growth in capital outlay of the 20 states in H1 FY2019, states may have to curtail the pace of growth of capex in H2 FY2019 to avoid a fiscal slippage in FY2019.

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