STATE GOVERNMENT FINANCES

Sharp rise in indicative SDL borrowings for Q4 FY2019 led by back ended redemptions and higher net issuance, to result in gross SDL issuance of Rs. 5.1 trillion in FY2019, in line with ICRA's estimate

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HIGHLIGHTS

- ***The calendar of market borrowings by the state governments for Q4 FY2019 issued recently by the Reserve Bank of India (RBI), indicates a tentative gross issuance of state development loans (SDLs) of Rs. 2,190.6 billion, implying a substantial YoY growth of 61.3% for this quarter. The sharp pace of growth is being boosted by the back-ended redemption of SDLs due in Q4 FY2019, as well as a considerable 44.0% YoY expansion in the net SDL issuance projected for the quarter, following the marginal 1.3% rise recorded in 9M FY2019.***
- ***In absolute terms, the gross SDL issuance in Q4 FY2019 is projected to rise by Rs. 832.9 billion relative to Q4 FY2018, of which ~51% (Rs. 427.9 billion) is on account of higher redemptions, and ~49% (Rs. 405.0 billion) is on account of a rise in net borrowings. The uptick in net borrowings may be partly related to the implementation of various policy measures announced previously (such as the pay revision for government employees effective from January 1, 2019 in Maharashtra) as well as welfare measures announced recently by some of the state governments. However, it is unlikely to be attributable to the funding of the loan waivers recently announced by some of the state governments, the payout of which is likely to be staggered in FY2020 and beyond.***
- ***Maharashtra (Rs. 280.0 billion), Karnataka (Rs. 220.0 billion) and Uttar Pradesh (UP; Rs. 255.0 billion) are expected to account for over a third of the total indicative borrowings in Q4 FY2019. The SDL issuance by Maharashtra in Q4 FY2019 is expected to be more than double the total SDLs issued by it in 9M FY2019 (Rs. 128.7 billion). Similarly, the indicative SDL issuances by Karnataka and UP, in Q4 FY2019 are expected to be nearly as large as the total SDLs issued by them in 9M FY2019 (Rs. 211.0 billion and Rs. 230.0 billion, respectively).***
- ***If the gross SDL issued in Q4 FY2019 is in line with the amount (Rs. 2,190.6 billion) indicated by the RBI, the total gross SDL issuance would expand by 20.8% in FY2019 to Rs. 5,062.2 billion from Rs. 4,191.0 billion in FY2018, in line with the estimate (Rs. 4,866.9 billion to Rs. 5,208.2 billion) published by ICRA in October 2018. Moreover, after accounting for the sharp rise in redemptions to Rs. 1,283.6 billion in FY2019 from Rs. 778.3 billion in FY2018, the net SDL issuance in FY2019 is projected at Rs. 3,778.6 billion, implying a YoY growth of 10.7%, in line with our forecast of net SDLs (Rs. 3,583.3 billion to Rs. 3,924.6 billion) released in October 2018.***

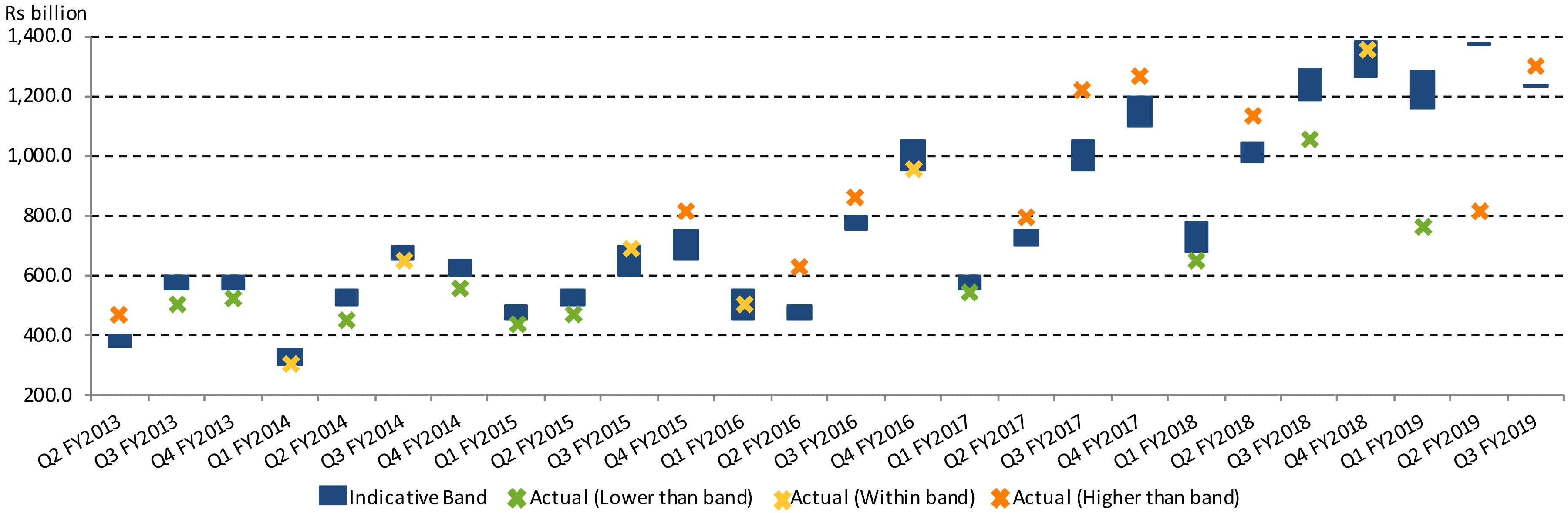
The open market borrowings/SDLs are the chief source of funding of the gross fiscal deficit of the state governments. After consultations with the state governments, the RBI[1] releases an indicative quarterly calendar of market borrowings at the beginning of each quarter, which includes the range of the magnitude of likely market borrowings every quarter, the names of the states that have confirmed participation and the tentative amount of borrowings by the participating states in the ensuing quarter. This note includes ICRA's comments on the key trends in the SDL auctions in Q3 FY2019, the highlights of the indicative calendar for Q4 FY2019 and the total gross and net SDL issuance that are expected in FY2019.

[1]The market borrowings of the state governments are controlled by the Government of India (GoI) vide Article 293 (3) of the Constitution, which indicates that if a state government is indebted to the GoI, the former is required to take the latter's approval for any further borrowing. Accordingly, the Ministry of Finance, GoI determines the borrowing limit of each state government in a fiscal (through multiple sources, including SDLs, loans from banks and financial institutions, loans from the Centre, etc), based on the prevailing norms for that year, and communicates the same to the states. The RBI vide agreements with the state governments, acts as the banker and debt manager for each of the 29 state governments and the Union Territory (UT) of Puducherry primarily through the SDL route.

Trends in SDL issuance in Q3 FY2019

The indicative calendar of market borrowings by the states, released by the RBI on September 27, 2018, had expected borrowings of Rs. 1,231.8 billion by 23 states (including a UT)[2] in Q3 FY2019 (range of Rs. 1,232 billion – Rs. 1,285 billion). The combined gross SDL eventually raised by 26 states stood at Rs. 1,296.6 billion in Q3 FY2019, 5.3% higher than the amount indicated for the quarter and 23.0% higher than the borrowings in Q3 FY2018 (Rs. 1,054.4 billion). This was in contrast to the trend in the previous two quarters, in which the actual borrowings were sharply lower than the indicative amount (refer Exhibit 1).

EXHIBIT 1: Indicative versus actual SDL issuances



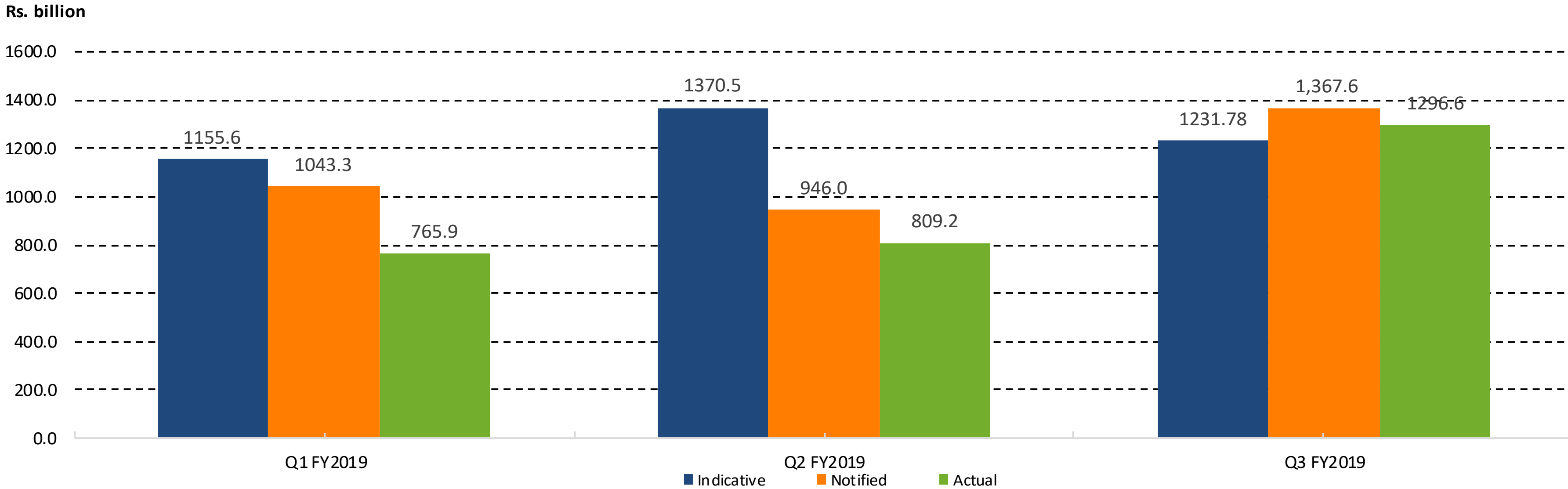
Source: RBI, ICRA research

Seven states had not indicated their participation in the Q3 FY2019 market borrowing programme, including, Bihar, Maharashtra, Haryana and four north-eastern states. However, out of this sub-set, Maharashtra (Rs. 20.0 billion), Haryana (Rs. 45.0 billion) and Tripura (Rs. 2.4 billion) cumulatively borrowed Rs. 67.4 billion in Q3 FY2019. Additionally, Karnataka (Rs. 30.0 billion), Punjab (Rs. 15.0 billion) and West Bengal (WB; Rs. 59.8 billion) borrowed more than the amount indicated by each of these states in the beginning of Q3 FY2019. The combined borrowings by Maharashtra, Haryana and Tripura, along with the higher-than-indicated borrowing by Karnataka, Punjab and WB together comprised 13.3% of the total borrowings in Q3 FY2019. In contrast, the borrowings of a few states including Uttar Pradesh (Rs. 30.0 billion), Gujarat (Rs. 10.3 billion), Odisha (Rs. 25.0 billion) and Assam (Rs. 20.0 billion) were below the indicated amount, partially offsetting the excess borrowings by the aforementioned six states in Q3 FY2019.

The actual gross SDL issuance of Rs. 1,296.6 billion was equivalent to ~95% of the borrowing of Rs. 1,367.6 billion notified on a weekly basis in Q3 FY2019 (refer Exhibit 2). This represents an improvement from Q1 FY2019 and Q2 FY2019 wherein 73.4% and 85.5% of the notified amount, respectively, were borrowed by the states.

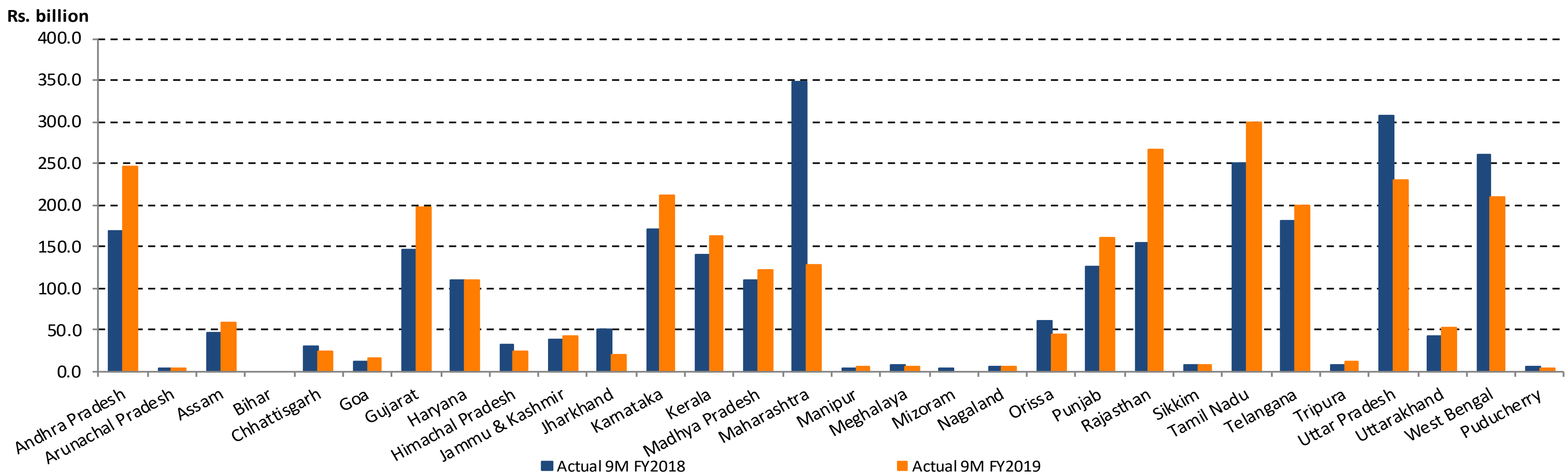
[2] *Andhra Pradesh (AP), Assam, Chhattisgarh, Goa, Gujarat, Himachal Pradesh, Jammu & Kashmir, Jharkhand, Karnataka, Kerala, Madhya Pradesh (MP), Meghalaya, Nagaland, Odisha, Punjab, Rajasthan, Sikkim, Tamil Nadu (TN), Telangana, UP, Uttarakhand and WB and the Union territory of Puducherry*

EXHIBIT 2: Quarter-wise indicated, notified and actual SDL issuances in FY2019



Note: Indicative as per the borrowing calendar issued on April 5,2018, June 28, 2018 and September 27, 2018; Notified as per the weekly notification from the RBI typically released on the Friday prior to each auction
Source: RBI, ICRA research

EXHIBIT 3: State-wise actual SDL issuances in 9M FY2018 and 9M FY2019



Source: RBI, ICRA research

9M FY2019 Vs 9M FY2018: Overall, the gross SDL issuance stood at Rs. 2,871.6 billion in 9M FY2019, a modest 1.3% higher from the SDL issuance of Rs. 2,833.8 billion in 9M FY2018. The YoY growth in SDL issuances in 9M FY2019 was mainly dampened by lower SDL issuances by Maharashtra (to Rs. 128.7 billion in 9M FY2019 from Rs. 348.9 billion in 9M FY2018), UP (to Rs. 230.0 billion in 9M FY2019 from Rs. 380.0 billion in 9M FY2018) and WB (to Rs. 209.8 billion in 9M FY2019 from Rs. 260.0 billion in 9M FY2018). In contrast, among the larger borrowers, some states including Andhra Pradesh (to Rs. 246.6 billion in 9M FY2019 from Rs. 169.0 billion in 9M FY2018), Gujarat (to Rs. 196.7 billion in 9M FY2019 from Rs. 147.0 billion in 9M FY2018), Karnataka (to Rs. 211.0 billion in 9M FY2019 from Rs. 171.0 billion in 9M FY2018), Rajasthan (to Rs. 266.0 billion in 9M FY2019 from Rs. 155.0 billion in 9M FY2018), and Tamil Nadu (to Rs. 298.9 billion in 9M FY2019 from Rs. 251.2 billion in 9M FY2018) reported a YoY increase in SDL issuance in 9M FY2019 (refer Exhibit 3).

Indicative borrowings in Q4 FY2019

On December 31, 2018, the RBI released the indicative calendar of market borrowings by the state governments for Q4 FY2019, which pegs the total market borrowing in the range of Rs. 2,190.6 billion – Rs. 2,255.9 billion. A tentative borrowing of Rs. 2,190.6 billion has been indicated by 26 states[3] that have confirmed their participation in the Q4 FY2019 market borrowing programme, a substantial 61.3% higher than the actual combined borrowings in Q4 FY2018.

The sharp rise in the indicative borrowing amount in Q4 FY2019, on a YoY as well as QoQ basis, is partly on account of the considerable uptick in the redemption of SDLs in Q4 FY2019 (Rs. 865.9 billion in Q4 FY2019 vs. Rs. 438.0 billion in Q4 FY2018 and Rs. 219.2 billion in Q3 FY2019). The rise in redemptions largely follows the substantial increase in 10-year SDL issuances in Q4 FY2009. Following the onset of the global financial crisis, the sluggish economic growth in India in H2 FY2009 had affected the revenue collections of the state governments, leading to a sharp rise in their market borrowings, especially in Q4 FY2009. The total SDL issuances with a standard 10-year tenor had nearly doubled to Rs. 767.9 billion in Q4 FY2009 from Rs. 413.5 billion during Q1-Q3 FY2009. According to the RBI, Rs. 1,283.6 billion of SDLs are scheduled for redemption in FY2019, of which only a third or Rs. 417.7 billion were redeemed till December 21, 2018 and the balance Rs. 865.9 billion of SDL are largely scheduled for redemption in Q4 FY2019.

Moreover, on a net basis, the indicative borrowing calendar suggests a substantial 44.7% YoY increase in SDL issuance in Q4 FY2019, following the muted rise in issuance in 9M FY2019, which suggests that some states have chosen to back-end their borrowings in FY2019, perhaps in line with their assessed cash flow requirements. In absolute terms, the gross SDL issuance in Q4 FY2019 is projected to rise by Rs. 832.9 billion, of which ~51% (Rs. 427.9 billion) is on account of higher redemptions, and ~49% (Rs. 405.0 billion) on account of a rise in net borrowings relative to Q4 FY2018. The uptick in net borrowings may be partly related to the implementation of various policy measures taken previously as well as welfare measures announced recently by some of the states. However, it is unlikely to be attributable to the funding of the loan waivers recently announced by some of the states, the payout of which is likely to be staggered in FY2020 and beyond.

Notably, Maharashtra (Rs.280.0 billion), Karnataka (Rs. 220.0 billion) and UP (Rs. 255.0 billion) are expected to account for more than a third of the total indicative borrowings of Rs. 2,190.6 billion in Q4 FY2019. The SDL issuance by Maharashtra in Q4 FY2019 is expected to be more than twice its total SDLs issuance in 9M FY2019 (Rs. 128.7 billion). Similarly, the indicative SDL issuances by Karnataka and UP in Q4 FY2019 are expected to be nearly as large as the total SDLs issued by them in 9M FY2019 (Rs. 211.0 billion and Rs. 230.0 billion, respectively). This trend of large SDL issuances by some of the states in Q4 FY2019 could partly reflect the impact of the policy decisions taken by these states. For instance, the Government of Maharashtra is expected to revise the pay scales of its employees w.e.f. January 1, 2019, which would augment its borrowing requirement. Additionally, Karnataka and UP had announced loan waivers[4] of Rs. 422.0 billion and Rs. 363.6 billion, respectively, in CY2017 and/or CY2018, which are being

[3]*AP, Assam, Chhattisgarh, Bihar, Chhattisgarh, Gujarat, Haryana, HP, Jammu & Kashmir, Jharkhand, Karnataka, Kerala, MP, Maharashtra, Meghalaya, Mizoram, Nagaland, Odisha, Punjab, Rajasthan, Sikkim, TN, Telangana, Tripura, UP and WB.*

[4]*Karnataka had announced a waiver of crop loans of Rs. 82.0 billion in June 2017 and an additional waiver of crop loans of Rs. 340.0 billion In July 2018. UP had announced a crop loan waiver of Rs. 307.3 billion in April 2017 and an additional Rs. 56.3. billion for writing off the bad loans of farmers. Out of the total waivers announced by Karnataka and UP, Rs. 144.1 billion and Rs. 245.6 billion, respectively, have been provisioned in the revised estimates for FY2018 and budget estimates for FY2019.*

implemented in a staggered manner. The relatively high SDL issuances indicated by these states for Q4 FY2019 may be partly related to the funding of a portion of the loan waivers announced previously. Moreover, in December 2018, the Government of Karnataka declared drought in 156 out of the 176 *talukas* in the state, which would warrant additional spending in the ensuing months.

Expected gross and net borrowings in FY2019

If the gross SDL raised in Q4 FY2019 is in line with the indicated amount of Rs. 2,190.6 billion, the total gross SDL issuance in FY2019 would expand by 20.8% to Rs. 5,062.2 billion from Rs. 4,191.0 billion in FY2018 (refer Exhibit 4). After adjusting for the sharply higher redemptions in FY2019, the net SDL issuance in the current fiscal is projected at Rs. 3,778.6 billion, indicating a YoY growth of 10.7%. The expected gross and net SDL issuance in FY2019 are in line with ICRA's estimate (gross SDL issuance of Rs. 4,866.9 billion – Rs. 5,208.2 billion; net SDL of Rs. 3,583.3 billion – Rs. 3,924.6 billion) projected in October 2018[5].

EXHIBIT 4: Gross and net market borrowing of the state governments

Rs. billion	FY2017	FY2018	FY2019 (Expected)	YoY growth FY2019 (Expected)
Gross Borrowing	3,819.8	4,191.0	5,062.2	20.8%
Redemption	407.1	778.3	1,283.6	64.9%
Net Borrowing	3,412.7	3,412.7	3,778.6	10.7%

Source: RBI, ICRA research

In FY2019, several states (including some in which Legislative elections have concluded recently) announced various expenditure measures, such as crop loan waivers and other relief measures intended partly to support the rural economy (refer Box 1 for details). Moreover, Legislative elections are scheduled to be held in six states (Andhra Pradesh, Maharashtra, Odisha, Haryana, Sikkim and Arunachal Pradesh) in 2019, in addition to the Parliamentary elections. Therefore, there is a risk of continued pre-election expenditure announcements by the state governments. This along with other factors (staggered implementation of the pay revision, funding of a portion of the crop loan waivers announced since FY2018 by some states), may keep the aggregate revenue expenditure of the states elevated, going forward. Moreover, potential shortfalls in Central tax devolution could result in a fiscal slippage and increase the borrowing requirements unless there are cutbacks in the budgeted level of expenditure[6].

While some of the expenditure announcements may require to be funded in the immediate term, an analysis of the loan waivers announced by the various state governments in the past reveals that the spending on the same tends to be staggered over multiple years and the actual amount disbursed could vary from the announced amount. ***In ICRA's view, there is a low probability of the disbursal of a substantial portion of the recently announced crop loan waivers by the state governments in the remainder of FY2019; rather, the payouts are likely to be staggered to FY2020 and beyond. Therefore, the sharp spike in the growth of net SDL issuances in Q4 FY2019 is unlikely to be attributable to the funding of the crop loan waivers announced by some of the states in December 2018.***

[5] *For detailed note, refer ICRA's publication available on ICRA's website www.icra.in - 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).*

[6] *For detailed note, refer ICRA's publication available on ICRA's website www.icra.in - Fiscal deficit of 20 state governments increased by 8.3% YoY in H1 FY2019, led by healthy rise in capital outlay (December 2018)*

Box 1: Loan waiver/relief measures announced by the state governments in December 2018

In the last few weeks a few state governments announced either a crop loan waiver or other relief measures to alleviate the distress of the rural populace in their respective states. Based on the publicly available information (newspaper articles/media reports), the key features of the farm loan waivers announced by Assam, Chhattisgarh, Rajasthan and Madhya Pradesh, and relief/welfare measures announced by Gujarat, Maharashtra and Jharkhand in December 2018 are highlighted below:

Assam: The Government of Assam (GoA) approved a debt relief scheme in December 2018, wherein it would be writing off 25% of the loan availed by a farmer (maximum limit Rs. 25,000) through Kisan Credit Card and public sector banks. The cost of waiving such crop loans is estimated at Rs. 6.0 billion in FY2019. The GoA also announced an interest relief scheme in December 2018, under which farmers would be able to avail crop loans at zero interest rate from FY2020.

Chhattisgarh: After the elections that were held in November/December 2018, the newly formed government in Chhattisgarh, announced the waiver of crop loans of around Rs. 61.0 billion. The Chief Minister also announced that the state government will increase the minimum support price of paddy from Rs. 1,700 per quintal to Rs. 2,500 per quintal, which is likely to entail an additional cost.

Rajasthan: Following the Legislative elections, the Government of Rajasthan announced a waiver of the short-term crop loans availed by farmers in the state from cooperative banks and of loans of up to Rs. 0.2 million taken by farmers from nationalised and other banks. The state government estimates the total cost of these loan waivers at Rs. 180.0 billion, according to news reports.

Madhya Pradesh: The newly elected Government of Madhya Pradesh announced a waiver of short-term crop loans from nationalised and cooperative banks of eligible farmers as on March 31, 2018. According to news reports, the cost of the loan waiver is estimated by the state government to be in the range of Rs. 350.0 billion – Rs. 380.0 billion

Gujarat: In December 2018, the Government of Gujarat announced that it would waive off the electricity bills of people in rural areas. This is estimated to cost the state government around Rs. 6.5 billion.

Maharashtra: The Government of Maharashtra has announced a relief package of Rs. 1.5 billion in December 2018 for farmers who are selling onions at very low rates and are unable to recover the cost of growing the same. The state government has also decided to give an ex-gratia grant of Rs. 200 per quintal per farmer.

Jharkhand: The Government of Jharkhand recently issued the Mukhya Mantri Krishi Yojana, wherein it would transfer Rs. 5,000 per acre to 2.3 million farmers in the state from FY2020. This is estimated to cost the state government Rs. 22.5 billion in FY2020.

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