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ICRA forecasts gross and net SDL
issuance to increase to Rs. 9.3
trillion and Rs. 7.2 trillion,
respectively, in FY2022

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SUMMARY



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Q1 FY2022 indicative borrowing through SDLs pegged at Rs. 1,783 billion; Maharashtra, TN and UP to account for ~40% of planned SDL issuance in Q1 FY2022

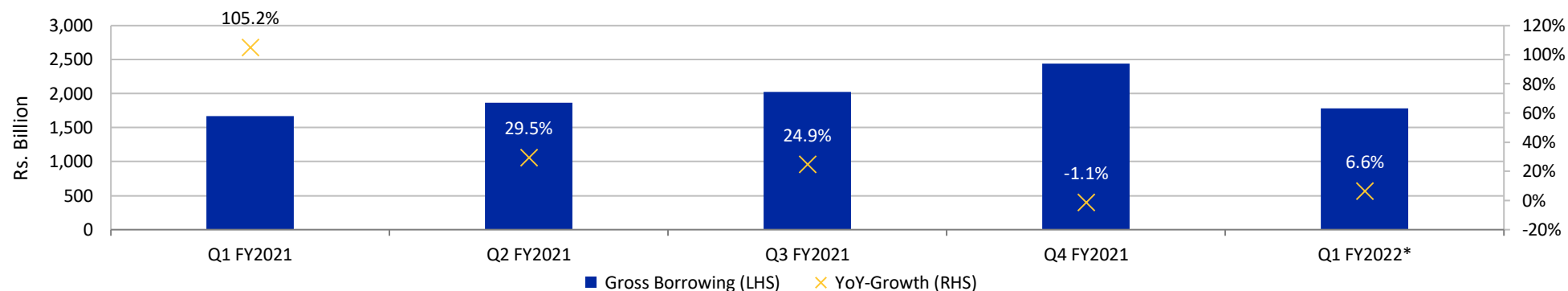
Based on our estimate of FY2022 GDP, gross and net SDL issuance could rise to Rs. 9.3 trillion and Rs. 7.2 trillion, respectively, in this fiscal

Measures announced by the RBI such as G-SAP 1.0 are likely to ease SDL cut-offs by 5-10 bps from their highs in March 2021

- The indicative calendar of market borrowings for Q1 FY2022 released by the Reserve Bank of India (RBI) on April 6, 2021, has pegged the market borrowing of 27 state governments/Union Territory (UT) at Rs. 1,783 billion, 6.6% higher than the total State Development Loan (SDL) issuance of Rs. 1,673 billion in Q1 FY2021. The combined borrowing indicated by Maharashtra, Tamil Nadu (TN) and Uttar Pradesh (UP) accounts for nearly 40% of the total issuance of Rs. 1,783 billion expected in this quarter.
- The last few weeks have witnessed a sharp surge in the Covid-19 infections, which has led to renewed uncertainty regarding the near-term economic outlook. Several states that have witnessed a spike in cases, have imposed localised restrictions to contain the spread of Covid-19. Such restrictions may curb activity in the contact-intensive services sectors, which may modestly constrain the indirect tax collections of those particular states. Simultaneously, some states may have to boost their health and social sector spending if the Covid-19 situation worsens. Overall, there could be a mild upside to the SDL issuance in the ongoing quarter.
- For funding the fiscal deficit of the state governments, the GoI has fixed the net borrowing limit at 4.0% of Gross State Domestic Product (GSDP) for FY2022, in line with the recommendation of the Fifteenth Finance Commission (FC). Based on ICRA's estimate of FY2022 GDP, we have forecast the base net borrowing limit of the state governments at Rs. 9,043 billion for FY2022. If 80% of this limit is utilised by the states for funding their deficits through SDLs, the net market issuance could rise by 10.8% to Rs. 7,235 billion in FY2022 from Rs. 6,532 billion in FY2021. ICRA estimates the SDL redemptions at Rs. 2,091 billion in FY2022, which implies that the gross SDL issuance could rise by 16.5% to Rs. 9,326 billion in FY2022 from Rs. 8,002 billion in FY2021.
- The recent announcement by the RBI to purchase Rs. 1.0 trillion of Government of India securities (G-sec) in the secondary market in Q1 FY2022, under its G-sec acquisition programme (G-SAP 1.0), has dampened the G-sec yields, and is expected to soften the SDL yields as well. In the first weekly auction held on April 8, 2021, the cut-off of the 10-year Rajasthan SDL was 6.75%, around 6 bps lower than the weighted-average cut-off of the 10-year SDLs in the last weekly auction of FY2021 held on March 30, 2021.
- The continuation of the enhanced Ways and Means Advances (WMA) limit of Rs. 516 billion to H1 FY2022 by the RBI would provide states with some additional space to tide over their temporary mismatches in their cash-flows in the ongoing uncertain environment.

States' market borrowing indicated to rise by a moderate 6.6% in Q1 FY2022, on the large base of Q1 FY2021: The indicative calendar of market borrowings² by the state governments and UTs for Q1 FY2022, released by the RBI on April 6, 2021, has pegged their total market borrowing at Rs. 1,783 billion for this quarter (refer Exhibit 1). On a YoY basis, the indicated gross borrowing for Q1 FY2022 is 6.6% larger (or an increase of Rs. 110 billion) than the actual borrowing of Rs. 1,673 billion in Q1 FY2021 (~21% of the total issuance in FY2021). The indicated growth in gross market borrowing in Q1 FY2022 is moderate, possibly benefitting from the additional Central tax devolution of Rs. 450 billion made by the GoI to the state governments in late-March 2021. Regardless, this seemingly modest expansion comes on the back of a substantial YoY rise in gross issuance in Q1 FY2021, to Rs. 1,673 billion from Rs. 815 billion in Q1 FY2020, which had reflected the shock to the revenues of the state governments in Q1 FY2021 following the nationwide lockdown to contain the spread of the Covid-19 pandemic.

Exhibit 1: Gross SDL borrowings by all state governments/UTs and their YoY growth



Note: FY2022 based on Q1 indicative borrowing and YoY growth is over actual SDL issued in Q1 FY2021

Source: RBI; ICRA research

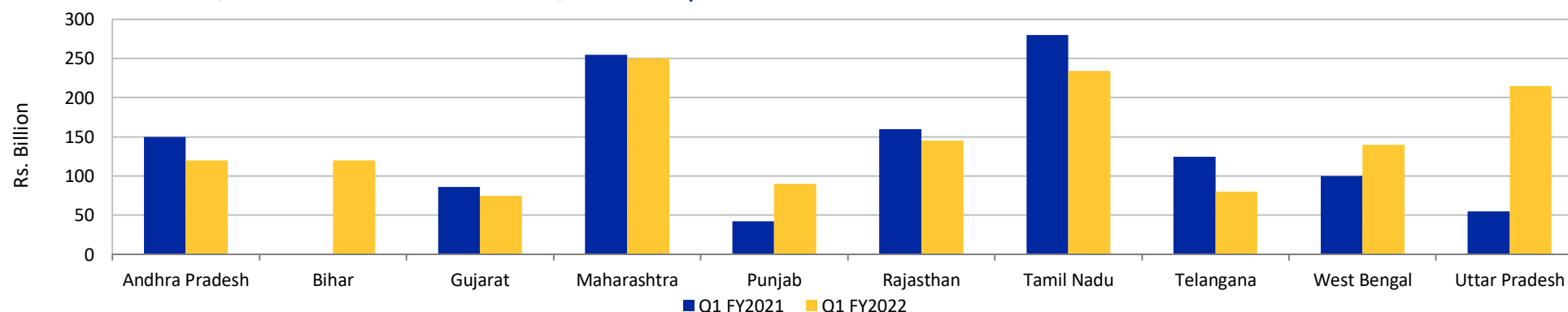
We estimate a rise in SDL redemptions to Rs. 335 billion in Q1 FY2022 from Rs. 282 billion in Q1 FY2021. Accordingly, the net SDL issuance in Q1 FY2022 is expected at Rs. 1,448 billion, a modest 4.1% higher than the Rs. 1,391 billion raised in Q1 FY2021.

The indicative borrowing calendar has pegged the SDL issuances in April 2021 at Rs. 487 billion or ~27% of the total indicated amount (Rs. 1,783 billion) for Q1 FY2022, with the size of the weekly auctions varying from a modest Rs. 40 billion to a sizable Rs. 180 billion. Notably, the SDL auctions, which are typically conducted on Tuesdays by the RBI, are proposed to be held on non-Tuesdays in three of the four weeks of April 2021. This could possibly have been done to aid in the smooth settlement of the SDL auctions, given that there are several public holidays in April 2021. Subsequently, Rs. 587 billion or a third of the total SDL issuance in Q1 FY2022 is proposed to be issued in May 2021 in four weekly auctions (only one auction on a non-Tuesday), with a size ranging between Rs. 108 billion to Rs. 180 billion. The balance Rs. 710 billion or ~40% of the SDL issuance indicated for Q1 FY2022 is expected to be issued over five weekly auctions in June 2021 (all auction on Tuesdays), with a weekly size of Rs. 115 billion-Rs. 169 billion.

Indicated SDL issuance by Maharashtra, Tamil Nadu (TN) and Uttar Pradesh (UP) in Q1 FY2022 to account for nearly 40% of the total borrowing: As many as 27 states/UT (except Karnataka, Manipur and Puducherry) have indicated that they would raise funds through SDL in Q1 FY2022. Maharashtra has indicated that it will borrow Rs. 250 billion in this quarter, the highest among the 27 states/UT (refer Exhibit 2), followed by TN (Rs. 235 billion) and UP (Rs. 215 billion). The combined borrowing indicated by these three states in Q1 FY2022 accounts for nearly 40% of the total issuance of Rs. 1,783 billion expected in this quarter. It is interesting to note that the SDL issuance indicated by UP in Q1 FY2022 is a substantial Rs. 160 billion higher than the level in Q1 FY2021. In contrast, TN and Maharashtra, respectively, have indicated that they will raise Rs. 46 billion and Rs. 5 billion less through SDLs in Q1 FY2022, relative to their issuance in Q1 FY2021.

Apart from TN and Maharashtra, some of the other states that have indicated that they will issue lower SDLs in Q1 FY2022 compared to Q1 FY2021, include Kerala (by Rs. 74 billion), Telangana (by Rs. 45 billion), Haryana (by Rs. 35 billion), Andhra Pradesh (by Rs. 30 billion) and Rajasthan (by Rs. 15 billion). Additionally, Karnataka has indicated that it will not participate in the SDL auctions in Q1 FY2022. This seems to be a reversal to the practice followed by it during FY2017-FY2020, of abstaining from issuing SDLs in the first quarter of those fiscals. In a break from this practice, Karnataka had raised Rs. 70 billion in Q1 FY2021, to address the sudden shortfall in revenues due to the onset of the pandemic from March 2020 onward. Manipur and Puducherry are the other two states/UTs that have not indicated their participation in the market borrowing programme in Q1 FY2022. In contrast, Bihar has indicated that it will borrow a substantial in Rs. 120 billion in Q1 FY2022, in a change from the trend of no issuance in Q1 in FY2017-FY2021.

Exhibit 2: SDL issuance in Q1 FY2021 and indicated issuance for Q1 FY2022 of top 10 issuers



Source: RBI; ICRA research

The last few weeks have witnessed a sharp surge in the Covid-19 infections, which has led to renewed uncertainty regarding the near-term economic outlook. The total number of active cases has increased to 0.8 million as on April 7, 2021 from 0.2 million in mid-March 2021. Out of the total active cases on April 7, 2021, nearly two-thirds were in Maharashtra, Karnataka, Kerala and Tamil Nadu. Several states that have witnessed a spike in cases, have imposed localised restrictions to contain the spread of Covid-19. **Such restrictions may curb activity in the contact-intensive services sectors, which may modestly constrain the indirect tax collections of those particular states. With the vaccine rollout drive already having begun, we think**

that the extent of the restrictions, and their impact on economic activity, will be relatively contained. Although we anticipate that the level of preparedness of the state governments to tackle the Covid-19 cases would be better in FY2022 than it was in FY2021, they may still have to boost their health and social sector spending if the Covid-19 situation worsens. Overall, there could be a mild upside to the SDL issuance in the ongoing quarter relative to the indicated amount, given the evolving Covid-19 situation.

ICRA estimates net SDL issuance at Rs. 7,235 billion in FY2022: The Gol has accepted the recommendation of the Fifteenth FC of fixing the net borrowings limit of the state governments at 4.0% of GSDP for FY2022. Based on ICRA’s estimate of FY2022 GDP, we have forecast the base net borrowing limit of the state governments at Rs. 9,043 billion for FY2022. If 80% of this limit is utilised by the states for funding their deficits through SDLs, **the net issuance could rise by 10.8% to Rs. 7,235 billion in FY2022 from Rs. 6,532 billion in FY2021 (refer Exhibit 3).** **ICRA estimates the SDL redemptions at Rs. 2,091 billion in FY2022, which implies that the gross SDL issuance could rise by 16.5% to Rs. 9,326 billion in FY2022 from Rs. 8,002 billion in FY2021.**

Exhibit 3: Net and gross SDL issuance in FY2022 and YoY growth

Amount in Rs. Billion	FY2021	FY2022	YoY growth
Net Borrowing	6,532	7,235	10.8%
Redemption	1,470	2,091	42.2%
Gross Borrowing	8,002	9,326	16.5%

Source: RBI; ICRA research

The recent announcement by the RBI to purchase Rs. 1.0 trillion of G-secs in the secondary market in Q1 FY2022, under its G-SAP 1.0 (of which purchase of Rs. 250 billion would be conducted on April 15, 2021) has dampened the G-sec yields. Given that the pricing of the SDLs is linked to the G-sec yields, the SDL cut offs are expected to ease from their recent highs by 5-10 bps. For instance, in the first weekly auction held on April 8, 2021¹, the cut-off of the 10-year Rajasthan SDL was 6.75%, around 6 bps lower than the weighted-average cut-off of the 10-year SDLs in the last weekly auction of FY2021 held on March 30, 2021. With the large supply of SDLs expected in FY2022, lower cut-offs would help in reducing the debt servicing burden of the state governments.

In addition, the RBI has extended the enhanced limit of the WMA to the state governments of Rs. 516 billion from April 1, 2021 to September 30, 2021, in line with the recommendation of an advisory committee appointed by it, which is a positive for the states. The continuation of the enhanced WMA limit to H1 FY2022 would provide states with some additional space to tide over their temporary mismatches in their cash-flows in the ongoing uncertain environment.

¹ On April 8, 2021, Andhra Pradesh borrowed Rs. 20 billion through 17-year and 18-year SDLs in equal proportions at a cut-off of 6.78% for both the maturities. Rajasthan issued Rs. 4 billion 4-year SDLs at a cut-off of 5.94% and Rs. 10 billion 10-year SDLs at a cut-off of 6.75%.

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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