



STATE GOVERNMENT FINANCES - UPDATE APRIL 2020

**Substantial
enhancement in WMA
limits for state
governments to narrow
SDL spreads**



Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

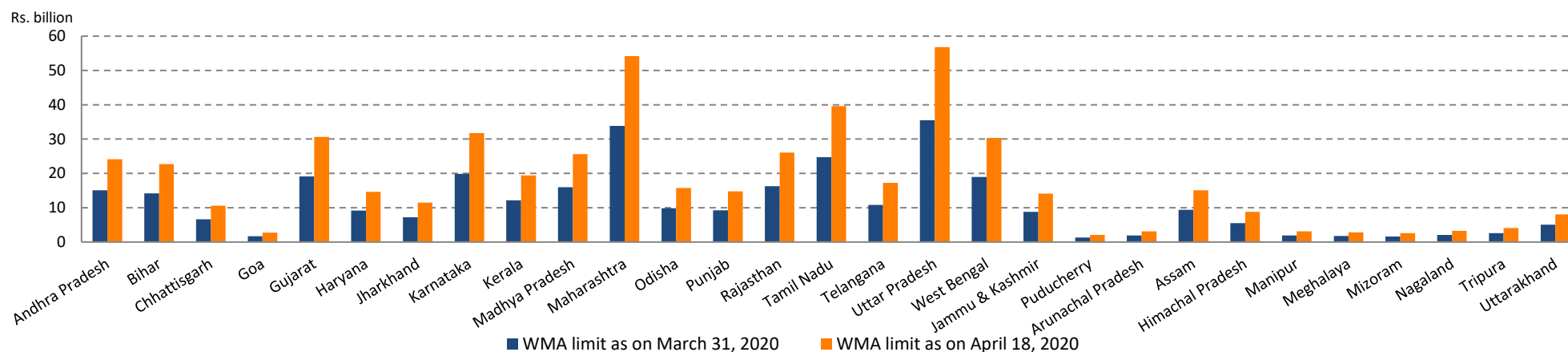
Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Neetika Shridhar
+91 124 4545 305
neetika.shridhar@icraindia.com

Jaspreet Kaur
+91 124 4545 853
jaspreet.kaur@icraindia.com

On April 17, 2020, the Reserve Bank of India (RBI) increased the Ways and Means Advances (WMA) limits of the state governments/Union territories (UTs) by 60%, from the level prevailing on March 31, 2020.¹ Such enhanced limits will be available to the state governments/UTs till September 30, 2020. Following this revision, ICRA estimates that the WMA limit of the states/UTs have increased to a substantial Rs. 516 billion from Rs. 322 billion, with the highest limit set for Uttar Pradesh (UP; Rs. 57 billion; refer Exhibit 1) followed by Maharashtra (Rs. 54 billion) and Tamil Nadu (TN; Rs. 40 billion). The combined WMA limit of all states/UTs of Rs. 516 billion is equivalent to ~8% of our forecast of net state development loan (SDL) issuance (Rs. 6.2-6.4 trillion) for FY2021. In our assessment, the enhanced WMA limit will be useful in alleviating the liquidity tightness that the states are experiencing in the aftermath of the Covid-19 outbreak, and will temper the surge in SDL issuance by the states in H1 FY2021. This should also lead to some cooling of the 10-year SDL spreads over the 10-year Government of India securities (G-sec), compared to the alarmingly high levels seen since the second fortnight of March 2020, although they may still remain higher than the 60-70 bps recorded during most of April 2019-February 2020.

Exhibit 1: Old and revised WMA limits of state governments/UTs



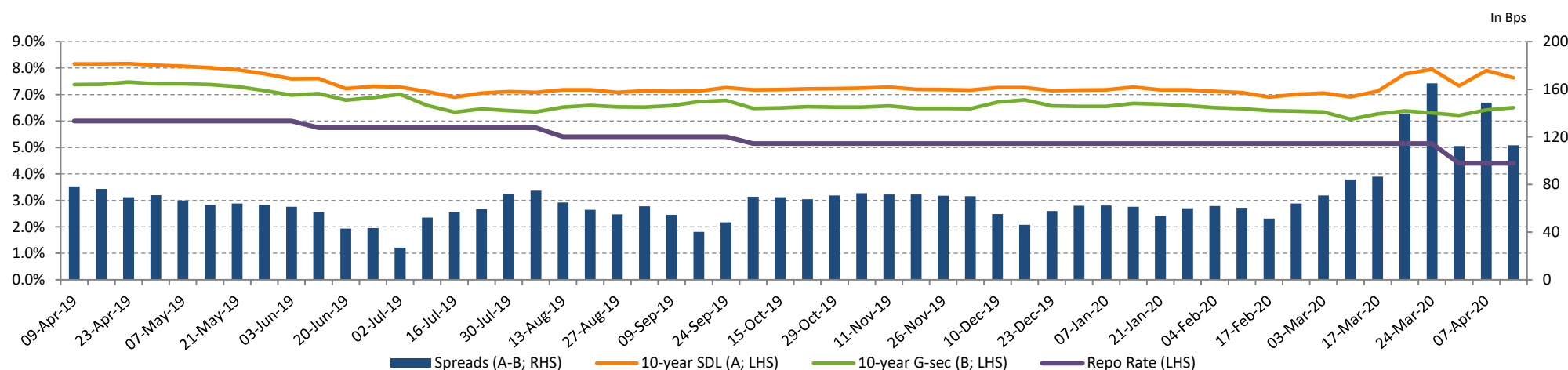
Source: RBI, ICRA research

The prevailing nationwide lockdown that has been enforced from March 24, 2020 by the Government of India (GoI) to contain the spread of the Covid-19 has restricted consumption to largely essential items, which is expected to sharply curtail the inflow of various tax revenues, including state Goods and Services Tax (GST), sales tax/VAT on petroleum products, stamps and registration duties, motor vehicle tax etc., to the state governments. Moreover, the immediate spending requirement of the state

¹ On April 1, 2020, the RBI had revised the WMA limits of the states/UTs upward by 30% from the level as on March 31, 2020. Subsequently, the RBI on April 17, 2020 has revised the limits upward by 60% from the level prevailing on March 31, 2020.

governments, especially the ones that have been relatively badly affected by the Covid-19 health crisis and those with a higher proportion of daily wagers or migrant workers, is likely to have risen sharply in the prevailing scenario. This has expectedly tightened the liquidity situation of the state governments, which was reflected in the sharp upward revision in the notified amount of market borrowings to Rs. 375 billion in the first SDL auction of the current fiscal held on April 7, 2020 compared to Rs. 261 billion that was initially indicated by the state governments to the RBI. Moreover, the spread between the 10-year SDL and the 10-year G-sec was exceptionally wide in a range of 140-175 bps in the SDL auction held on April 7, 2020, reflecting both the large supply of SDLs as well as concerns of the market participants on the challenging fiscal situation of the states in the aftermath of the Covid-19 crisis.

Exhibit 2: 10-year G-sec, weighted average SDL cut-offs and repo rate since April 2019



Source: RBI; ICRA research

Factoring in the impact of the Covid-19 outbreak on state governments' revenues and expenditure, ICRA had estimated a 25%-30% increase in net SDL issuance to Rs. 6.2-6.4 trillion in FY2021 from around Rs. 5 trillion in FY2020². ***The revised WMA limit of Rs. 516 billion is equivalent to ~8% of our forecast of net SDL issuance for FY2021. In our assessment, the enhanced WMA limit will be useful in alleviating the liquidity tightness that the states are currently experiencing and will temper the surge in SDL issuance by the states in H1 FY2021, thereby resulting in a less front-loaded issuance calendar in this fiscal. This should also lead to some cooling of the 10-year SDL spreads over the 10-year G-sec, compared to the alarmingly high levels seen since the second fortnight of March 2020, although they may still remain higher than the 60-70 bps recorded during most of April 2019-February 2020 (refer Exhibit 2).***

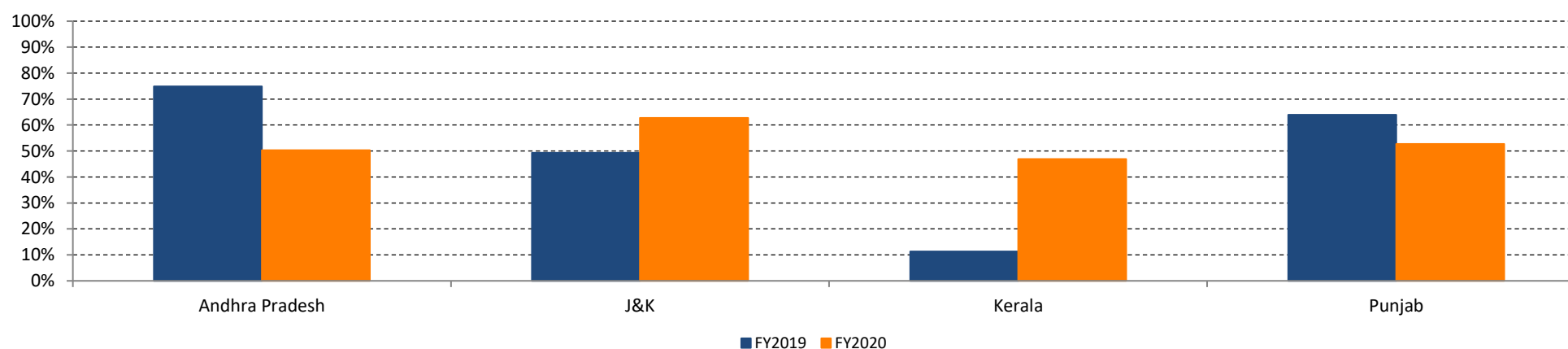
² Refer to ICRA's publication, Covid-19 related rise in spending amidst lower revenue receipts to enlarge gross SDL issuance to Rs. 7.6-7.8 trillion in FY2021, published in April 2020.

Exhibit 3: Availment of SDF, WMA and Overdraft (OD) by state governments/UTs (number of states/UTs)

	SDF	WMA	OD
FY2018	11	13	7
FY2019	11	14	10
FY2020 (till February 2020)	15	13	9

Source: RBI, ICRA research

Trends in utilization of the SDF, WMA and the OD: The number of states/UTs accessing the special drawing facility (SDF; refer Box 1) and/or the WMA facility have been limited to 11-15 during FY2018- FY2020 (till February 2020; refer Exhibit 3). Andhra Pradesh (AP), Goa, Jammu and Kashmir (J&K), Kerala, Manipur, Nagaland, Punjab, Telangana, Uttarakhand and West Bengal have frequently tapped this facility during this period. From among these states, AP, J&K, Kerala and Punjab accessed the WMA window in at least six out of the 12 months in both FY2019 and FY2020. Moreover, the average utilization level (expressed as a percentage of the WMA limit for that year) of J&K and Kerala worsened in FY2020 relative to FY2019, while that of AP and Punjab eased (refer Exhibit 4). Maharashtra, Rajasthan, Madhya Pradesh have accessed the SDF and/or the WMA facility only once or twice during FY2019-FY2020. States that did not tap the SDF and/or the WMA facility even once during FY2019-FY2020 include Assam, Bihar, Karnataka, Gujarat, Meghalaya, Odisha, Puducherry, TN and UP.

Exhibit 4: Average utilization of WMA as a proportion of the WMA limit

Note: WMA data for FY2020 is available only for 11 months

Source: RBI, ICRA research

Given the anticipated widespread liquidity tightness, the number of states availing WMA, as well as the extent of funding availed relative to the eligible level is likely to increase in FY2021 from the trend seen in the recent past. This will primarily be on account of the attractive rate of 4.4% (i.e. the prevailing Repo rate) that states will be required to pay on their WMA outstanding, in comparison to the SDL cut-off yields that would be determined in the weekly auctions, which are likely to be sharply higher. Specifically, we expect higher recourse to the WMA facility, by those states that have been relatively badly affected by the Covid-19 health crisis and those with a higher proportion of daily wagers or migrant workers, as such state governments' immediate spending requirement may rise fairly sharply, as well as those states which face a more acute dip in their revenues.

Box 1: WMA Scheme – some key points

The WMA is the financial accommodation provided by the RBI to those states, which bank with it (all states except Sikkim), through an agreement for meeting the temporary mismatch in their cash-flows. The rate of interest charged on the WMA is the applicable Repo rate (at present 4.4%) and states are generally encouraged to restrict WMA to a maximum of three months from the date of advance. In case the WMA outstanding continues for more than three months from the date of such advance, an interest rate equivalent to the prevailing Repo rate plus 100 bps is charged. The WMA limit for the state governments are revised by the RBI from time to time.

The RBI also provides an SDF to the state governments, which is a secured advance, the magnitude of which is linked to their respective investments in the GoI's dated securities, auction treasury bills and the incremental investments in the Consolidated Sinking Fund (CSF) and Guarantee Redemption Fund (GRF). The quantum of funds that can be accessed by the states under the SDF is subject to applicable haircut/valuation norms of the GoI securities. The rate of interest on the SDF is also linked to the Repo rate and was revised to 200 basis points below the Repo rate in June 2018, from 100 bps below the Repo rate previously.

An OD facility is extended by the RBI when the advances to the state government exceed their SDF and WMA limits. The interest rate on the same is 200 bps above the prevailing Repo rate. On April 7, 2020, the RBI increased the number of days for which a state government/UT can be in overdraft continuously (a) to 21 working days from 14 working days previously and (b) 50 working days in a quarter from 36 working days previously.



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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.



Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad - 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata - 700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com

Helpdesk: 9354738909

Website: www.icra.in/ www.icraresearch.in