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SDL issuance indicated at Rs. 2.1 trillion
for Q2 FY2023, YoY increase of 29%
following end of GST compensation
period

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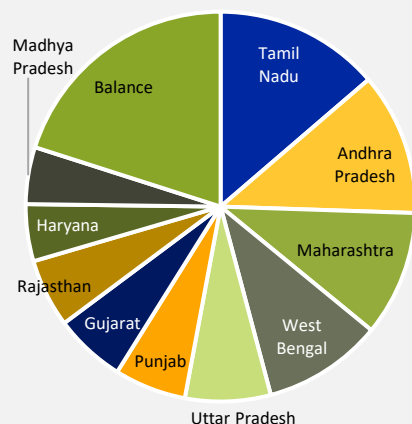


SUMMARY



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Exhibit: State-wise share in Q2 FY2023 indicative SDL issuance



The Reserve Bank of India (RBI) has pegged the gross State Development Loan (SDL) issuance at Rs. 2.1 trillion for Q2 FY2023, an eight quarter high growth of 28.7% relative to the Rs. 1.6 trillion raised in Q2 FY2022, following the end of the Goods and Services Tax (GST) compensation period of five years. On a sequential basis, the increase is even sharper; the indicated issuance for Q2 FY2023 is nearly twice as large as the Rs. 1.1 trillion actually raised in Q1 FY2023. The latter was, however, sharply lower than the amount indicated in the Q1 FY2023 auction calendar, on account of the delay in permission received by some states from the Government of India (GoI) following the requirement of adjustment of the off-budget borrowings from the net borrowing ceiling (NBC) of FY2023.

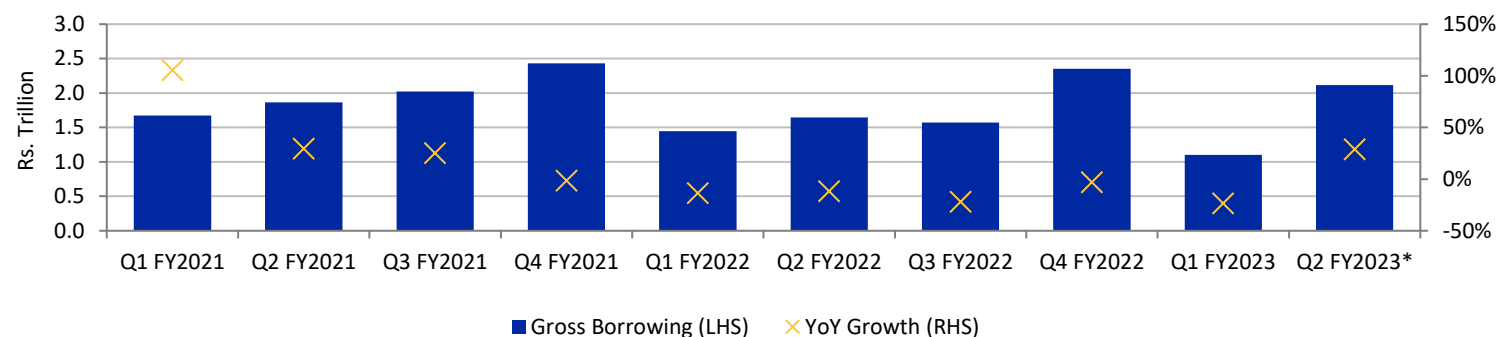
The comfortable cash flow position of the state governments is likely to have allowed them to temporarily withstand the changes related to their borrowing permission. Looking ahead, the actual SDL issuance could materially differ from the indicative calendar for Q2 FY2023 for those states whose borrowing permissions are not yet fully in place, and also, if the actual Central tax devolution differs from what the states have assumed while assessing their borrowing requirement for this quarter.

- SDL issuance for Q2 FY2023 indicated at Rs. 2.1 trillion:** 23 states and two Union Territories (UTs) have indicated borrowings of Rs. 2.1 trillion for Q2 FY2023, 28.7% higher than the amount raised in Q2 FY2022. This YoY increase is likely to partly reflect the concerns of some states related to their cash flows, following the end of the five-year GST compensation regime on June 30, 2022.
- Five states account for nearly half of indicated Q2 FY2023 borrowings:** The combined borrowing plans of Andhra Pradesh (AP; Rs. 250 billion), Maharashtra (Rs. 220 billion), Tamil Nadu (TN; Rs. 290 billion), West Bengal (WB; Rs. 210 billion) and Uttar Pradesh (UP; Rs. 150 billion) are set to account for more than half of the total indicated SDL issuances for Q2 FY2023. In contrast, Arunachal Pradesh, Karnataka, Jharkhand, Odisha and Tripura have not indicated their participation in the Q2 FY2023 auction calendar.
- Sharp increase in indicative borrowings on quarter-on-quarter basis:** The indicated supply of Rs. 2.1 trillion for Q2 FY2022 is nearly twice as large as the Rs. 1.1 trillion raised in Q1 FY2023. The latter was a substantial ~42% lower than what was indicated, which, seems to have been impacted by changes initiated by the GoI in determining the NBC of the state governments for FY2023. The highly back-ended release of the tax devolution to the states in FY2022 and release of the GST compensation grant in May 2022 are likely to have eased their cash flow position, and reduced their borrowing requirement in Q1 FY2023.
- Size of monthly tax devolution and pending borrowing permission to states to impact the size of issuance in Q2 FY2023:** We expect an upside of Rs. 1.1 trillion in the Central tax devolution in FY2023 over and above the Rs. 8.1 trillion budgeted by the GoI for FY2023. A step-up in the tax devolution in Q2 FY2023 from the amount released in Apr-May FY2022, may impact the size of the SDL issuances during this quarter. Moreover, the actual issuance of some states could differ from the amount indicated in Q2 FY2023 auction calendar, if there are further delays in receiving the full borrowing permission from the GoI.

GROSS SDL ISSUANCE IN Q2 FY2023 INDICATED AT Rs.2.1 TRILLION, 28.7% HIGHER ON A YOY BASIS

The indicative calendar of market borrowings by 23 state governments and two UTs for Q2 FY2023, released by the RBI on July 1, 2022, has pegged their total market borrowing at Rs. 2.1 trillion, 28.7% higher than the actual borrowing of Rs. 1.6 trillion in Q2 FY2022 (refer Exhibit 1). This eight-quarter high growth is likely to have been boosted by the concerns some states may have regarding their cash flows going forward, with the five-year GST compensation period having ended on June 30, 2022.

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



Note: * FY2023 based on Q2 indicative borrowing and YoY growth is over actual SDL issued in Q2 FY2022

Source: RBI; ICRA Research

Nearly 58% of the incremental gross borrowing of Rs. 471 billion in Q2 FY2023 relative to Q2 FY2022 is led by TN (Rs. 290 billion vs Rs. 150 billion), and AP (Rs. 250 billion vs Rs. 118 billion). Other states with a large YoY step-up in borrowings include Haryana, Punjab and Gujarat. Many of these states were large recipients of the GST compensation flows in Q1 FY2023. Notably, these five states accounted for more than a quarter of the total GST compensation of Rs. 869 billion released by the GoI in May 2022 (TN: Rs. 96 billion, Punjab: Rs. 59 billion, Gujarat: Rs. 34 billion, AP: Rs. 32 billion and Haryana: Rs. 13 billion). Most of these states have an above-average dependence on GST compensation within their overall revenue sources, based on data for FY2021.

In contrast, UP (Rs. 150 billion vs. 225 billion) and Telangana (Rs. 90 billion vs. Rs. 100 billion) have indicated a step-down in their issuances in Q2 FY2023 relative to Q2 FY2022.

We estimate the SDL redemptions to rise to Rs. 499 billion in Q2 FY2023 from Rs. 398 billion in Q2 FY2022. Accordingly, the net SDL issuance in Q2 FY2023 is assessed at Rs. 1.6 trillion, 29.7% higher than the net SDL issuance of Rs. 1.2 trillion in Q2 FY2022.

25 states/UT have indicated borrowings of Rs. 2.1 trillion for Q2 FY2023, 28.7% higher than Q2 FY2022, led by TN and AP

AP, MAHARASHTRA, TN, WB AND UP ACCOUNT FOR MORE THAN HALF OF THE INDICATED SDL ISSUANCE FOR Q2 FY2023

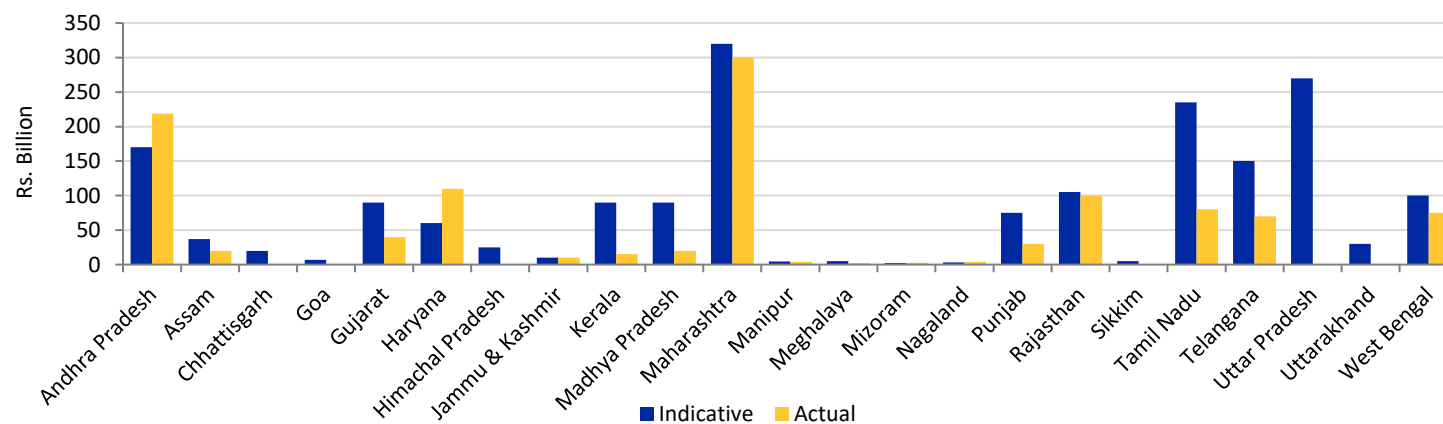
The indicative borrowing calendar has pegged the SDL issuance in July 2022 at Rs. 626 billion, or nearly 30% of the total indicated amount (Rs. 2.1 trillion) for Q2 FY2023, with the size of the weekly auctions varying from Rs. 103 billion to Rs. 240 billion. Subsequently, a considerable Rs. 816 billion or ~39% of the total SDL issuance in Q2 FY2023 is proposed to be issued in August 2022 in five weekly auctions, with a size ranging between Rs. 122 billion to Rs. 245 billion. Three weekly auctions in August 2022 will be held on non-Tuesdays. The balance Rs. 673 billion or ~32% of the SDL issuance indicated for Q2 FY2023 is expected to be issued in September 2022, with a weekly size ranging from Rs. 103 billion to Rs. 287 billion.

The indicated borrowings of AP (Rs. 250 billion), Maharashtra (Rs. 220 billion), TN (Rs. 290 billion), UP (Rs. 150 billion) and WB (Rs. 210 billion) account for more than half of the total indicated SDL issuance of Rs. 2.1 trillion by 25 states/UTs for Q2 FY2023. Arunachal Pradesh, Karnataka, Jharkhand, Odisha and Tripura have not indicated their participation in the Q2 FY2023 auction calendar.

INDICATED SDL ISSUANCE FOR Q2 FY2023 NEARLY TWICE AS LARGE AS ACTUAL ISSUANCE IN Q1 FY2023

The indicated issuance of Rs. 2.1 trillion for Q2 FY2022 is nearly twice as large as the Rs. 1.1 trillion raised by 18 states/UT in Q1 FY2023. However, the latter was a substantial ~42% lower than the Rs. 1.9 trillion that 23 states/UT had indicated they would borrow in the auction calendar released at the start of that quarter (refer Exhibit 2).

Exhibit 2: Gross indicated and actual SDL borrowings in Q1 FY2023



Source: RBI; ICRA Research

AP, Maharashtra, TN, WB and UP have indicated combined borrowing of Rs. 1.1 trillion in Q2 FY2023, nearly 53% of the total indicated borrowing

Actual issuance of Rs. 1.1 trillion in Q1 FY2023 was 42% lower than indicated

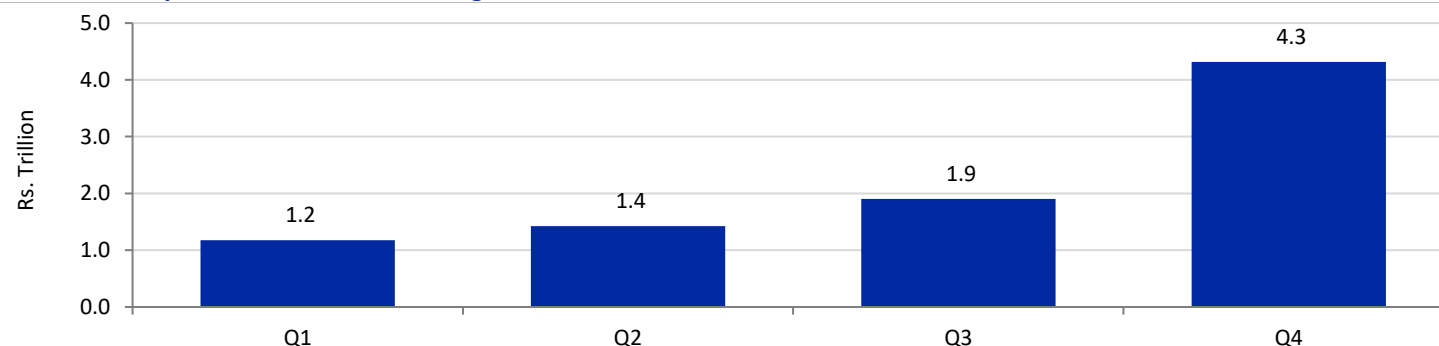
Adjustment in the NBC for FY2023 along with comfortable cash flow position of the state governments likely to have compressed SDL issuance by ~42%, relative to auction calendar for Q1 FY2023

Chhattisgarh (Rs. 20 billion), Himachal Pradesh (Rs. 25 billion), Sikkim (Rs. 5 billion), UP (Rs. 270 billion) and Uttarakhand (Rs. 30 billion) did not issue SDLs in Q1 FY2023 compared to the combined indicated borrowing of Rs. 350 billion included in the auction calendar for that. Moreover, 13 states issued Rs. 552 billion less SDLs in Q1 FY2023 compared to the indicated amount. This subset included Tamil Nadu (by Rs. 155 billion), Telangana (by Rs. 80 billion), Kerala (by Rs. 75 billion), Madhya Pradesh (by Rs. 70 billion), Gujarat (by Rs. 50 billion), Punjab (by Rs. 45 billion) etc. However, Andhra Pradesh (by Rs. 49 billion), Haryana (by Rs. 50 billion), Mizoram (by Rs. 0.3 billion) and Nagaland (by Rs. 1 billion) together issued Rs. 100 billion additional SDLs above the amount indicated in the Q1 FY2023 auction calendar, while Jammu and Kashmir's SDL issuance was in line with the indicated amount (Rs. 10 billion).

The sharp variation in the actual SDL issuance in Q1 FY2023, relative to the amount indicated in the auction calendar, seems to have been impacted by the changes initiated by the GoI in determining the NBC of the state governments for FY2023. At the time of communicating the annual borrowing permission for FY2023, the GoI had informed the state governments that their off-budget borrowings for FY2021 and FY2022 would be adjusted from their NBC for FY2023. It appears that the calculation of the adjusted the NBC for FY2023 entailed submission of detailed data by the state governments related to their off-budget borrowings for the last two fiscals and a subsequent thorough assessment of the same by the GoI. The absence of issuances by TN, Telangana, Gujarat and MP prior to May 31, 2022, suggests that these states may have received either their full or just an ad hoc borrowing permission, on a later date compared to AP, Maharashtra, Haryana, Punjab, which raised the SDLs in the first few weeks of Q1 FY2023.

In addition, the highly back-ended release of the tax devolution to the states in FY2022 (refer Exhibit 3) and release of the GST compensation grant for several months in one single tranche in May 2022 are likely to have eased the cash flow position of the states, reducing their Q1 FY2023 borrowings below the indicated amount, and allowing the states to withstand the changes related to the borrowing permission.

Exhibit 3: Quarterly tax devolution to all state governments in FY2022

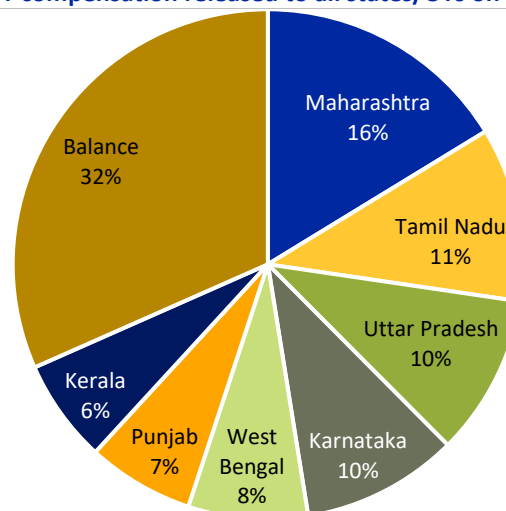


Source: RBI; ICRA Research

The GoI had released a substantial Rs. 8.8 trillion to the states in FY2022, compared to the Rs. 7.4 trillion included in the revised estimates for FY2022. Moreover, the pattern of tax devolution in FY2022 was highly back-ended with the aggregate transfer of Rs. 4.3 trillion to all states in Q4 FY2022, nearly as large as the Rs. 4.5 devolved during Apr-Dec FY2022. Within Q4 FY2022, following a lumpy release of Rs. 2.4 trillion to the states in February FY2022, the GoI released Rs. 951 billion towards end-March 2022. Possibly, the last instalment of tax devolution was released to the states after they had finalised and submitted their borrowing requirement for Q1 FY2023 to the RBI.

Additionally, the GoI had transferred Rs. 869 billion as GST compensation grants to the states/UTs on May 31, 2022 (refer Exhibit 4). This included Rs. 467 billion for the pending GST compensation till Jan 2022, Rs. 213 billion for Feb-March 2022 and Rs. 180 billion for Apr-May 2022. Accordingly, only the GST compensation for the month of June 2022 remained to be paid to the state governments. The release of GST compensation in May 2022 along with the large tax devolution in Q4 FY2022, is likely to have led to a comfortable cash flow position of the states, reducing the need for borrowings to fund their expenditures in Q1 FY2023.

Exhibit 4: State-wise share in total GST compensation released to all states/UTs on May 31, 2022



Source: RBI; ICRA Research

The five-year transition period after the introduction of the GST has ended on June 30, 2022. The discontinuation of the GST compensation flows would alter the revenue composition of some states adversely, particularly those with a relatively larger share of such receipts in their overall revenue streams. To offset a portion of the associated revenue loss, we expect such states to enhance their borrowings and/or to undertake some expenditure adjustments.

Seven states received nearly two-thirds of the total GST compensation released to all states/UTs on May 31, 2022

Net SDL issuance estimated in a range of Rs. 5.1-5.8 trillion in FY2023

Gross SDL estimated in a range of Rs. 7.4-8.2 trillion in FY2023

Other factors that could influence the actual SDL issuances in the ongoing quarter include the pattern of tax devolution in Q2 FY2023 and the status of the full-year borrowing permission for those states that had not received it from the GoI by end-June 2022. Five states had not issued SDLs in Q1 FY2023, despite having indicated they would in the auction calendar for that quarter; of these, UP is a relatively large borrower compared to the others (Uttarakhand, Sikkim, HP and Chhattisgarh). These five states have indicated a modest combined borrowing of Rs. 216 billion for Q2 FY2023. Bihar, which had not indicated it would borrow in Q1 FY2023, has now indicated it will issue Rs. 70 billion SDLs in Q2 FY2023. It is unclear if these six states have received the borrowing permission for FY2023 from the GoI. Moreover, we understand that some states only received an ad hoc borrowing permission in Q1 FY2023. The actual issuance of such states could differ from the amount indicated in the Q2 FY2023 auction calendar.

Moreover, we estimate the total tax devolution for FY2022 excluding the normal adjustment for FY2021 as well as a prior period adjustment for FY1997-18, at Rs. 8.2 trillion, similar to the estimate that the GoI had included in the Union Budget FY2023. **If tax devolution grows by 14%, similar to our forecast of nominal GDP growth (15%) then the states may be entitled to as much as Rs. 9.3 trillion in FY2023. This entails an upside of Rs. 1.1 trillion relative to the FY2023 BE.** During April and May 2022, the GoI had devolved Rs. 476 billion each to the states as aggregate tax devolution, which is equivalent to 5.8% each of the Rs. 8.1 trillion budgeted for FY2023. **If the GoI decides to step-up the tax devolution to the states in the coming months, it may alter the size of the SDL issuance from the amount indicated in the Q2 FY2023 auction calendar.**

ICRA ESTIMATES GROSS SDL ISSUANCE AT Rs. 7.4-8.2 TRILLION IN FY2023

Data on the off-budget borrowings of all states is not available, therefore the actual extent of downward adjustment in the NBC for FY2023 is difficult to assess at this point. Assuming gross SDL issuance in Q3 and Q4 FY2023 are similar to the issuance indicated for Q2 FY2023 (Scenario I), we estimate the gross SDL issuance at Rs. 7.4 trillion in FY2023, a moderate 6.2% higher than the Rs. 7.0 trillion in FY2022. Adjusting for the estimated redemptions of Rs. 2.4 trillion in FY2023, the net issuance is pegged at Rs. 5.1 trillion, 2.6% higher than Rs. 4.9 trillion net issuances in FY2022(refer Exhibit 5).

However, if actual issuance is around Rs. 2.5 trillion each in Q3 and Q4 FY2023 (Scenario II), the highest seen in any quarter till date, we estimate the gross issuance at Rs. 8.2 trillion in FY2023, 17.1% higher than Rs. 7.1 trillion issued in FY2022. Adjusting for the estimated SDL redemptions in FY2023, we peg the net SDL issuance at Rs. 5.8 trillion in FY2023, 18.2% higher than the Rs. 4.9 trillion seen in FY2022.

Exhibit 5: Net and gross SDL issuance estimate in FY2023

	FY2022	Q1 FY2023	Q2 FY2023	H2 FY2023		FY2023	
				Scenario I	Scenario II	Scenario I	Scenario II
Net SDL	4.9	0.6	1.6	2.8	3.6	5.1	5.8
Redemption	2.1	0.5	0.5	1.4	1.4	2.4	2.4
Gross SDL	7.0	1.1	2.1	4.2	5.0	7.4	8.2

Source: RBI; ICRA Research



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