# VII PUBLIC DEBT MANAGEMENT

*The expansionary counter-cyclical fiscal policy stance adopted by the Government, in the face of emerging ramifications of the global economic crisis for growth and aggregate demand, resulted in a sharp increase in both the borrowings of the Central and State Governments during 2008-09 over their respective budget estimates. The key challenge for the Reserve Bank in its debt management operations for 2008-09, therefore, was to manage this vastly expanded government market borrowing programme without creating any disruptive pressures on the government securities market. The Reserve Bank employed a combination of measures involving monetary easing and use of innovative debt management tools such as synchronising the Market Stabilisation Scheme (MSS) buyback auctions and open market purchases with the Government's normal market borrowings and de-sequestering of MSS balances. By appropriately timing the release of liquidity to the financial system to coincide with the auctions of government securities, the Reserve Bank ensured a relatively smooth conduct of the Governments' market borrowing programme, resulting in the decline in the cost of borrowings during 2008-09 for the first time in the last five years. Reflecting the continued need for fiscal stimulus in 2009-10, the combined net market borrowing programme of the Centre and the State Governments (dated securities and 364-day Treasury Bills) is estimated to be Rs.5,37,957 crore as against Rs.3,46,083 crore in 2008-09. This calls for continuance of the active debt management strategy by the Reserve Bank so as to mitigate pressures on interest rates and avert possible crowding-out of private sector demand for credit.*

VII.1 Management of large government borrowing programme in a manner supporting the expansionary counter-cyclical fiscal policy stance of the Government without creating any disruptive pressures on the government securities market was a key challenge for the Reserve Bank in 2008-09. To deal with the growth dampening moderation in private consumption and investment demand, some deviation from the fiscal consolidation path and introduction of adequate fiscal stimulus became essential, which concomitantly escalated the size of the borrowing programme significantly. In 2008-09, larger recourse to market borrowing and flight to safety were the common trends across countries around the world; while the cost of borrowings declined in general, reflecting the low policy interest rates and quantitative easing stance of the central banks, significant increase in risk aversion and resultant preference for government securities led to a larger demand for these securities.

VII.2 Recognising the challenge, the Reserve Bank had to continuously review and adapt its debt management strategy, in consultation with the Central Government, in response to the evolving economic conditions, while striving to ensure that the sharp and abrupt increase in the Government's market borrowing programme was conducted in a non-disruptive manner, without any conflict with its monetary management function. Higher government borrowings could potentially raise the interest rates in the system by pushing up yields on government securities, which entail the risk of conflicting with the low interest rate stance that may be pursued by the monetary authority in the face of an economic slowdown. During the second half of 2008-09, the Reserve Bank's policy stance aimed at increasing bank credit to the commercial sector at lower cost, reflecting the trends in policy rates to support the revival of economic growth; this objective had to be attained while managing a large Government borrowing programme. The Reserve Bank, therefore, employed a combination of measures involving easing of monetary conditions and use of innovative tools for debt management such as synchronising the Market Stabilisation Scheme (MSS) buyback auctions and open market purchases with Government's normal market borrowings and de-sequestering of MSS balances. The release of liquidity to the financial system by the Reserve Bank was timed appropriately to coincide with the auctions of government securities, ensuring the smooth conduct of the large market borrowing programme of the Government.

VII.3 The debt management operations of the Reserve Bank during 2008-09 are presented in this chapter in the context of specific policy issues. The fiscal year 2008-09 saw a sharp increase in the market borrowings of Central and State Governments on account of the fiscal stimulus measures undertaken by the Governments in the wake of the global economic slowdown and other additional expenditures such as the Agricultural Debt Waiver and Debt Relief Scheme, various rural development schemes and the revision in Central Government pay scales following the recommendations of the Sixth Pay Commission. Despite the sharp increase in the quantum of market borrowings, the debt management strategy continued to be guided by the prime objectives of minimisation of cost over time and determination of maturity profiles consistent with rollover risk. In the first half of the year, the debt management operations were undertaken in an environment of pre-emptive monetary tightening measures that aimed at containing the inflationary impulses in the economy. During the second half, however, while the monetary conditions eased significantly, in response to the softening of inflationary pressures coupled with economic slowdown, the frequency and amount of issuances by the Central and State Governments increased significantly.

VII.4 The gross market borrowing programme of the Central Government (dated securities and 364-day Treasury Bills) was about 181 per cent of the budget estimate for 2008-09 and the net borrowing, about 210 per cent of the budget estimates. During the first half of the year, the auctions for dated securities were broadly in accordance with the relevant issuance calendar. For the second half, though, three additional calendars were issued in supersession of the scheduled issuance calendar, which became necessary to meet the additional expenditure approved under supplementary demands for grants. The weighted average cost of market borrowings moved upwards up to August 2008 but decelerated subsequently, up to January 2009, largely reflecting the pattern in monetary policy rates. Due to higher than expected borrowing programme by both the Central and the State Governments, however, the weighted average cost of borrowings moderately increased thereafter. For the year as a whole, the weighted average yield was lower than in 2007-08.

VII.5 As in the previous two financial years, the entire market borrowing programme of the State Governments during 2008-09 was conducted through the auction route. The gross amount raised during 2008-09 was 74 per cent higher than that in the previous year as States were sanctioned additional allocations by the Centre to meet the shortfall in the National Small Savings Fund (NSSF) collections and to facilitate additional capital expenditure by the States as part of the fiscal stimulus measures. The weighted average yield on the State Development Loans (SDLs) decreased by 38 basis points during the year, although the weighted average spread over comparable Central Government securities was higher by 74 basis points, reflecting the increased size and bunching of issuances during the last quarter of the year, particularly during March 2009 when about 26.5 per cent of the total borrowings of the States were raised.

VII.6 The combined net market borrowings of the Central and the State Governments in 2008-09 were 209 per cent of their net borrowings during 2007-08. In addition, special securities (oil and fertiliser bonds) amounting to Rs.95,942 crore were issued by the Central Government outside the market borrowing programme for 2008-09.

## CENTRAL GOVERNMENT

### Market Borrowings

*Dated Securities*

VII.7 In line with global trends of increased Government spending as a response to counter economic slowdown, the Government of India announced three stimulus packages in 2008-09. Accordingly, the net market borrowing through dated securities was nearly twice the amount raised in 2007-08 and more than twice the budget estimate for 2008-09 (Table 7.1). The gross market borrowing through dated securities was 75 percent higher than during 2007-08 (6.8 per cent higher in 2007-08) (Appendix Table 58).

VII.8 The Reserve Bank continued with the policy of passive consolidation of dated securities during 2008-09. Barring four new securities, of which two were 10-year benchmark securities, the remaining securities issued during the year were reissuances (Appendix Table 59). In 2007-08, out of the securities issued during the year, only one was a new security. Over one quarter of the outstanding securities, each with a minimum outstanding amount of Rs.25,000 crore, accounted for 61 per cent of the total outstanding amount as at end-March 2009 as against 54 per cent at end-March 2008. In a year that encountered pressures on market liquidity, this trend provides an indication of potential liquidity in these securities.

VII.9 The aggregate amount raised during the first half of 2008-09 was Rs.1,06,000 crore, which was Rs.10,000 crore more than the amount indicated in the issuance calendar. The issuances were in accordance with the calendar for the first half of the year, except on two occasions. In the auction of July 24, 2008, a 10-year benchmark security was issued in place of a security with higher maturity in view of the uncertain market conditions. An auction of dated securities amounting to Rs.10,000 crore was advanced to September 26, 2008 from the second half of the year, keeping in view the emerging requirements of the Government, market conditions and other relevant factors. The auction schedule for the second half of 2008-09 (October-March) was revised due to the unprecedented developments in the global financial market and their impact on India in terms of the increased demand for liquidity as well as the substantial increase in Government borrowings. There were two cancellations of auctions scheduled for October 2008. While the auction scheduled for October 10, 2008 for dated securities amounting to Rs.10,000 crore was cancelled in view of the then prevailing tight liquidity conditions that emerged from the financial turmoil in the global markets, the auction scheduled for October 20, 2008 was cancelled in view of the cut in the repo rate that was announced on the same day. The proposed market borrowing of Rs.39,000 crore in the second half of the year was completed by end-November 2008 with the advancement of an auction scheduled for December 5-12, 2008. Due to the sharp increase in government spending and deceleration in tax revenues, the Reserve Bank, in consultation with the Central Government, issued three additional indicative calendars on December

**Table 7.1: Gross and Net Market Borrowings of the Central Government#**

(Rupees crore)

| Item | 2007-08 | 2008-09 | | | 2009-10 | |
|---|---|---|---|---|---|---|
| | Actual | Budget Estimates | Revised Estimates | Actual | Budget Estimates | Actual* |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| Gross borrowing | 1,88,205 | 1,76,453 | 3,42,769 | 3,18,550 ^ | 4,91,044 ^ | 2,63,302 ^ |
| Net Borrowing | 1,09,504 | 1,15,571 | 2,66,539 | 2,42,317 ^ | 3,97,957 ^ | 2,16,368 ^ |
| i. Dated Securities | 1,10,671 | 1,00,571 | 2,61,972 | 2,28,972 ^ | 3,97,957 ^ | 2,19,911 ^ |
| ii. 364-day Treasury Bills | -1,167 | 15,000 | 4,567 | 13,345 | - | -3,543 |
| *Memo* | | | | | | |
| i. Additional 182-day Treasury Bills | -76 | -1,000 | 19,390 | 10,995 | - | 200 |
| ii. Additional 91-day Treasury Bills | -431 | -1,571 | 43,720 | 45,224 | - | 951 |
| iii. MSS de-sequestering | - | - | - | 12,000 | 33,000 | 28,000 |

# : Dated securities and 364-day Treasury Bills. ^ : Includes MSS de-sequestering * : Up to August 17, 2009 .

5, 2008, January 6, 2009 and February 10, 2009 and accordingly, Rs.1,16,000 crore was raised between December 2008 and March 2009.

VII.10 The challenge posed to the debt management function needs to be viewed in the context of global developments whereby many countries, including advanced economies, announced fiscal stimulus packages to compensate for the fall in consumption and investment demand (Box VII.1). In India, specific strategic measures

**Box VII.1**
**Debt Management and the Global Financial Crisis**

The global financial crisis created large and unanticipated pressures on the fiscal position of many countries. While some countries had to support the financial sector directly or through operations giving rise to higher contingent liabilities, most countries had to expand fiscal expenditure to contain recessionary impulses.

While fiscal balances have been affected by the crisis in the short-run, the impact on government debt ratios will be felt over the medium term. The deterioration of the fiscal outlook raises issues of fiscal solvency and has the potential to trigger adverse market reactions. In turn, higher interest rates (and exchange rate depreciations in countries with significant borrowing in foreign currency, like most emerging economies) could further add to government debts which in some cases, result in 'snowballing' debt dynamics.

Market confidence in gilts issued by various Governments has been a source of stability and has, so far, helped to avoid a complete meltdown of financial markets, notwithstanding the hardening of credit default swap (CDS) premia for many Government issues, implying higher cost of insurance against default. Thus far, government debt market reaction to the weaker fiscal outlook has been relatively muted. Nevertheless, some of the Government bond auctions since January 2009 have witnessed pressures. UK, Germany and Netherlands could not mobilise the notified amount on some occasion/s whereas France, Italy, Austria and Portugal were forced to pay higher interest rates. On May 25, 2009, the UK DMO failed for the first time since 1995 to sell conventional government bonds in an auction, attracting bids of 1.63 billion pounds against the notified amount of 1.75 billion pounds of 2049 gilts. The Ministry of Finance, China also failed to sell, for the first time since 2003, one-year government bonds of yuan 28 bn in an auction held on July 7, 2009. On May 7, 2009, US Treasury yields soared by 20 basis points to 4.30 per cent after the 30-year bond auction saw poor demand. The rating outlook of sovereign borrowings for countries, such as Portugal, Spain, Greece and the UK was downgraded by credit rating agencies. An abrupt market reaction to weakening fundamentals remains a concern. Towards boosting nominal demand by increasing broad money, lowering gilt yields and improving corporate credit markets, the Bank of England has undertaken open market purchase of government bonds while the US Federal Reserve and the Bank of Japan have also carried out such open market purchases towards 'quantitative' easing. In the context of the on-going global financial crisis, Iceland has recently shifted debt management from the DMO to the central bank. For smooth conduct of large borrowing programme of the Governments, with minimal impact on the financial markets, closer co-ordination between the Treasury and the central bank, as is being practised in large countries like the US, Canada and India has assumed greater importance.

Deterioration in the fiscal position and increased government borrowings have raised the level of roll-over risk even for advanced economies. Many sovereign defaults have originated in the past, from situations of excessive short-term debt. It is, therefore, imperative for the debt management authorities to set an acceptable level of roll-over risk. If there is a high default risk premium built into longer term rates, shorter term debt may be cheaper but could increase risk by increasing the volatility of debt-servicing costs. Building up liquidity in longer benchmark maturities could help in reducing refinancing risk and also decrease risk premia over time, even if there are higher debt-servicing costs when this strategy is initially adopted.

In some countries, Government support to weak financial institutions has been extended as implicit or explicit guarantees or similar forms of contingent liability. A sharp increase in contingent liabilities introduces greater uncertainty to the fiscal position as it could complicate accurate estimation of the probability of devolvement. Debt managers need to not only reckon such contingent liabilities but also estimate probability of devolvement and consequent addition to public debt.

As the frequency and volume of public debt increases significantly, debt managers need to ensure transparency so that investors are not taken by surprise. Clarity in communication and adherence to the indicative borrowing programme would add credibility and thereby cushion volatility in market yields, which ultimately may help in contributing to lower cost of borrowing.

**References**

1. BIS Quarterly Review (2009)– Government debt management at low interest rates, June.
2. The IMF (2009) - The State of Public Finances: Outlook and Medium-Term Policies After the 2008 Crisis, March 6.
3. Standard and Poors (2009), United Kingdom Outlook Revised To Negative On Deteriorating Public Finances; 'AAA/A-1+' Ratings Affirmed, May 21.

were initiated to conduct the increased market borrowings in a non-disruptive manner. The Memorandum of Understanding (MoU) signed between the Government of India and the Reserve Bank in March 2004 on the Market Stabilisation Scheme (MSS) was amended on February 26, 2009, to enable the Reserve Bank to de-sequester MSS cash balance for financing the Government's approved expenditure in *lieu* of the approved market borrowings. Accordingly, it was decided to transfer an amount of Rs.45,000 crore in installments, as and when necessitated, from the MSS cash account to the regular cash account of the Government of India by March 31, 2009.[1] An equivalent amount of government securities was to form part of the normal borrowing of the Central Government. An amount of Rs.12,000 crore was, accordingly, transferred from the MSS cash account to the regular cash account of the Central Government on March 4, 2009. In view of its comfortable cash position, the Government of India, in consultation with the Reserve Bank, decided not to transfer the balance amount of Rs.33,000 crore in 2008-09. Based on the emerging funding requirements of the Government, an amount of Rs.28,000 crore was de-sequestered from the MSS cash account on May 2, 2009 against the approved market borrowing programme for 2009-10.

VII.11 During the first half of 2008-09, the weighted average yield increased from 8.14 per cent in April 2008 and peaked at 8.81 per cent in September 2008. The yields softened thereafter, reflecting the availability of liquidity in the system (Chart VII.1). The weighted average yield on dated securities issued during the year, therefore, decreased for the first time in the last five years in 2008-09. The weighted average coupon on the outstanding stock of dated securities as on March 31, 2009 also declined over the previous year. The weighted average maturity of the dated securities issued during the year was the lowest since 2003-04. As a result, the weighted average maturity of the outstanding stock as on March 31, 2009 decreased over the previous year (Table 7.2).

**Chart VII.1: Weighted Average Yield of Primary Issues of Dated Securities**


VII.12 The yield movement in the primary market was, in general, marginally higher than the secondary market yield (10-year bench-mark securities) (Table 7.3). As opposed to the variable price auctions normally used, during 2008-09, uniform price-based auctions for dated securities were held on July 24, August 8 and 22, 2008 and March 26, 2009, in view of the uncertain market conditions. Overall, the weak market sentiments subsequent to the announcement of additional market borrowings, were reflected in higher devolvement on primary dealers (PDs) during the year (Rs.10,773 crore) than in 2007-08 (Rs.957 crore).

VII.13 The maturity pattern of outstanding Government of India securities (excluding MSS) shows that two-thirds of the securities (face value) had residual maturity of less than 10 years, while 15.6 per cent of the securities had a residual maturity of more than 20 years as at end-March 2009

[1] Under MSS cash account, the funds are unavailable to the Government for its expenditure and the same is impounded by the Reserve Bank for the purpose of liquidity management. Under the regular cash account, however, the funds are available to the Government to finance its expenditure needs.

**Table 7.2: Central Government's Market Loans - A Profile***

(Yield in per cent / Maturity in years)

| Year | Range of YTMs at Primary Issues | | | Issues during the year | | | Outstanding Stock | |
|---|---|---|---|---|---|---|---|---|
| | under 5 years | 5-10 years | Over 10 years | Weighted Average Yield | Range of Maturities | Weighted Average Maturity | Weighted Average Maturity | Weighted Average Coupon |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| 2003-04 | 4.69 | 4.62-5.73 | 5.18-6.35 | 5.71 | 4-30 | 14.94 | 9.78 | 9.30 |
| 2004-05 | 5.90 | 5.53-7.20 | 4.49-8.24 | 6.11 | 5.30 | 14.13 | 9.63 | 8.79 |
| 2005-06 | - | 6.70-7.06 | 6.91-7.79 | 7.34 | 5-30 | 16.90 | 9.92 | 8.75 |
| 2006-07 | 7.69-7.94 | 7.06-8.29 | 7.43-8.75 | 7.89 | 4-30 | 14.72 | 9.97 | 8.55 |
| 2007-08 | - | 7.55-8.44 | 7.62-8.64 | 8.12 | 6-29 | 14.90 | 10.59 | 8.50 |
| 2008-09 | 6.24-6.77 | 5.44-9.14 | 6.53-10.03 | 7.69 | 4-30 | 13.81 | 10.45 | 8.23 |

*: Excludes issuances under MSS; YTM: Yield to Maturity; - : No Issues

(Table 7.4). During 2008-09, 61 per cent of the market borrowings was raised through issuances of dated securities having residual maturity of up to 10 years, the same as in 2007-08. However, while the predominant share of market borrowings belonged to the 5-10 year maturity bucket, 6 per cent of the securities issued during 2008-09 had residual maturities less than 5 years, unlike the previous year when no security of less than 5-year maturity was issued.

VII.14 The sharp increase in the financing requirements of the Government, some of which were not provided for in the Budget for 2008-09, gave rise to market strains in terms of rising yields. As the size and frequency of borrowings increased, the Reserve Bank's efforts were aimed at ensuring that the borrowing programme was completed in a non-disruptive manner. The sharp increase in the size and frequency of borrowings raised apprehensions about the ability of the market to absorb the borrowing programme and whether the issue of private placements with the Reserve Bank should be revisited. In India, the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, precludes the Reserve Bank from subscribing to the primary issuances of Central Government, barring under exceptional circumstances. Cross-country practices indicate that while in some countries the constraint on Central Government's

**Table 7.3: Primary Cut-Off Yield and Prevailing Secondary Market Yield**
(10-year benchmark securities)

| Date of Auction | Residual Maturity (Years) | Gross Amount Raised (Rs. Crore) | Cut-off Yield (%) | Prevailing Secondary Market Yield (%) | Spread (basis points) (4-5) | Bid- Cover Ratio |
|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| April 21, 08 | 10.00 | 6,000 | 8.24 | 8.23 | 1 | 3.49 |
| May 23, 08 | 9.91 | 6,000 | 8.07 | 8.13 | -6 | 3.16 |
| June 6, 08 | 9.87 | 6,000 | 8.26 | 8.26 | 0 | 3.13 |
| July 4, 08 | 9.79 | 6,000 | 9.13 | 8.92 | 21 | 2.03 |
| August 8, 08 | 9.70 | 6,000 | 9.14 | 9.10 | 4 | 2.50 |
| September 12, 08 | 9.60 | 5,000 | 8.30 | 8.27 | 3 | 2.11 |
| November 7, 08 | 9.45 | 6,000 | 7.73 | 7.71 | 2 | 2.62 |
| January 16, 09 | 9.26 | 3,000 | 5.44 | 5.71 | -27 | 2.30 |
| January 30, 09 | 10.00 | 4,000 | 6.05 | 6.18 | -13 | 4.51 |
| February 13, 09 | 9.96 | 6,000 | 5.94 | 5.89 | 5 | 3.48 |
| March 6, 09 | 9.90 | 8,000 | 6.50 | 6.30 | 20 | 1.72 |
| March 20, 09 | 9.86 | 6,000 | 6.59 | 6.51 | 8 | 2.36 |
| March 26, 09 | 9.84 | 7,000 | 6.97 | 6.97 | 0 | 1.79 |

**Table 7.4: Maturity Profile of Central Government Dated Securities***

(per cent)

| Year | Issued during the year | | | Outstanding Stock # | | |
|---|---|---|---|---|---|---|
| | Under 5 Years | 5-10 Years | Over 10 Years | Under 5 Years | 5-10 Years | Over 10 Years |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 2004-05 | 11 | 11 | 78 | 25 | 31 | 44 |
| 2005-06 | 0 | 26 | 74 | 25 | 32 | 43 |
| 2006-07 | 7 | 47 | 46 | 26 | 35 | 39 |
| 2007-08 | 0 | 61 | 39 | 26 | 38 | 36 |
| 2008-09 | 6 | 55 | 39 | 26 | 40 | 34 |

* : Excludes issuances under MSS. # : As at end-March.

access to central bank credit is binding, in some others it is weak (Box VII. 2).

*Market Borrowings during 2009-10*

VII.15 The gross and net market borrowings of the Central Government through dated securities for 2009-10 are budgeted higher, at Rs.4,51,093 crore and Rs.3,97,957 crore, respectively, than the actual amount raised in 2008-09. On March 26, 2009, the issuance calendar for dated securities for the first half of 2009-10 (April-September) was released in consultation with the Central Government. Accordingly, an amount of Rs.2,41,000 crore was scheduled to be raised as compared with Rs.1,06,000 crore raised during the corresponding period of the previous year. Following the revision in the market borrowing requirement as per the Union Budget, 2009-10, a new issuance calendar for dated securities was released on July 16, 2009 for mobilization of Rs. 1,10,000 crore during July 18, 2009 through September 30, 2009 (as against Rs. 79,000 crore as per the earlier calendar issued on March 26, 2009).

VII.16 During 2009-10 so far (up to August 17, 2009), the Central Government raised Rs.2,25,000 crore on gross basis (excluding MSS de-sequestering of Rs.28,000 crore) and the net market borrowings amounted to Rs 1,91,911 crore, through dated securities under the market borrowing programme. Market borrowing through dated securities was higher than that indicated in the calendar on account of increased requirement of the Government. The monthly amount raised increased from Rs.48,000 crore in April 2009 to Rs.60,000 crore in June 2009 before declining to Rs.39,000 crore in July 2009. The weighted average yield of dated securities issued during 2009-10 (up to August 17, 2009) declined to 6.96 per cent from 8.72 per cent in the corresponding quarter of the previous year. The weighted average maturity of securities issued was lower at 10.92 years as compared with 15.21 years in the corresponding period of the previous year.

**Treasury Bills**

VII.17 The notified amounts of 91-day,182-day and 364-day Treasury Bills under the normal market borrowing programme as per the annual issuance calendar released on March 24, 2008, were kept unchanged at Rs.500 crore (weekly auction), Rs.500 crore (fortnightly auction) and Rs.1,000 crore (fortnightly auction), respectively, for 2008-09. Additional Treasury Bills over and above the notified amounts were, however, raised during 2008-09, which were nearly seven times those raised during 2007-08 (Appendix Table 60). The additional Treasury Bills issuances were spread throughout the year unlike in 2007-08 when they were concentrated in the month of June to enable the Government to acquire the Reserve Bank's stake in State Bank of India in 2007. During 2008-09, while initially the additional resources raised through Treasury Bills were meant to partly meet the expenditure on agricultural debt waiver scheme,

**Box VII.2**
**Private Placement of Sovereign Debt with the Central Banks – Cross-country Practices**

The extent of accommodation of fiscal deficit by the central bank is often seen as an indicator of the nature of co-ordination between monetary and fiscal authorities. The monetisation of fiscal deficit through devolvement in auctions or private placement entails the risk of subordinating monetary policy to the fiscal policy, which, in turn, could engender inflationary expectations. Since inflation expectations play a key role in determining actual inflation, central banks aim at entrenching their credibility so that inflation expectations could be stabilised at lower levels. Prohibition of central bank credit to the Government is one of the instruments for achieving this credibility. The sanctity of prohibition on central bank credit to the Government usually stems from frameworks based on clear mandate/fiscal rule as enshrined in fiscal responsibility legislation or central bank Act. Countries with binding constraints on Government's access to central bank credit include the US, the UK, the Euro zone, Mexico, Peru and Argentina. Countries with weak constraints or flexible legislation include Canada, Chile, Japan, Korea, Malaysia and South Africa permitting central bank purchases of Government securities from the primary market as detailed below.

***Canada***: The Bank of Canada Act, 1934 permits the central bank to make loans to the Government of Canada or the Government of a province, within stipulated limits.

***Chile***: The Basic Constitutional Act of the Central Bank of Chile prohibits the Central Bank from directly purchasing securities from the Government. However, in the event of foreign war or threat of foreign war, to be qualified by the Council on National Security by means of a secret resolution, the Bank may obtain, confer or finance credits to the state and to public or private entities.

***Japan***: The Public Finance Law, 1947 explicitly prohibits the Bank of Japan from directly participating in the primary issuance of public bonds and from underwriting the issue. However, the prohibition is relaxed for some special reasons and the DIET (the Japanese Parliament) may allow private placement within the approved limits.

***Korea***: Korean Central Bank is permitted by the Bank of Korea Act, 1950 to subscribe to the Government Bond issues and also to the bonds guaranteed by the Government.

***Malaysia***: Bank Negara Malaysia is permitted by the Central Bank of Malaysia Act, 1958 to invest in Central Government securities and also to underwrite the same.

***South Africa***: South African Central Bank is prohibited from holding government securities directly purchased from the Treasury, beyond certain limits stipulated by the South African Reserve Bank Act of 1989.

In the Indian context, the Reserve Bank of India Act, 1934 authorises the Bank to grant advances repayable not later than three months from the date of advance, thereby enabling the Government to bridge the temporary mismatches in its receipts and expenditures. These provisions are, however, enabling and are not mandatory. In practice, this became a permanent source of financing the Government budget deficit through automatic creation of *ad hoc* Treasury Bills (with a tenor of 91 days) whenever Government's balances with the Reserve Bank fell below the minimum stipulations. Monetisation of deficit was not restricted to the amount issued through the *ad hoc* Treasury Bills but also by way of subscription to primary issuances of Government securities. In September 1994, the Reserve Bank and the Central Government signed a landmark agreement to phase out automatic monetisation through *ad hoc* Treasury Bills. Effective April 1997, with the phasing out of *ad hoc* Treasury Bills, the scheme of Ways and Means Advances (WMA) was introduced which provides temporary accommodation to the Government (up to 90 days) and is subject to limits. The Fiscal Responsibility and Budget Management (FRBM) Act 2003 which was subsequently enacted has since prohibited direct borrowings by the Centre from the Reserve Bank with effect from April 2006 except by way of WMA or under exceptional circumstances. Till date, the proviso in the FRBM Act 2003 permitting borrowings from the central bank under exceptional circumstances has not been invoked.

**Source:** Websites of respective central banks.

subsequently, in view of the large increase in the gross fiscal deficit (GFD) which could not be entirely funded by issuances of dated securities, Treasury Bills also served as an instrument of financing GFD. Reflecting the disinvestment by States in the non-competitive segment of the auction treasury bills, the net issuances of Treasury Bills during 2008-09 amounted to Rs.69,564 crore, contributing to financing 21.3 per cent of GFD (as per the revised estimates) as against a negative contribution of 1.8 per cent to GFD financing in 2007-08 (Appendix Table 61).

VII.18 The primary market yields of Treasury Bills across all maturities hardened up to August 2008 and softened, thereafter, reflecting the interest rate cycle coupled with improvement in liquidity conditions from October 2008 (Table 7.5 and

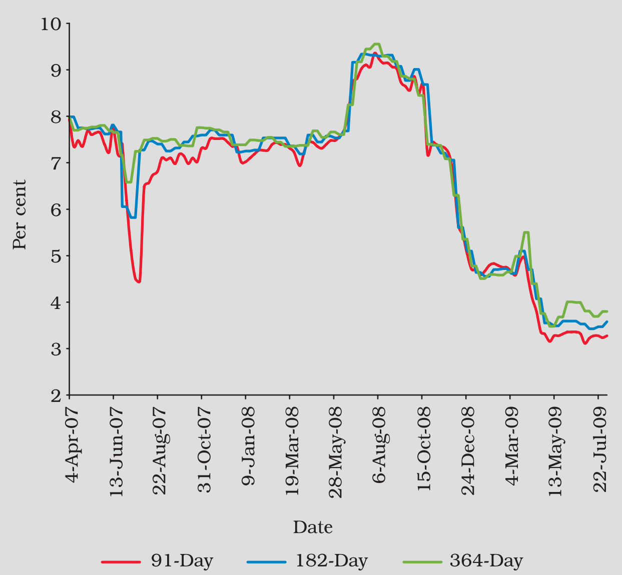
**Table 7.5: Treasury Bills in the Primary Market**

| Year / Month | Notified Amount * (Rs. Crore) | Average Implicit Yield at Minimum Cut-off Price (Per cent) | | | Average Bid-Cover Ratio | | |
|---|---|---|---|---|---|---|---|
| | | 91-day | 182-day | 364-day | 91-day | 182-day | 364-day |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| **2008-09** | 2,99,000@ | 7.10 | 7.22 | 7.15 | 3.43 | 2.91 | 3.47 |
| April | 26,000 | 7.28 | 7.41 | 7.53 | 2.64 | 3.17 | 2.36 |
| May | 17,000 | 7.41 | 7.55 | 7.61 | 2.92 | 2.73 | 3.43 |
| June | 11,500 | 8.01 | 8.42 | 7.93 | 2.45 | 2.76 | 2.80 |
| July | 21,000 | 9.07 | 9.33 | 9.39 | 2.84 | 2.72 | 3.52 |
| August | 18,500 | 9.15 | 9.31 | 9.24 | 2.99 | 2.86 | 4.24 |
| September | 25,000 | 8.74 | 8.92 | 8.83 | 3.06 | 3.04 | 3.57 |
| October | 35,000 | 8.13 | 8.36 | 7.92 | 1.95 | 2.42 | 4.00 |
| November | 28,000 | 7.30 | 7.13 | 7.23 | 2.40 | 2.97 | 3.51 |
| December | 18,000 | 5.49 | 5.35 | 5.47 | 7.01 | 4.67 | 5.59 |
| January | 37,000 | 4.69 | 4.60 | 4.55 | 2.30 | 3.22 | 3.54 |
| February | 32,000 | 4.78 | 4.71 | 4.62 | 2.81 | 1.86 | 2.62 |
| March | 30,000 | 4.77 | 4.86 | 5.25 | 2.60 | 2.67 | 1.44 |
| **2009-10** | | | | | | | |
| April | 39,000 | 3.81 | 4.11 | 4.07 | 3.22 | 2.79 | 5.07 |
| May | 29,000 | 3.26 | 3.54 | 3.58 | 3.18 | 2.25 | 3.14 |
| June | 22,500 | 3.35 | 3.56 | 3.99 | 3.37 | 5.65 | 2.86 |
| July | 40,000 | 3.23 | 3.45 | 3.76 | 3.92 | 2.86 | 3.90 |

@ : Total for the financial year.
* : Excludes issuances under MSS.

Chart VII.2). During March 2009, however, the yields hardened from their levels in January and February 2009 due to increased market borrowings

**Chart VII.2: Primary Market Yields of Treasury Bills**




by both the Central and the State Governments and quarterly advance tax outflows.

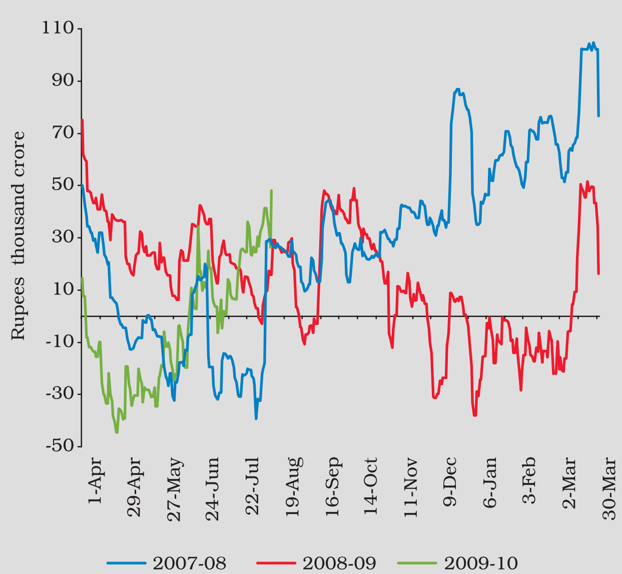
VII.19 The calendar for the regular auction of Treasury Bills for 2009-10 was announced on March 31, 2009. It was decided to rollover the Treasury Bills which were issued for enhanced amounts in the fiscal year 2008-09 and were due for redemption in the first quarter of 2009-10. Accordingly, the issuance of 91-day Treasury Bills for the first quarter was raised to Rs.8,000 crore for five weekly auctions since April 10, 2009, which was revised downward to Rs.5,000 crore for the remaining weekly auctions during the first quarter except for June 5, 2009 where the notified amount was fixed at Rs.4,500 crore. On July 16, 2009, it was decided to rollover the maturing amount of Treasury Bills till September 30, 2009. Accordingly, Treasury Bills amounting to Rs.1,27,000 crore, Rs.14,375 crore and Rs.10,302 crore were issued in respect of 91-day, 182-day and 364-day Treasury Bills up to August 17, 2009.

## Cash Management

VII.20 The limits for Ways and Means Advances (WMA) for 2008-09 were initially fixed at Rs.20,000 crore for the first half of the year (April to September) and Rs.6,000 crore for the second half (October to March) in consultation with the Government of India. In view of the unanticipated mismatches between Government receipts and payments arising from the cancellation of two auctions scheduled for October 2008 due to the then prevailing liquidity conditions, and the bunching of the expenditure following the approval of supplementary demand for grants, the limit for the third quarter (October-December) was retained at the first half limit of Rs.20,000 crore, while that for the fourth quarter was kept at the original limit of Rs.6,000 crore.

VII.21 As the Central Government started the year 2008-09 with a large surplus cash balance of Rs.76,686 crore, which was built up primarily from the State Governments' surplus balances invested in Treasury Bills, its recourse to WMA was limited to brief spells during the first half of 2008-09, *viz.,* during August 4-6, 2008 and again during September 2-14, 2008 (Chart VII.3). During the third quarter of 2008-09, following the unfolding ramifications of the global financial crisis, the Central Government announced fiscal stimulus packages even as revenue receipts, as estimated in the Budget did not materialise due to the sluggishness in tax revenues. Consequently, the Central Government had to resort to WMA for 23 days and was in overdraft (OD) for 10 days during the third quarter. With the cash flow mismatches persisting during the fourth quarter, the Central Government resorted to WMA for 70 days and was in OD for 55 days. Thus, for the year as a whole, the Central Government was in cash deficit for 109 days (65 days in OD) as against 91 days (37 days in OD) during 2007-08. The daily average utilisation of WMA and OD by the Central Government during 2008-09 were at Rs.2,077 crore and Rs.1,823 crore, respectively, as compared with Rs.3,605 crore and Rs.647 crore, respectively, during 2007-08. Unlike the previous years, the Government was in cash deficit mostly during the second half of the year. Consequently, the cash surplus, which generally remained high in recent years, was at a lower level of Rs.16,319 crore as on March 31, 2009.

**Chart VII.3: Cash Balances of the Central Government**




VII.22 The WMA limit for the first half of 2009-10 was kept unchanged at Rs.20,000 crore, as in the previous year while the limit for the second half was fixed higher at Rs.10,000 crore. The Central Government started the year 2009-10 with a modest surplus cash balance of Rs.16,319 crore, and soon took recourse to WMA on April 4, 2009 due to its expenditure commitments. Having reached the WMA ceiling of Rs.20,000 crore on April 15, 2009, it went into OD. The Central Government continued to be in WMA up to June 15, 2009 and was also on OD on three occasions during the year so far. The cash balances turned positive thereafter on account of the quarterly advance tax inflows and stood at Rs.33,918 crore as on August 11, 2009. The surplus transfer from the Reserve Bank amounting to Rs 25,009 crore on August 13, 2009 boosted the Government's cash balance to Rs. 48,071 crore as on August 13, 2009. The Centre, however, availed WMA during July 6-9, 2009.

**Special Securities issued by the Central Government**

VII.23 In addition to dated securities, the Central Government issued special securities aggregating to Rs.95,942 crore to oil marketing companies and fertiliser companies during 2008-09, as compared with Rs.38,050 crore during 2007-08. With a view to compensating oil marketing companies towards estimated under-recoveries on account of sale of petroleum products at administered prices, the Central Government issued four special securities to three oil marketing companies for an aggregate amount of Rs.75,942 crore: Rs.22,000 crore (15-year maturity) on November 10, 2008, Rs.22,000 crore (16-year maturity) on December 23, 2008, Rs.21,942 crore (17-year maturity) on February 4, 2009 and Rs.10,000 crore (17-year maturity) on March 23, 2009. During 2008-09, the Central Government issued three special securities of 14-year maturity, each, aggregating to Rs.20,000 crore to fertiliser companies as compensation towards fertiliser subsidy during 2008-09: Rs.10,000 crore on December 10, 2008, Rs.4,000 crore on December 24, 2008 and Rs.6,000 crore on January 29, 2009.

## STATE GOVERNMENTS

**Market Borrowings**

VII.24 The net allocation under the market borrowing programme of State Governments inclusive of additional allocations for shortfall in National Small Savings Fund (NSSF) collections and towards the second stimulus package for 2008-09 was about two-thirds higher than that in 2007-08. Taking into account the repayments, the gross allocation amounted to Rs.1,29,081 crore during 2008-09, of which 91.5 per cent was actually raised by the State Governments during the year (Table 7.6, Appendix Table 62). The entire amount was raised through the auction route during 2008-09 as in the previous year. Two States (*viz.*, Chhattisgarh and Orissa) did not participate in the market borrowing programme during 2008-09 as against four States (*viz.*, Chhattisgarh, Haryana, Orissa and Tripura) during 2007-08. Besides, 13 States did not raise their full allocations as against 11 States during 2007-08.

**Table 7.6 : Annual Market Borrowings of State Governments #**

(Rupees crore)

| Item | 2007-08 | 2008-09 |
|---|---|---|
| 1 | 2 | 3 |
| 1. Net Allocation | 28,781 | 51,719 |
| 2. Additional Allocation | 4,454 | 14,326 |
| 3. Additional Allocation on account of NSSF shortfall | 35,780 | 19,768 |
| 4. Additional Allocation towards second stimulus package | - | 28,896 |
| 5. Total Net Allocation (1+2+3+4) | 69,015 | 1,14,709 |
| 6. Repayments | 11,555* | 14,371 |
| 7. Gross Allocation (5+6) | 80,570 | 1,29,081 |
| 8. Total Amount Raised | 67,779 | 1,18,138 |
| 9. Net Amount Raised (8-6) | 56,224 | 1,03,766 |
| 10. Outstanding State Development Loans (end-period) | 2,98,845 | 4,02,611 |

# : Includes the Union Territory of Puducherry.
* : Excludes Rs.156 crore of buy-back of securities by the Government of Orissa.

VII.25 During 2008-09, 27 State Governments/UT (i.e., except Chhattisgarh and Orissa) accessed the market in 23 tranches as compared with 25 States/ UT through 18 tranches during 2007-08. Almost all the States accessed the market during the second half of the year raising 86.6 per cent of the total borrowings during the year, the bulk of which was in the fourth quarter. In March 2009 alone, more than a quarter of the total borrowings was raised, which exerted pressure on the market. As a result, the net supply of State Development Loan (SDL) securities in the market increased from Rs.8,472 crore during the first half of 2008-09 to Rs.95,294 crore during the second half. The bunching of SDLs of the States/UT during the last quarter was mainly due to the Government of India's sanctions under Article 293(3) towards NSSF shortfalls and the second stimulus package sanctioned during the quarter. All the issues during 2008-09 were of 10-year maturity.

VII.26 Reflecting the softer interest rate environment since the second half of the year, the weighted average yield of State Government

**Table 7.7: Yield on State Government Securities**

(Per cent)

| Year | Range | Weighted Average |
|---|---|---|
| 1 | 2 | 3 |
| 1997-98 | 12.30-13.05 | 12.82 |
| 1998-99 | 12.15-12.50 | 12.35 |
| 1999-00 | 11.00-12.25 | 11.89 |
| 2000-01 | 10.50-12.00 | 10.99 |
| 2001-02 | 7.80-10.53 | 9.2 |
| 2002-03 | 6.60-8.00 | 7.49 |
| 2003-04 | 5.78-6.40 | 6.13 |
| 2004-05 | 5.60-7.36 | 6.45 |
| 2005-06 | 7.32-7.85 | 7.63 |
| 2006-07 | 7.65-8.66 | 8.10 |
| 2007-08 | 7.84-8.90 | 8.25 |
| 2008-09 | 5.80-9.90 | 7.87 |

securities issued during 2008-09 was lower than the previous year despite the significantly larger market borrowings (Table 7.7). The average range of cut-off yield during 2008-09, however, was considerably wide due to large intra-year variations. The cut-off yield increased gradually and peaked in July 2008 before declining till January 2009 due to easy liquidity conditions in the market. The cut-off yield moved up, thereafter, in February and March 2009 (Table 7.8). The spread in the auction of the SDLs over the corresponding Central Government securities of 10-year tenor was widely dispersed, reflecting the investor response to the sheer size of the borrowings and the concentration of the issuances of securities in the second half of the year. The spread between the weighted average yield of SDLs and that of the Central Government 10-year security narrowed in the auction held on September 25, 2008 but widened significantly thereafter, up to December 2008. The spread declined briefly in January 2009 but reached its maximum in the auction held on March 9, 2009 (Chart VII.4). Following the monetary easing, the yield curve shifted downwards and the spread over Central Government yield declined in the last auction held on March 24, 2009. The weighted

**Table 7.8: Month-wise Market Borrowings of State Governments**

| Month/ Date | No. of States /U.T. | No. of Tranches | Amount (Rupees crore) | Cut-off Yield (Percent) | Spread over Central Government Dated Security (Basis points) |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| **2008-09** | | | | | |
| 1. April | 4 | 1 | 2,648 | 8.50-8.60 | 35-45 |
| 2. May | 5 | 1 | 3,264 | 8.39-8.68 | 30-59 |
| 3. June | 3 | 1 | 2,300 | 9.38-9.59 | 77-98 |
| 4. July | 4 | 2 | 2,600 | 9.81-9.90 | 48-52 |
| 5. August | 3 | 1 | 2,060 | 9.30-9.44 | 34-48 |
| 6. September | 5 | 2 | 3,012 | 8.80-8.88 | 21-34 |
| 7. October | 8 | 2 | 6,312 | 7.97-8.89 | 41-85 |
| 8. November | 12 | 2 | 8,445 | 7.77-8.54 | 51-84 |
| 9. December | 13 | 2 | 10,705 | 6.34-7.10 | 43-80 |
| 10. January | 15 | 3 | 18,498 | 5.80-7.13 | 58-120 |
| 11. February | 19 | 3 | 26,935 | 7.24-7.98 | 132-196 |
| 12. March | 24 | 3 | 31,358 | 8.08-8.89 | 136-236 |
| **Total** | | **23** | **1,18,138** | **5.80- 9.90** | **21-236** |
| **2009-10** | | | | | |
| 1. April | 7 | 3 | 7,316 | 7.04-7.77 | 83-115 |
| 2. May | 5 | 2 | 7,000 | 7.10-7.53 | 77-100 |
| 3. June | 10 | 1 | 5,950 | 7.80-7.89 | 81-90 |
| 4. July | 9 | 3 | 12,300 | 7.76-7.97 | 85-96 |
| 5. August* | 6 | 1 | 7,474 | 7.95-8.03 | 95-103 |

* : Up to August 17, 2009 . U T: Union Territory of Puducherry.

**Table 7.9 : Weighted Average Spreads during 2008-09**

| Weighted Average Spread (Basis Points) | General Category States/UTs | Special Category States |
|---|---|---|
| 1 | 2 | 3 |
| up to 50 | – | Sikkim |
| 51-100 | Kerala, Punjab and West Bengal | Manipur and Uttarakhand |
| 101-150 | Andhra Pradesh, Goa, Gujarat, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and Puducherry | Himachal Pradesh, Jammu & Kashmir, Meghalaya, Mizoram and Nagaland |
| 151-200 | Bihar, Haryana, Jharkhand, Karnataka | Arunachal Pradesh and Tripura |
| above 200 | – | Assam |

average spread was lower at below 50 basis points for Sikkim and over 200 basis points for Assam (Appendix Table 63). The spread was between 100-150 basis points in respect of 14 States during the year (Table 7.9). The differential in spread is observed to be a function, among others, of the liquidity conditions in the market, supply of securities, the timing of the borrowing and the market perceptions of fiscal conditions.

VII.27 Some State Governments accessed the market very frequently during the year. West Bengal accessed the market as many as eleven times, followed by Andhra Pradesh, Kerala and Tamil Nadu, on ten occasions. Arunachal Pradesh, Sikkim and Tripura raised their loans on one occasion only (Table 7.10 and Appendix Table 64). In all, 141 new securities were issued by all the States taken together during 2008-09 for a gross amount of Rs.1,18,138 crore averaging Rs.838 crore per issue. The corresponding average issue size stood at Rs.565 crore during the previous year. The increase in the average issue size of State Governments securities during 2008-09 was mainly on account of the additional allocation compensating for the NSSF shortfall and for meeting the fiscal stimulus package.

VII.28 At end-March 2009, about 71 per cent of the total outstanding debt of State Governments was in the maturity bucket of 6-10 years as compared with 68.1 per cent at end-March 2008. The share of loans in the maturity bucket of 6-10

**Chart VII.4: Weighted Average Yield on SDLs and Yield to Maturity (YTM) on 10-year Central Government Security**

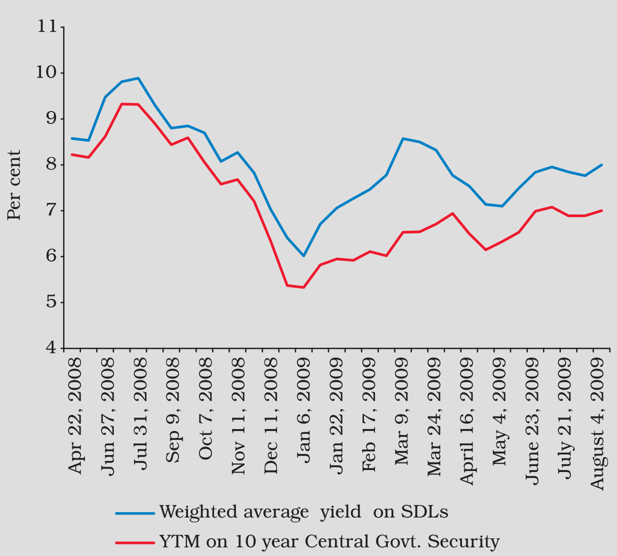



**Table 7.10 : Frequency Distribution of Tranches of Auctions during 2008-09**

| No. of times States accessed the market | No. of States* | No. of Securities Issued |
|---|---|---|
| 1 | 2 | 3 |
| 1 | 3 | 3 |
| 2 | 4 | 8 |
| 3 | 3 | 9 |
| 4 | 3 | 12 |
| 5 | 3 | 15 |
| 6 | 3 | 18 |
| 8 | 1 | 8 |
| 9 | 3 | 27 |
| 10 | 3 | 30 |
| 11 | 1 | 11 |
| Total | 27 | 141 |

* : including Union Territory of Puducherry.

years ranged between 39.7 per cent (Orissa) and 100.0 per cent (Puducherry) (Appendix Table 65). It may be noted that Orissa did not raise resources through market borrowings since 2006-07 and Puducherry started participation in market borrowing programme only since 2007-08. The maturity profile of market borrowings shows large repayment obligations in the years 2017-18 and 2018-19 reflecting the sharp increase in market borrowings in the past two years. The outstanding SDLs and power bonds of all the State Governments increased by 31.2 per cent in 2008-09 over the previous year (Table 7.11).

*Market Borrowings of State Governments during 2009-10*

VII.29 During 2009-10 (up to August 17, 2009), ten tranches of auctions have been conducted under the market borrowing programme of the State Governments. Seventeen State Governments raised an aggregate amount of Rs.40,041 crore as compared to Rs.10,812 crore by eight State Governments during the corresponding period of the previous year. The cut-off yield ranged between 7.04-8.03 per cent as compared to 8.39-9.90 per cent during the corresponding period of the previous year. The spread arrived in the auctions of the SDLs over the corresponding Central Government securities of 10-year tenure ranged between 77-115 basis points compared to 30-98 basis points during the corresponding period of 2008-09. The weighted average yield of gross borrowings of the States was 7.72 per cent as compared with 9.07 per cent during the corresponding period of 2008-09.

**Table 7.11 : Maturity Profile of Outstanding State Development Loans and Power Bonds**

(Rupees crore)

| Year of Maturity | State Development Loans | Power Bonds | Total Outstanding |
|---|---|---|---|
| 1 | 2 | 3 | 4 |
| 2009-10 | 16,238 | 2,907 | 19,145 |
| 2010-11 | 15,660 | 2,907 | 18,567 |
| 2011-12 | 21,993 | 2,907 | 24,900 |
| 2012-13 | 30,628 | 2,870 | 33,498 |
| 2013-14 | 32,079 | 2,870 | 34,949 |
| 2014-15 | 33,384 | 2,870 | 36,254 |
| 2015-16 | 35,191 | 2,907 | 38,098 |
| 2016-17 | 31,522 | 1,453 | 32,975 |
| 2017-18 | 67,779 | 0 | 67,779 |
| 2018-19 | 1,18,138 | 0 | 1,18,138 |
| **Total** | **4,02,611** | **21,691** | **4,24,302** |

## Cash Management

VII.30 Keeping in view the cash position of the State Governments, the WMA limits of State Governments have been left unchanged since 2006-07. Accordingly, the extant State-wise Normal WMA limits was fixed at Rs.9,925 crore for 2008-09 (inclusive of Rs.50 crore for the Union Territory of Puducherry) and the limit has been retained for the year 2009-10 as well (Appendix Table 66). The rate of interest on Normal and Special WMA and OD continued to be linked to the repo rate. The net incremental annual investment in the revised Consolidated Sinking Fund (CSF) and the revised Guarantee Redemption Fund (GRF) continued to be eligible for fixing Special WMA limit, up to a ceiling equivalent to the Normal WMA limit.

VII.31 The monthly average utilisation of Normal WMA by the State Governments showed a fluctuating trend. During 2008-09, six States, *viz.,* Kerala, Madhya Pradesh, Nagaland, Punjab, West Bengal and Uttarakhand resorted to WMA as against eight States, *viz.,* Kerala, Nagaland, Punjab, West Bengal, Himachal Pradesh, Manipur, Mizoram and Uttarakhand in the previous year. The monthly average utilisation of ODs by the States in 2008-09 was significantly lower than the previous year (Table 7.12). Three States, *viz.,* Nagaland, West Bengal and Uttarakhand resorted to ODs during 2008-09 while Kerala, West Bengal and Nagaland were the three states that resorted to overdraft in 2007-08. During 2008-09, West Bengal availed of WMA for a maximum 39 days whereas Uttarakhand availed of OD for 15 days during the year (Table 7.13).

VII.32 Despite some deterioration in their finances during the second half of 2008-09 on account of the fiscal stimulus measures

**Table 7.12 : WMA/Overdrafts of the State Governments***

(Rupees crore)

| Month | Special WMA | | | Normal WMA | | | Overdraft | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007-08 | 2008-09 | 2009-10 | 2007-08 | 2008-09 | 2009-10 | 2007-08 | 2008-09 | 2009-10 | 2007-08 | 2008-09 | 2009-10 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| April | 235 | 489 | 619 | 114 | 287 | 294 | 15 | 139 | 111 | 364 | 916 | 1024 |
| May | 437 | 310 | 126 | 654 | 3 | 50 | 461 | 0 | 2 | 1552 | 313 | 178 |
| June | 204 | 9 | 5 | 222 | 0 | 67 | 10 | 0 | 0 | 436 | 9 | 72 |
| July | 389 | 25 | 76 | 310 | 0 | 7 | 3 | 0 | 0 | 702 | 25 | 83 |
| August | 307 | 2 | | 476 | 47 | | 281 | 0 | | 1064 | 49 | |
| September | 961 | 139 | | 601 | 18 | | 225 | 0 | | 1787 | 158 | |
| October | 254 | 653 | | 184 | 83 | | 128 | 0 | | 566 | 736 | |
| November | 279 | 754 | | 351 | 152 | | 127 | 0 | | 757 | 906 | |
| December | 161 | 223 | | 103 | 0 | | 13 | 0 | | 277 | 223 | |
| January | 72 | 370 | | 81 | 0 | | 34 | 0 | | 187 | 370 | |
| February | 72 | 86 | | 8 | 0 | | 0 | 0 | | 80 | 86 | |
| March | 5 | 320 | | 1 | 62 | | 0 | 11 | | 6 | 392 | |
| **Average** | **281** | **282** | **206** | **259** | **54** | **105** | **108** | **13** | **28** | **648** | **349** | **339** |

*: Average of daily outstanding.

undertaken by them, most of the State Governments accumulated sizeable cash surpluses, reflecting the sharp increase in their market borrowings during 2008-09. The surplus cash balances of State Governments are automatically invested in 14-day Intermediate Treasury Bills, the discount rate of which is fixed at 5 per cent. While the monthly average outstanding investment in the 14-day Intermediate Treasury Bills by the State Governments during 2008-09 increased by around 35 per cent, that in auction Treasury Bills decreased by around 15 per cent over the previous year. Total investment in Treasury Bills was, however, higher on an average in 2008-09 than in 2007-08 (Table 7.14).

*Consolidated Sinking Fund (CSF) and Guarantee Redemption Fund (GRF)*

VII.33 The Reserve Bank maintains the consolidated sinking fund (CSF) and the guarantee redemption fund (GRF) on behalf of the State

**Table 7.13 : State-wise Availment of WMA/Overdraft**

| States | WMA | | Overdraft | | | |
|---|---|---|---|---|---|---|
| | 2007-08 | 2008-09 | 2007-08 | | 2008-09 | |
| | Number of days | Number of days | Number of Occasions* | Number of of days | Number of Occasions* | Number of days |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| **Non-Special Category States / U.T.** | | | | | | |
| 1. Kerala | 184 | 18 | 9 | 51 | 0 | 0 |
| 2. Madhya Pradesh | 0 | 2 | 0 | 0 | 0 | 0 |
| 3. Punjab | 19 | 21 | 0 | 0 | 0 | 0 |
| 4. West Bengal | 142 | 39 | 6 | 65 | 1 | 4 |
| **Special Category States** | | | | | | |
| 1. Himachal Pradesh | 1 | 0 | 0 | 0 | 0 | 0 |
| 2. Manipur | 3 | 0 | 0 | 0 | 0 | 0 |
| 3. Mizoram | 4 | 0 | 0 | 0 | 0 | 0 |
| 4. Nagaland | 30 | 18 | 1 | 3 | 1 | 4 |
| 5. Uttarakhand | 5 | 28 | 0 | 0 | 2 | 15 |

* : Refers to fresh occurrences of overdrafts during the year.

**Table 7.14 : Investments of the State Governments / UT***

(Rupees crore)

| Month | Investment in 14-day Treasury Bills | | | Investment in Auction Treasury Bills | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2007-08 | 2008-09 | 2009-10 | 2007-08 | 2008-09 | 2009-10 | 2007-08 | 2008-09 | 2009-10 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| April | 31,160 | 48,192 | 74,607 | 34,496 | 31,780 | 8,875 | 65,656 | 79,972 | 83,482 |
| May | 31,359 | 48,280 | 66,585 | 32,612 | 32,244 | 8,664 | 63,971 | 80,525 | 75,249 |
| June | 44,430 | 42,865 | 69,482 | 32,500 | 40,285 | 6,125 | 76,930 | 83,150 | 75,607 |
| July | 35,938 | 46,742 | 75,403 | 39,557 | 38,802 | 2,125 | 75,495 | 85,543 | 77,528 |
| August | 36,458 | 44,110 | | 42,477 | 43,069 | | 78,935 | 87,179 | |
| September | 34,282 | 40,112 | | 39,201 | 40,927 | | 73,483 | 81,038 | |
| October | 32,052 | 39,328 | | 35,195 | 32,705 | | 67,247 | 72,033 | |
| November | 30,556 | 41,878 | | 33,872 | 26,988 | | 64,428 | 68,866 | |
| December | 38,042 | 51,551 | | 31,565 | 24,055 | | 69,607 | 75,606 | |
| January | 45,029 | 63,420 | | 29,661 | 20,084 | | 74,690 | 83,504 | |
| February | 50,633 | 75,193 | | 32,403 | 14,150 | | 83,036 | 89,342 | |
| March | 65,910 | 1,01,557 | | 29,181 | 6,893 | | 95,091 | 1,08,450 | |
| **Average** | **39,654** | **53,602** | **71,519** | **34,393** | **29,332** | **6,447** | **74,047** | **82,934** | **77,966** |

*: Average of Friday outstanding.

Governments from contributions made by them. While the CSF provides a cushion for amortisation of market borrowing/liabilities, the GRF provides a cushion for the servicing of contingent liability arising from invocation of guarantees issued by the State Governments in respect of bonds issued and other borrowings by state level undertakings or other bodies. The aggregate outstanding investments in CSF by the 18 State Governments increased to Rs. 24,032 crore at end-March 2009 from Rs.18,946 crore in respect of 17 States at end-March 2008. As on March 31, 2009, nine States notified their GRF scheme and the aggregate outstanding investments in GRF by these States increased to Rs.3,082 crore as on March 31, 2009 from Rs.2,805 crore in respect of 8 States as on March 31, 2008.

*Conference of State Finance Secretaries*

VII.34 The 21st Conference of State Finance Secretaries was held on May 15, 2008. Apart from operational issues pertaining to Government transactions, the discussions primarily focused on issues relating to the fiscal transparency at the State level, financing of local (urban) bodies, management of investment portfolio of the States, estimation of the States' market borrowings and budget management of the States. Following discussions in the Conference, three Working Groups, *viz.,* Working Groups on 'Fiscal Management beyond FRBM', 'Local (urban) Finances' and 'Fiscal Transparency at State Level' have been set up to examine the related issues. The major issues focused in the 22nd Conference of the State Finance Secretaries held on May 29, 2009, related to surplus cash balances of the State Governments; projections on market borrowings of the States; advance planning for borrowing by the States; imparting of liquidity to the State Development Loans by reissuance and consolidation; electronic benefit transfer to the beneficiaries of the social security assistance of the Governments and impact of counter-cyclical fiscal measures taken by the States.

VII.35 The Reserve Bank has responded to the challenge of managing the large market borrowing programme with an appropriate assessment of the liquidity conditions and market disruptions have been avoided by synchronising liquidity enhancing operations, such as unwinding balances under the MSS and conducting open market purchases of government securities, with the timing of borrowing programmes, while also seeking feedback from market participants on a regular basis. Hence, despite the sharp increase in the size of borrowings, the market borrowing programme of the Central and State Governments during 2008-09 could be completed in a non-disruptive manner. Apart from the Reserve Bank's active and dynamic debt management strategy which was well co-ordinated with monetary management in terms of ensuring ample liquidity in the system and cut in monetary policy rates, other factors which facilitated the relatively smooth conduct of the market borrowing programme included decline in inflation, weak private sector demand for credit and greater appetite for government securities by commercial banks due to higher risk aversion.

VII.36 The size of combined net market borrowing requirements of the Central and State Governments for 2009-10 (dated securities and 364-day Treasury Bills), at Rs.5,37,957 crore, is estimated to be higher than the 2008-09 actual borrowings by 55.4 per cent, which was on top of an increase of 108.8 per cent over 2007-08. Accordingly, the smooth conduct of debt management would assume even greater importance during the current fiscal year. Hardening of yields witnessed in recent months could militate against the low interest rate regime required to stimulate and revive the economy. The Reserve Bank would continue with its active liquidity management policy to ensure that the large government borrowing does not crowd out present and potential credit demand from the private sector. As the private sector demand picks up with the revival of the economy, and the need for fiscal stimulus also declines correspondingly, the Government could phase out its large borrowings, thereby allowing the private sector demand to propel and sustain the growth momentum, without being constrained by concerns on the availability of liquidity in the system.