VII PUBLIC DEBT MANAGEMENT

The Reserve Bank successfully managed the market borrowing requirements of the central and state governments during 2016-17 in an orderly manner in the face of multiple challenges such as glide path for reduction in Held to Maturity(HTM) category and Statutory Liquidity Ratio(SLR), supply concerns over increased state government issuances, issuances of UDAY bonds and global uncertainties. The borrowing programme was conducted in line with the debt management strategy of low cost, risk mitigation and market development while factoring in domestic as well as global economic and financial conditions. The maturity profile of dated securities was elongated to contain rollover risk while lowering overall borrowing cost, keeping risk at prudent levels. Despite volatility triggered by both domestic and global factors during the year, G-sec yields witnessed significant softening, particularly after demonetisation in November 2016 and the consequent surplus liquidity of the banking system. However, the yields hardened in February 2017 in response to shift in the monetary policy stance from accommodative to neutral. The agenda for 2017-18 includes elongation of maturity profile of government debt and widening the bouquet of products for diverse investors.

VII.1 The Internal Debt Management Department of the Reserve Bank manages the domestic debt of the central government by statute *vide* Sections 20 and 21 of the RBI Act, 1934 and that of 29 state governments and the Union Territory of Puducherry in accordance with bilateral agreements, as provided in Section 21A of the said Act. The Reserve Bank also provides short-term credit up to three months to both central and state governments in the form of Ways and Means Advances (WMA) to bridge temporary mismatches in their cash flows in terms of Section 17(5) of the Act.

Agenda for 2016-17: Implementation Status

VII.2 During the year, the Reserve Bank successfully managed the borrowing programme of the central government and state governments, notwithstanding multiple challenges in the form of the glide path for reduction in HTM category of banks' investment portfolio and SLR requirements and supply concerns over increased issuances by state governments, including *Ujwal DISCOM Assurance Yojana* (UDAY) bonds. The borrowing programme of the central government in 2016-17, was conducted in accordance with the overall debt management strategy of low cost, risk mitigation and market development, while factoring in domestic and global economic and financial conditions. In line with the above objectives, a strategy of active consolidation through buyback/ switches was adopted and debt to the extent of ₹641.33 billion and ₹405.10 billion was bought back and switched, respectively. This had a salutary effect on the weighted average maturity of central government debt. To widen retail investments, access was given to individuals under the non-competitive bidding in the primary auction of Treasury Bills (T-Bills). Following the deliberations by the Cash Co-ordination Committee comprising officials of the Reserve Bank and the Government of India (GoI), GoI issued guidelines towards better information sharing and cash flow forecasting.

VII.3 With a view to increasing acceptability of the Sovereign Gold Bond (SGB) scheme and widening the investor base of SGBs, the scheme was modified suitably. The minimum subscription amount was reduced to one gram of gold, a discount of ₹50 offered on the face value of the security and the number of receiving agencies increased to include stock exchanges.

VII.4 As part of the ongoing endeavour to consolidate the debt in State Development Loans (SDLs) through buyback, the state of Maharashtra repurchased its high cost debt. Further, the states that do not maintain reserves in the form of consolidated sinking fund (CSF) and guarantee redemption fund (GRF) were encouraged to do so as a prudent risk management measure.

VII.5 Government securities (G-sec) yields witnessed significant softening during the year, particularly after demonetisation and the consequent surplus liquidity in the banking system. The yields, however, hardened in February 2017 in response to the shift in monetary policy stance from accommodative to neutral. The benchmark yield softened thereafter on lower inflation data, FPI buying and expectations of normal monsoon.

Debt Management of the Central Government

VII.6 The Reserve Bank in consultation with GoI followed a strategy of front loading of issuances, but modulated its market borrowings from the budget estimates during the fourth quarter, reducing thereby, the supply of sovereign paper in the market. As against gross market borrowings of ₹6,000 billion through dated securities proposed in the Union Budget 2016-17, the actual amount mobilised was modulated to ₹5,820 billion on the back of higher surplus cash balances of the central government. Net market borrowings through dated securities amounted to ₹4,082 billion in 2016-17, registering a decline of 7.4 per cent and financing 76.4 per cent of the gross fiscal deficit (GFD), as against 82.0 per cent in the previous year. On the other hand, net short term market borrowings through T-Bills increased to ₹186 billion during 2016-17 from ₹152 billion in 2015-16 mainly due to higher issuances in H1 of 2016-17. In the aggregate, however, net market borrowing through dated securities and T-Bills declined by ₹291 billion to ₹4,268 billion in 2016-17 (Table VII.1).

Table VII.1: Net Market Borrowings of the Central Government

(₹ billion)

Item	2014-15	2015-16	2016-17	2017-18*
1	2	3	4	5
Net Borrowings	4635	4559	4268	2517
(i) Dated Securities	4,532	4,406	4,082	1312
(ii) 91-day T-Bills	32	39	245	885
(iii) 182-day T-Bills	9	5	57	26
(iv) 364-day T-Bills	62	109	-115	5

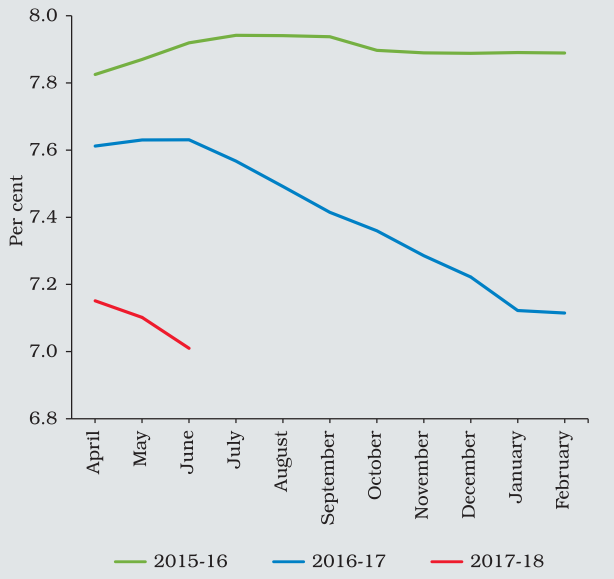
*: Up to June 30, 2017.

Debt Management Operations

VII.7 The weighted average yield (WAY) of dated securities of central government issued during the year declined by 73 bps to 7.16 per cent in 2016-17 while the weighted average coupon (WAC) on the outstanding stock of dated securities declined by 9 bps to 7.99 per cent as on March 31, 2017. The declining trend in yield continued in 2017-18 so far (upto June 30) reflecting benign market conditions and increased liquidity (Chart VII.1).

VII.8 The weighted average maturity (WAM) of the outstanding stock increased marginally to 10.65 years as at end-March 2017 (Table VII.2). However, the WAM of issuances during 2016-17 declined by 1.27 years to 14.76 years, reflecting relatively larger issuances in the maturity buckets below 19 years. The Reserve Bank continued its policy of passive consolidation by way of reissuances and active consolidation through

Chart VII.1: Weighted Average Yield of GoI Securities



buyback/switches. Out of 164 auctions, 156 were reissuances during the year. Buyback/ switches amounted to ₹1,046 billion in 2016-17 as compared to ₹611 billion in the previous year. Furthermore, the share of issuances in the two long maturity buckets declined from 38 per cent in 2015-16 to 29 per cent in 2016-17, mirroring the relatively muted demand for long bonds.

VII.9 During 2016-17, the residual maturity of 59 per cent of the market borrowings through dated securities was 10 years and beyond, as compared with 66 per cent during the previous year, mirroring an increase in the share of maturities less than 10 years (Table VII.3). With the objective of catering to the demand for long term investors such as insurance companies and pension funds, 30 and 35-year tenor bonds were issued during the year.

Primary Dealers and Devolvement

VII.10 The elevated supply of SDLs, including UDAY bonds during 2016-17 resulted in devolvement of central government securities on Primary Dealers (PDs) on four instances for an aggregate amount of ₹53 billion, as compared with devolvement of ₹110 billion during the previous year. The share of the PDs in the subscription to primary auctions of central government securities stood at 47.6 per cent in 2016-17, down from 54.2 per cent in 2015-16. The underwriting commission paid to PDs during 2016-17 declined to ₹0.357 billion from ₹0.471 billion during 2015-16, mainly on account of ample liquidity conditions. There was only a single instance of devolvement amounting to ₹32 billion in Q1 of 2017-18. All the standalone PDs complied with their target commitments in auction bidding, secondary market turnover targets and continued to maintain capital to risk weighted assets ratio (CRAR) above the minimum requirement of 15 per cent.

Table VII.2: Market Loans of Central Government – A Profile*

(Yield in per cent /Maturity in years)

Years	Range of YTMs at Primary Issues			Issued during the Year			Outstanding stock	
	Under 5 years	5-10 years	Over 10 years	Weighted Average Yield	Range of Maturities of New Loans	Weighted Average Maturity	Weighted Average Maturity	Weighted Average Coupon
1	2	3	4	5	6	7	8	9
2012-13	8.21-8. 82	7.86-8.76	7.91-8.06	8.36	5-30	13.50	9.66	7.97
2013-14	7.22-9.00	7.16-9.40	7.36-9.40	8.41	6-30	14.23	10.00	7.98
2014-15	-	7.66-9.28	7.65-9.42	8.51	6-30	14.66	10.23	8.08
2015-16	-	7.54-8.10	7.59-8.27	7.89	6-40	16.03	10.50	8.08
2016-17	-	6.13-7.61	6.46-7.87	7.16	5-40	14.76	10.65	7.99
2017-18#	-	6.52-6.95	6.74-7.53	7.01	6-39	14.99	10.67	7.95

Note: YTM: Yield to Maturity; #: Up to June 30, 2017; -: No issues; *: excluding buyback/switch in GoI securities and special securities.

Table VII.3: Issuance of Government of India Dated Securities – Maturity Pattern

(Amount in ₹ billion)

Residual Maturity	2014-15		2015-16		2016-17		2017-18*	
	Amount raised	Percentage to total	Amount raised	Percentage to total	Amount raised	Percentage to total	Amount raised	Percentage to total
1	2	3	4	5	6	7	8	9
Less than 5 years	-	-	-	-	180	3.1	-	-
5 -9.99 years	2,350	39.7	2,000	34.2	2,220	38.1	880	44.7
10-15.99 years	1,510	25.5	1,600	27.4	1,710	29.4	519	26.4
16 -19.99 years	960	16.2	1,120	19.1	820	14.1	250	12.7
20 years & above	1,100	18.6	1,130	19.3	890	15.3	320	16.3
Total	**5,920**	**100.0**	**5,850**	**100.0**	**5,820**	**100.0**	**1,969**	**100.0**

*: As on June 30, 2017; -: No Issues.

Ownership of Securities

VII.11 The outstanding dated securities of central government registered 8.4 per cent year-on-year growth in 2016-17. Commercial banks, including the PD segment remained the largest holder with 40 per cent share as at end-March 2017, followed by insurance companies with a share of 22.9 per cent. The Reserve Bank held 14.7 per cent while provident funds held 6.3 per cent.

Sovereign Gold Bond Scheme

VII.12 The Reserve Bank successfully managed the issuances of SGBs during 2016-17. Four tranches of SGBs for an aggregate amount of ₹34.69 billion (11.44 ton) were issued during the year. Since the inception of the scheme in November 2015, a total of ₹60.29 billion (20.73 ton) has been mobilised and SGBs have been allotted to approximately 1.4 million retail investors including the issuances of two tranches in (May and July) 2017-18.

Medium Term Debt Management Strategy (MTDS)

VII.13 The MTDS was formulated as a debt management framework in 2015, in consultation with the Government of India, for a period of three years and rolled over each year. It is premised on three broad pillars: low cost, risk mitigation and market development. The MTDS, which is in line with international best practices, calibrates certain benchmarks on the composition of debt in terms of short and long term, floating and fixed rate, and maturity of debt. It also stipulates stress tests and scenario analysis in relation to costs, maturity and potential risks. The debt of the central government has been reviewed against the MTDS benchmarks and found to be stable and sustainable.

Treasury Bills

VII.14 With a view to encouraging wider participation and retail holding of T-Bills and in line with the first bi-monthly monetary policy statement of 2015-16, the central government in consultation with the Reserve Bank, extended the non-competitive bidding facility in T-Bills to retail investors up to a ceiling of 5 per cent of the notified amount. As mentioned earlier, net market borrowings through T-Bills increased during 2016-17. The yields on T-Bills largely mimicked the declining trend in the yields of dated securities in 2016-17. Reflecting the increase in appetite for T-Bills from market participants, the Primary Dealers' share in T-Bills auctions declined to 74.4 per cent from 75.4 per cent during 2015-16. The PDs individually achieved the stipulated minimum success ratio of 40 per cent in bidding while the success ratio of the PD system as a whole was 58.8 per cent and 60.0 per cent during H1 and H2, respectively, of 2016-17.

Market Stabilisation Scheme (MSS)

VII.15 With a view to absorbing excess liquidity in the banking system following demonetisation in November 2016, the limit for the MSS was increased. Under MSS, the total amount of cash management bills (CMBs) issued, for tenors ranging from 14 to 63 days, amounted to ₹10,115 billion, with associated interest outgo of ₹57 billion. During 2017-18 (up to June 30), T-Bills issued under MSS for tenors ranging from 312 to 329 days amounted to ₹1,000 billion.

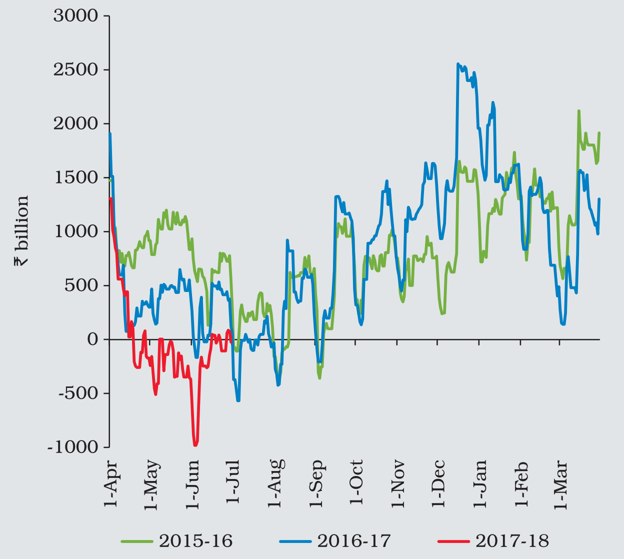
Pradhan Mantri Garib Kalyan Deposit Scheme (PMGKDS)

VII.16 In the wake of demonetisation, the central government launched the PMGKDS on December 17, 2016, as a tax amnesty scheme available from December 17, 2016 to March 31, 2017. Under this scheme, the deposits are held at the credit of the declarant of tax in the bonds ledger account (BLA) maintained with the Reserve Bank and a certificate of holding is issued to the declarant. Deposits mobilised under this scheme amounted to ₹12.4 billion.

Cash Management of the Central Government

VII.17 The WMA limits for the central government for the first and the second halves of 2016-17 were increased each by ₹50 billion to ₹500 billion and ₹250 billion, respectively. The government was in WMA for 26 days during 2016-17 *vis-à-vis* 15 days during the previous year. The accommodation to the central government under WMA was ₹1,567 billion during 2016-17 as compared with ₹838 billion in 2015-16. The government resorted to overdraft (amounting to ₹68 billion) only once during the year on July 5, 2016. The government's cash position improved subsequently, mainly on account of increased tax flows and higher investments in intermediate/auction treasury bills (ITBs/ATBs) by state governments (Chart VII.2).

Chart VII.2: Cash Balance of the Central Government



VII.18 With the advancement of budget presentation this year, the government units have started to frontload expenditure, unlike in the previous years. This combined with low net tax receipts and large redemption pressure in the first quarter of 2017-18, caused the cash balances of the central government to move into prolonged periods of deficit, warranting issue of CMBs of ₹1,300 billion during the Q1 of 2017-18. The switch operations undertaken in January, March and June 2017 helped in easing the stress in the cash balances to a certain extent. The WMA limit for the first quarter of 2017-18 was set at ₹600 billion while the same for the second quarter would be ₹700 billion.

Debt Management of State Governments

VII.19 The gross market borrowings of the state governments amounted to ₹3,820 billion in

Table VII.4: Market Borrowings of States through SDLs

(₹ billion)

Item	2014-15	2015-16	2016-17	2017-18*
1	2	3	4	5
Maturities during the year	334	352	393	74
Gross sanction under article 293(3)	2,435	3,060	4,000	2,980
Gross amount raised during the year	2,408	2,946	3,820	650
Net amount raised during the year	2,075	2,594	3,427	576
Amount raised during the year to total sanctions (per cent)	99	96	96	22
Outstanding liabilities (at the end period)#	12,757	16,389	20,896	21,472

Including UDAY and other special securities; *: Up to June 30, 2017.

2016-17 as compared with ₹2,946 billion in the previous year (Table VII.4).

VII.20 The WAY of state government securities issued during 2016-17 stood lower at 7.48 per cent than that of 8.28 per cent in the previous year. Despite softening of yield across securities, the weighted average spread of SDL issuances over the comparable central government securities increased to 60 bps from 50 bps in 2015-16. The inter-state spread which was on an average in the range of 7 bps in 2016-17 same as in the previous year though higher than 4 bps in 2014-15, however, does not reflect the fiscal strength of the states in the pricing of SDLs.

VII.21 During 2016-17, thirteen states issued UDAY bonds for ₹1,091 billion as against ₹990 billion raised by eight states in the previous year. The spreads of UDAY bonds during 2016-17 declined to 35-75 bps over the corresponding tenor/10-year FIMMDA G-Sec yield as compared with a fixed spread of 75 bps in 2015-16. Approximately 45 per cent of the total UDAY bond issuances in 2016-17 were concentrated in Q4. The large volume of SDL issuances including UDAY, was one of the major factors that resulted in weighted average spread to widen from 54 bps in Q1 to 83 bps in Q4 of 2016-17.

VII.22 In 2016-17, five states including Puducherry issued SDLs with tenors above 10 years and many states issued non-standard securities of tenors ranging from 2 to 20 years. As a strategic response to higher spreads, four states rejected all the bids in some auctions. Furthermore, the Reserve Bank has been working closely with state governments to facilitate efficient cash and liability management operations of states, with the objective of consolidation through elongation of debt, reissuances and buyback of high cost debt, while keeping an eye on redemption capacities of states. As part of the ongoing endeavour to consolidate the debt in SDLs through buybacks, the state of Maharashtra repurchased ₹10.83 billion of its debt.

Cash Management of State Governments

VII.23 The aggregate WMA limit for 28 states and the Union Territory of Puducherry was revised from ₹154 billion to ₹322 billion with effect from February 1, 2016. Eleven states resorted to WMA in 2016-17, the same number as in the previous year. Consequent to the increase in WMA limits, only 4 states resorted to overdrafts in 2016-17 as against 9 states in 2015-16.

VII.24 Outstanding investment of states in ITBs increased further to ₹1,561 billion as at end-March 2017, while that in ATBs declined for the third year

Table VII.5: Investments in ITBs and ATBs by State Governments/UT

(₹ billion)

Item	Outstanding as on March 31					
	2013	2014	2015	2016	2017	As on June 30, 2017
1	2	3	4	5	6	7
14-Day (ITBs)	1,181	862	842	1,206	1,561	1,179
ATBs	286	463	394	383	366	1,025
Total	**1,466**	**1,325**	**1,236**	**1,589**	**1,927**	**2,204**

in succession to ₹366 billion (Table VII.5). With the objective of dynamically aligning the interest rate on ITBs with market levels, effective January 30, 2017, the discount rate on 14 days ITBs was re-fixed at the reverse repo rate minus 200 bps, subject to an upper ceiling of 5 per cent. The rediscount rate has, consequently, also been re-fixed at reverse repo rate minus 150 bps, subject to an upper ceiling of 5.5 per cent.

Investments in Consolidated Sinking Fund (CSF)/ Guarantee Redemption Fund (GRF)

VII.25 Outstanding investment by states in the CSF and the GRF as at end-March 2017 stood at ₹884 billion and ₹49 billion, respectively. During the year, total investment in CSF and GRF was ₹176 billion (including fresh investment of ₹57 billion and reinvestments of ₹119 billion) as compared to ₹134 billion during 2015-16.

Agenda for 2017-18

VII.26 The Union Budget 2017-18 projected gross market borrowings of ₹5,800 billion through dated securities, a marginal decline of ₹20 billion from that in the previous year. Net short term borrowings (*i.e.,* through T-Bills) is budgeted at ₹20 billion, substantially lower than that of ₹186 billion in the previous year. Net market borrowings *via* dated securities and T-Bills would finance 77.8 per cent of the GFD in 2017-18 as compared with 79.6 per cent in 2016-17. In line with the policy of front-loading of issuances, 64 per cent (*i.e.,* ₹3,720 billion) of the gross market borrowings is slated to be raised in the first half of 2017-18. This, in turn, would also help to manage the redemption pressure during H1 of 2017-18 when 90 per cent (*i.e.,* ₹1,566 billion) of the total redemptions would fall due. The borrowing programme of the centre and state governments would continue to be guided by the pillars of low cost, risk mitigation and market development by adopting the following strategic measures :

i. Issuance/re-issuance of longer tenor bonds to help elongate the weighted average maturity of debt.

ii. Host a single web link on the Reserve Bank website for public debt through consolidation of various links pertaining to internal and external public debt information.

iii. Preparation of draft compendium for state governments on best practices in cash management and a model cash flow statement on pilot basis.

iv. Capacity building programmes for Finance Departments/AG Offices of state governments/other central banks.

v. Keeping in view the fiduciary risk for state governments, a Working Group on Monitoring and Reporting of Contingent Liabilities at the state level has been constituted under the aegis of 29th State Finance Secretaries Conference. The thrust of the Working Group is towards identifying contingent liabilities and standardising risk management and mitigation measures, while bringing in uniformity in disclosure across states for better peer group analysis. The Working Group is expected to submit its report shortly.