VII PUBLIC DEBT MANAGEMENT

The large borrowing programme of the Government in 2009-10 reflected the need to sustain the expansionary fiscal stance to stimulate a faster recovery in growth. The challenge for the Reserve Bank, therefore, was to manage borrowing programme without disrupting market liquidity or adding much pressure on the interest rate structure, both of which could have impeded the recovery in growth. Although high fiscal deficit and inflationary expectations led to some pressure on medium to long-term yield, excessive pressure on yield was largely contained through active liquidity management operations and by shortening the maturity profile of government bonds. Subdued demand for credit from the private sector, particularly in the first half of the year, also contributed to the non-disruptive completion of the borrowing programme. The borrowing programme for 2010-11 has to be managed, keeping in view the pressure on yield from the elevated inflation, gradual withdrawal of excess liquidity and stronger pick-up in the private sector credit demand.

VII.1 The public debt management strategy of the Reserve Bank during 2009-10 was guided by the imperatives to finance the large fiscal gap arising from the continuation of the fiscal stimulus to sustain recovery in growth, while striving to maintain stability in the government securities yield. In view of the sharp increase in the size as also the frequency of market borrowings by the Centre and the State governments, the Reserve Bank took steps in a pro-active manner to manage the borrowing programme by modulating market liquidity as well as the maturity profile of securities to contain excessive pressure on interest rates. Thus, despite concerns of high fiscal deficit and elevated inflation, the weighted average cost of borrowings of the Centre decreased during 2009-10. These policy measures also helped contain excessive pressure on the secondary market yield on government securities.

VII.2 The market borrowing programme of the State governments during 2009-10 was also conducted successfully even as the gross borrowings were higher than that of the previous year. The higher deficit concerns and inflation expectations also weighed on the cost, leading to a marginal increase in the weighted average yield on the State government securities. The spread on State government securities over Central government securities, however, moderated, reflecting the more evenly distributed auctions of State loans. Given the surplus cash position of State governments, the WMA limits of the State governments have been kept unchanged since 2006-07.

DEBT MANAGEMENT OF CENTRAL GOVERNMENT

Market Borrowings

VII.3 The gross and net amounts raised through dated securities were around 65 per cent and 74 per cent higher in 2009-10 than those raised in the previous year (Table VII.1). The Reserve Bank managed the enhanced borrowing programme, keeping in view the twin objectives of minimisation of cost over time and balancing of maturity profiles that are consistent with low rollover risk. First, the Reserve Bank front-loaded the borrowing programme for 2009-10 as credit off-take by the private sector is usually low in the first half and credit demand was expected to pick-up in the second half with stronger recovery in growth. Second, Market Stabilisation Scheme (MSS)

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

(Rupees crore)

Item	2008-09			2009-10			2010-11	
	Budget Estimate	Revised Estimate	Actual	Budget Estimate	Revised Estimate	Actual	Budget Estimate	Actual@
1	2	3	4	5	6	7	8	9
Gross borrowing	1,76,453	3,42,769	3,18,550*	4,91,044 *	4,92,368 *	4,92,497 *	4,98,635	1,99,376
Net Borrowing	1,15,571	2,66,539	2,42,317*	3,97,957 *	3,94,229 *	3,94,358 *	3,45,010	1,07,083
(i) Dated Securities	1,00,571	2,61,972	2,28,972*	3,97,957 *	3,98,411 *	3,98,411 *	3,45,010	1,02,966
(ii) 364-day TBs	15,000	4,567	13,345	-	-4,182	-4,053	0	4,117
Memo:								
(i) Additional 182-day TBs	-1,000	19,390	10,995	-	-	1,325	-	300
(ii) Additional 91-day TBs	-1,571	43,720	45,224	-	-	-4,046	-	-21,649
(iii) MSS De-sequestering	-	-	12,000	33,000	33,000	33,000	-	-

#: Dated securities and 364-day Treasury Bills. *: Includes MSS de-sequestering. @: Up to July 31, 2010.

securities were de-sequestered to meet a part of the borrowing requirements. Third, the Reserve Bank resorted to active liquidity management by way of unwinding of MSS securities and purchase of securities through pre-announced calendar of open market operations (OMO) in order to reduce uncertainty and infuse confidence in the market (for details, refer Chapter III). The Reserve Bank also continued with the policy of passive consolidation of dated securities during 2009-10. Out of 108 auctions during the year, 101 securities were reissues of existing securities and seven were new securities.

VII.4 There was pressure on yields throughout the year, particularly for medium to long-term securities, stemming from high fiscal deficit and inflationary expectations. The weighted average yield on the dated securities issued during the year, however, moderated somewhat (Table VII.2), which was attained, *inter alia*, through reduction in the weighted average maturity of the loans issued. The maturity profile of debt issuances during the year was modulated keeping in view the capacity and preference of various market segments (Table VII.3). Despite a reduction in maturity profile, average maturity of the outstanding stock would still continue to be higher than that of many developed countries and EMEs.

VII.5 The surplus liquidity and interest rates prevailing in money markets kept the yield on Treasury Bills low during most part of 2009-10. The yields, however, hardened during the fourth quarter, reflecting, *inter alia*, the increase in CRR in January 2010 and hike in repo and reverse repo rates in March 2010 (Table VII.4). The bid-cover ratio in the auctions during 2009-10 improved over the previous year as the liquidity remained comfortable

Table VII.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
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
2009-10	6.09-7.27	6.07-7.77	4.86*-8.43	7.23	5-30	11.16	9.83	7.89

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

* : Cut-off yield on the floating rate bond amounting to ₹2,000 crore with 11-year tenor auctioned on December 18, 2009.

Table VII.3: Maturity Profile of Central Government Dated Securities*

(Per cent of total)

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
2009-10	12	45	43	29	38	33

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

and the market interest in Government securities generally improved.

VII.6 The Reserve Bank continued with the uniform price auction format introduced in 2008-09 in view of the uncertain market environment and the need for enabling aggressive bidding by the investors in the context of large market borrowing programme. With surplus liquidity conditions sustained by the Reserve Bank contributing to market confidence, the devolvement on primary dealers (PDs) during 2009-10 was lower at ₹7,219 crore than that of ₹10,773 crore in the previous year.

VII.7 One of the factors impeding banks' participation in the primary market had been the firming up of inflationary expectations and their apprehensions about a possible exposure to marked-to-market losses in their investment portfolio. The feedback from the banks and PDs indicated that floating rate bonds (FRBs), by reducing their portfolio duration, could insulate investors from the interest rate risk and enable them to undertake asset liability management in a more effective manner. It was also felt that the FRBs could turn out to be cost effective for the Government *vis-à-vis* fixed rate bonds. The product design of FRBs was changed in consultation with the market participants, permitting re-issuance of FRBs, and thereby enabling build up of liquidity. Accordingly, the Reserve Bank, after a gap of 5 years, issued 11-year FRBs on December 21, 2009. Subsequently, FRBs were reissued on January 25 and April 26, 2010.

VII.8 The Central Government issued special securities to oil marketing companies amounting to ₹10,306 crore on September 15, 2009, which stood much lower than ₹95,942 crore in 2008-09

Table VII.4: Treasury Bills in the Primary Market

(Per cent)

Year/ Month	Notified Amount (₹ crore)	Average Implicit Yield at Minimum			Average Bid-Cover Ratio		
		91-day	182-day	364-day	91-day	182-day	364-day
1	2	3	4	5	6	7	8
Apr-09	39,000	3.81	4.11	4.08	3.22	2.79	5.07
May-09	29,000	3.26	3.54	3.59	3.18	2.25	3.14
Jun-09	22,500	3.35	3.56	4.00	3.37	5.65	2.86
Jul-09	40,000	3.23	3.45	3.77	3.92	2.86	3.90
Aug-09	28,000	3.35	3.84	4.25	3.04	2.18	3.76
Sep-09	32,000	3.35	3.94	4.47	3.67	4.17	4.05
Oct-09	36,000	3.23	4.01	4.57	3.15	3.88	2.86
Nov-09	30,000	3.28	3.78	4.49	3.5	3.59	3.36
Dec-09	26,500	3.57	4.08	4.63	3.12	2.99	4.10
Jan-10	33,000	3.86	4.13	4.67	1.97	3.60	4.61
Feb-10	31,000	4.11	4.52	4.95	2.10	2.51	2.49
Mar-10	33,000	4.35	4.66	5.13	2.48	3.51	3.48
2010-11							
Apr-10	36,000	4.14	4.64	5.07	3.1	3.31	3.37
May-10	36,000	4.39	4.76	4.92	2.54	2.82	4.10
Jun-10	15,000	5.29	5.31	5.49	3.61	3.52	2.91
Jul-10	13,000	5.56	5.86	5.99	3.61	2.44	4.26

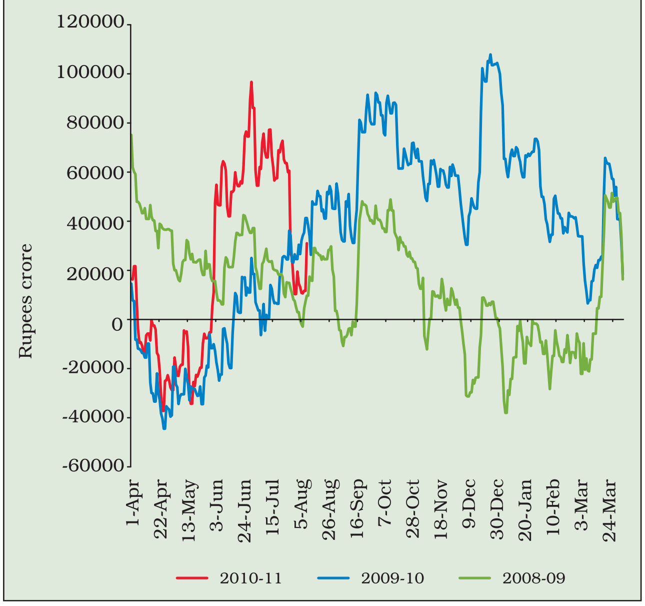
(issued to oil marketing and fertiliser companies). The Reserve Bank advised the Government on the prevailing market yield, spread, timing, maturity and the size of individual issuances of special securities as also their phased-in offloading by investors in the secondary market.

VII.9 Although the gross market borrowings of the Central Government through dated securities for 2010-11 are budgeted 9.4 per cent higher over the previous year, the net borrowings would be 5.6 per cent lower than the previous year (excluding MSS de-sequestering). The issuance calendar for dated securities for the first half of 2010-11 (April-September), released in consultation with the Central Government, is scheduled to raise ₹2,87,000 crore. The Central Government has raised a large part of the scheduled borrowing programme so far (up to July 31, 2010) (Table VII.1). The weighted average yield of dated securities issued during 2010-11 (up to July 31, 2010) was higher at 7.67 percent as compared with 6.93 percent during the corresponding period of the previous year.

Cash Management

VII.10 The cash balance position of the Central Government remained comfortable throughout 2009-10 except for the first quarter. The Government took recourse to ways and means advances (WMA) on April 4, 2009 due to large expenditure commitments. After reaching the WMA ceiling of ₹20,000 crore for the first half of the year on April 15, 2009, it resorted to overdrafts (OD). The Government continued to be in WMA up to June 15, 2009 and subsequently for three days during July 2009. The Government resorted to WMA for 76 days including OD for 28 days on three occasions during 2009-10. The cash balances turned positive since July 10, 2009 on account of the quarterly advance tax inflows, subsequently boosted by the surplus transfer from the Reserve Bank (₹25,009 crore) on August 13, 2009 (Chart VII.1). The Central Government started the financial year (2010-11) with a cash surplus but

Chart VII.1: Cash Balances of the Central Government



subsequently went into WMA on April 6, 2010 and continued to be in WMA up till May 30, 2010. The cash balances switched to surplus mode, thereafter, reflecting inflows on account of 3G/BWA spectrum auctions and quarterly tax receipts.

VII.11 The Government of India, in consultation with the Reserve Bank, decided to issue a new short-term instrument, known as Cash Management Bill (CMB) to meet the temporary cash flow mismatches of the Government. The CMBs are non-standard, discounted instruments for maturities of less than 91 days. Accordingly, two tranches of CMBs with maturity of 35 days and 28 days were issued in May 2010 amounting to ₹12,000 crore.

VII.12 Due to outflow of liquidity from the banking system on account of 3G/BWA spectrum auctions, inflationary pressures and rise in policy rates, the primary market yields on Treasury Bills firmed up. Liquidity pressures were addressed, *inter alia*, by scaling down the issuance of Treasury Bills in June and July 2010 by ₹22,000 crore and ₹20,000 crore, respectively. Further, the Government bought back dated securities to the tune of ₹9,614 crore. The notified amount of dated securities for July 2, 2010 auction was also lowered from the planned amount of ₹13,000 crore to ₹10,000 crore.

DEBT MANAGEMENT OF STATE GOVERNMENTS

Market Borrowings

VII.13 Despite an increase in borrowing requirements, the State governments completed their market borrowing programme smoothly given the comfortable liquidity conditions in the market (Table VII.5). Orissa was the only State that did not participate in the market borrowing programme in 2009-10, like the previous year when Orissa and Chhattisgarh both had abstained, in view of their improved revenue account position. Five States did not raise their full sanctioned amount in 2009-10 as against 15 States in 2008-09. The market borrowing programme was evenly spaced throughout the year.

VII.14 Reflecting the sheer size of issuances, the weighted average yield of the State government securities issued during 2009-10 stood higher than the previous year (Table VII.6). The spread between the benchmark Central Government securities and the State Development Loans (SDLs), however, stood lower during 2009-10, reflecting more evenly spaced distribution of market borrowings during 2009-10. Since 2005-06, all issuances of SDLs have a maturity of 10 years (Table VII.7).

VII.15 In order to raise resources at a lower cost, a State Government offered put option for its three issuances during September-October 2009, which could be exercisable by the investors after 4 to 5 years from the date of issue. Accordingly, the cut-off yields for the State in the auctions held on September 22, October 6 and October 29, 2009 were lower. Put options could be beneficial from the standpoint of price discovery and some reduction in the interest burden for the Government. There could, however, be rollover

Table VII.5 : Market Borrowings of State Governments #

(Rupees crore)

Item	2007-08	2008-09	2009-10
1	2	3	4
1. Net Allocation $	28,781	51,719	1,02,458
2. Additional Allocation @	40,234	62,990	2,679
3. Total Net Allocation (1+2)	69,015	1,14,709	1,05,137
4. Repayments	11,555	14,371	16,238
5. Gross Allocation (3+4)	80,570	1,29,081	1,21,375
6. Gross Sanctions under Article 293 (3) of the Constitution	80,570	1,25,019	1,36,948
7. Gross Amount Raised	67,779	1,18,138	1,31,122
8. Net Amount Raised	56,224	1,03,766	1,14,883
9. Amount Raised as a ratio of Amount Sanctioned (%)	84.1	94.5	95.7
10. SDLs outstanding (at the end-period)	2,98,845	4,02,611	5,17,472
Memo:			
No. of tranches	18	23	28

: Includes the Union Territory of Puducherry.

$: Net Allocation for 2009-10 pertains to 26 States/UT only

@ : Include allocation in lieu of NSSF shortfall for 2007-08, 2008-09 and 2009-10 and second stimulus package for 2008-09.

Table VII.6: 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	9.20
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
2009-10	7.04-8.58	8.11

Table VII.7: Residual Maturity Profile of Outstanding State Development Loans and Power Bonds

(Rupees crore)

Year of Maturity	State Development Loans	Power Bonds	Total
1	2	3	4
2010-11	15,641	2,907	18,548
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
2019-20	1,31,122	0	1,31,122
Total	**5,17,476**	**18,784**	**5,36,260**

risk and bunching of repayment obligations in the short-term if investors choose to exercise the option.

VII.16 Another important development during the year was the introduction of non-competitive bidding facility in the auction of SDLs. To widen the scope for participation of retail investors in the auction of SDLs, non-competitive bidding facility has been extended to SDLs since the auction held on August 25, 2009. Under the Scheme, up to 10 per cent of the notified amount of SDLs (5 per cent in the case of Central Government security) is allotted to eligible individuals and institutions, subject to a maximum of one per cent of the notified amount for a single bid per stock (₹2 crore in the case of Central government security). Retail/mid segment investors responded well due to the attractiveness of the scheme and as a result of wider retail participation, the cut-off yield was settled at a lower level in respect of many States.

VII.17 During 2010-11(up to July 2010), eight tranches of auctions were conducted under the market borrowing programme of the State Governments and 17 States raised an aggregate amount of ₹31,641 crore on a gross basis (net ₹23,519 crore) as compared to ₹32,566 crore (net ₹23,404 crore) raised by 17 States during the corresponding period of the previous year. The cut-off yield ranged 8.05-8.58 per cent as compared to 7.04-7.97 per cent during the corresponding period of the previous year. Consequently, the weighted average yield was higher at 8.28 per cent as compared with 7.65 per cent during the corresponding period of the previous year.

Cash Management

VII.18 Following the recommendations of the Advisory Committee on Ways and Means Advances and Overdrafts to State Governments (Chairman: Shri M.P. Bezbaruah), a revised WMA/OD Scheme was put in place with effect from 2006-07. Accordingly, the aggregate normal WMA limit for States for 2009-10 was ₹9,925 crore; on a review, the same limit has been retained for 2010-11. Reflecting the cash surplus position and management of cash balances by the States, the outstanding WMA/OD remained relatively moderate during 2009-10 (Table VII.8).

VII.19 Most State governments have accumulated sizeable cash surpluses in recent years, which reflected, inter alia, the fiscal consolidation process undertaken since 2005-06. The temporary setback to fiscal consolidation in the wake of the global crisis, however, did not affect much the pattern relating to cash surplus of the States. The liquidity

Table VII.8: WMA/Overdrafts of State Governments*

(Rupees crore)

Month	Special WMA			Normal WMA			Overdraft			Total		
	2008-09	2009-10	2010-11	2008-09	2009-10	2010-11	2008-09	2009-10	2010-11	2008-09	2009-10	2010-11
1	2	3	4	5	6	7	8	9	10	11	12	13
Apr	489	619	588	287	294	290	139	111	191	916	1,024	1069
May	310	126	298	3	50	14	0	2	0	313	179	312
Jun	9	5	36	0	67	0	0	0	0	9	71	36
Jul	25	76	2	0	7	0	0	0	0	25	83	2
Aug	2	55		47	52		0	0		49	107	
Sep	139	216		18	246		0	77		158	540	
Oct	653	54		83	161		0	2		736	216	
Nov	754	388		152	74		0	0		906	462	
Dec	223	22		0	31		0	0		223	53	
Jan	370	120		0	47		0	25		370	191	
Feb	86	508		0	32		0	0		86	540	
Mar	320	274		62	248		11	87		392	609	
Avg.	282	205	231	54	109	76	13	25	48	349	340	355

* : Average of daily outstanding.

Table VII.9: Number of days States availed of Special & Normal WMA and Overdraft

States	Special WMA			Normal WMA			Overdraft		
	2008-09	2009-10	2010-11*	2008-09	2009-10	2010-11*	2008-09	2009-10	2010-11*
1	2	3	4	5	6	7	8	9	10
Andhra Pradesh	0	1	3	0	0	0	0	0	0
Haryana	5	7	10	0	5	10	0	0	8
Kerala	105	18	0	18	2	0	0	0	0
Madhya Pradesh	2	11	0	2	11	0	0	0	0
Maharashtra	10	0	0	0	0	0	0	0	0
Nagaland	21	69	0	18	45	0	4	13	0
Punjab	23	130	0	21	128	0	0	29	0
Uttar Pradesh	0	8	4	0	8	4	0	0	0
West Bengal	168	95	38	39	15	12	4	8	4
Mizoram	0	29	25	0	15	15	0	0	0
Goa	0	0	0	0	1	0	0	0	0
Uttarakhand	57	69	33	28	26	12	15	9	10

* Up to July 31, 2010.

pressures, though, were confined to a few State Governments (Table VII.9).

VII.20 The surplus cash balances of the State Governments are automatically invested in 14-day Intermediate Treasury Bills, the discount rate of which is presently fixed at 5 per cent. The higher accumulation of surplus balances, particularly during the second half of 2009-10 were deployed in Intermediate Treasury Bills due to interest rate advantage (Table VII.10). The Government of Mizoram bought back SDLs amounting to ₹22 crore during 2009-10 under the "High Cost Debt Buy Back Scheme" of the State.

VII.21 The Reserve Bank, on behalf of the State governments, maintains the consolidated sinking fund (CSF) that provides a cushion for amortisation of market borrowing/liabilities and the guarantee redemption fund (GRF), which provides for the servicing of contingent liability arising from invocation of guarantees issued in respect of

Table VII.10 : Investments of the State Governments / UT*

(Rupees crore)

Month	Investment in 14-day Treasury Bills			Investment in Auction Treasury Bills			Total		
	2008-09	2009-10	2010-11	2008-09	2009-10	2010-11	2008-09	2009-10	2010-11
1	2	3	4	5	6	7	8	9	10
April	48,192	74,607	79,603	31,780	8,875	250	79,972	83,482	79,853
May	48,280	66,585	76,967	32,244	8,664	250	80,525	75,249	77,217
June	42,865	69,482	77,487	40,285	6,125	704	83,150	75,607	78,191
July	46,742	75,403	85,998	38,802	2,125	3,262	85,543	77,528	89,260
August	44,110	78,046		43,069	1,125		87,179	79,171	
September	40,112	73,663		40,927	1,125		81,038	74,788	
October	39,328	85,784		32,705	825		72,033	86,609	
November	41,878	87,974		26,988	750		68,866	88,724	
December	51,551	98,162		24,055	625		75,606	98,787	
January	63,420	1,01,871		20,084	500		83,504	1,02,371	
February	75,193	1,02,628		14,150	500		89,342	1,03,128	
March	1,01,557	1,06,697		6,893	313		1,08,450	1,07,009	
Avg.	**53,602**	**85,075**	**80,014**	**29,332**	**2,629**	**1,116**	**82,934**	**87,704**	**81,130**

*: Average of Friday outstanding.

borrowings by state level undertakings or other bodies. As on July 31, 2010, 20 State governments have notified CSFs and 10 have set up GRFs. The outstanding investments under CSF and GRF amounted to ₹32,316 crore and ₹3,466 crore, respectively, as at end-July 2010.

VII.22 Although the net market borrowings of the Central Government in 2010-11 would be lower than in the previous year, the borrowing programme, measured by the scale of fresh supplies of government paper, is likely to be much higher. The borrowing programme has to be managed keeping in view certain adverse factors. First, during 2009-10, the large market borrowing was facilitated by the unwinding of MSS securities and OMO purchases, as a result of which fresh issuance of securities constituted 63 per cent of the total budgeted market borrowings. In 2010-11, almost the entire budgeted market borrowings would, however, be funded by fresh issuance of securities. Therefore, notwithstanding the lower budgeted net market borrowings, fresh issuance of securities in 2010-11 would be significantly higher than during 2009-10. Second, in view of the revival in private credit demand and excess SLR holdings of banks, they may not invest in government securities as much as they did last year. Third, the demand for government securities from the state owned insurance companies could also be muted as they may participate in the disinvestment programme of the Government, while also meeting the rising long-term financing needs of the infrastructure sector. Therefore, the market conditions in 2010-11 are likely to be more challenging for the conduct of debt management operations. The auction calendar for dated securities for the first half of 2010-11, however, provides some comfort to the market as issuance of securities of 5-9 year maturities would continue to account for a significant portion of the borrowing programme. This is facilitated by the relatively higher duration of the outstanding stock of government securities.