

DEBT: GOVERNMENT MAY MONETISE DEBT IF FISCAL OVERSHOOTS: OFFICIAL

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

NEW DELHI: The government may consider monetising its borrowings if the fiscal deficit overshoots expectations sharply, a senior government official told ET.

The government has announced a Rs 20 lakh crore package to support the economy that's been locked down for nearly two months now, providing support to small businesses, non-banking finance companies (NBFCs), migrant labour and farmers among others. It has also rolled out a series of reforms as part of the programme. "There is no legal bar and there is no conceptual bar either when we have low inflation. We in fact have a situation of deficient demand," the official said. "So, this is not a situation where monetisation will be inflationary."

Experts said the impact of the package on government finances will be about 1% of GDP. The government has already raised its borrowing target for the year to Rs 12 lakh crore from 7.8 lakh crore announced in the budget, attributing it to the coronavirus outbreak that's stalled the economy. FM [Nirmala Sitharaman](#) has increased the borrowing limit of states to 5% of gross state domestic product ([GSDP](#)) in FY21 from 3%, a move that will make an additional Rs 4.28 lakh crore available to them. This was part of the overall stimulus.



High government borrowing from the market can raise interest rates and deny credit to the private sector. Monetisation can avert this but there are risks of high inflation and currency depreciation apart from a general deterioration in macroeconomic balance. Monetising the [debt](#) requires the Reserve Bank of India (RBI) to directly purchase government securities in the primary market to help the central government meet its expenditure, by printing more money. The [RBI](#) had ended the practice of direct monetisation in 1997. Economists are divided on the issue – while some have cautioned against the move, others say limited monetisation can be undertaken if needed.

"The government needs to take decisions based on what is the prudent level of spending that it has to incur. And then find money for it either by borrowing for it till the level the money can be sustained and then monetising to the extent it cannot be," the official said. In February, the government had announced its fiscal deficit target for FY21 at 3.5% but with the Covid-19 crisis, the math needs to be reviewed, experts said. Nomura expects the fiscal deficit to widen to 7% this financial year. A high fiscal deficit supported by borrowings can raise market interest rates. "Go directly to the market—the interest yields will rise, but if you don't, then interest rate remains the same and it might even fall," said the official cited above. Debt monetisation improves longterm sustainability as it will keep interest rates in check, he added.

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