

INDIAN STATES' RISING DEBT SEEN POSING CHALLENGE IN MEDIUM TERM

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

By **Anirban Nag**

Indian states racked up more [debt](#) to fund widening budget deficits after some of them announced waivers for farmers grappling with an [agrarian crisis](#).

The increase in debt levels is in turn boosting redemption pressure on states, which normally issue plain vanilla bonds, according to a [Reserve Bank of India](#) report published Monday. It implies borrowings by provinces might soar in the coming years and may lead to crowding out of the private sector in a market already cramped by issuances by the federal government and state-run enterprises.

“Outstanding debt of states have risen over the last five years to 25% of gross domestic product, posing medium term challenges to its sustainability,” the central bank said in the report, Study of State Finances. Their debt profiles are prone to risks, especially if power distribution companies owned by them pile up losses.

States finished the fiscal year to March 2019 with a combined fiscal deficit of 2.9%. While that was a touch lower than the 3% gap allowed by law, it was 34 basis points worse than what they had budgeted. The states' combined [budget deficit](#) for the financial year to March 2020 is forecast at 2.6%.

That estimate might already be under threat after Prime Minister Narendra Modi's government announced a \$20 billion tax break for companies last month as part of stimulus measures to revive economic growth. Since Indian states tend to get about a third of these taxes, their finances are likely to come under pressure.

A note from HSBC Securities and Capital Markets India on Monday forecast states' fiscal deficit to be 10 basis points higher this year. Fitch Ratings separately said the general government budget gap, which includes deficits of states, is seen at 7.5% of GDP in the year to March -- the highest in eight years.

“States have budgeted prudently for 2019-20, but macroeconomic risks to their combined budget estimates appear to be slanted to the downside,” the [RBI](#) said. “The loss of momentum in economic activity needs to be reversed soon, otherwise it can have revenue implications for state budgets, if not complemented by extra efforts toward revenue mobilization.”

The states' inflated debt sale schedule reflects that warning. They are scheduled to borrow up to 1.71 trillion rupees (\$24 billion) from the market in the October-December quarter, higher than the 1.23-1.29 trillion indicated in the year ago period.

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