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Interest payments: Centre's soaring debt may curb productive spending-Business Journal

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Moreover, with an eye on growth, the government has budgeted an impressive 26.2% hike in capital expenditure, which has high multiplier effect, for FY22. Of course, the Budget math may go haywire again due to the second pandemic wave.

India's elevated general government debt of about 90% of gross domestic product (GDP) in the wake of the Covid-19 outbreak can potentially inflate interest payments and impair the ability of the Centre as well as states to boost productive spending, economists and senior executives at global rating agencies told FE.

Given the damage caused by the second wave, some economists expect the FY22 fiscal deficit to exceed the 6.8% target by as much as one percentage point.

The need of the hour, therefore, is to rekindle growth impulses fast, which will bolster revenue mop-up and enable the country to pare down its debt, they stressed. This must also be followed up with a credible road map, which should be more sacrosanct than the oft-relaxed FRBM rules, to reduce debt.

Expeditious containment of the second wave and effective implementation of structural reforms, especially in factors of production, are key to the country's growth objectives, some of them said. Else, given the parlous state of finances, any threat to GDP growth outlook will only weigh down debt affordability.

According to the IMF data, from a peak of 84.2% of GDP in 2003 (since liberalisation), the general government debt ratio eased to 66% by 2010, before inching up again to reach 73.9% in 2019. In 2020, a deadly combination of a Covid-induced GDP contraction and massive borrowing to bolster spending inflated debt ratio to as high as 89.6%.

Jeremy Zook, director (sovereign ratings) at Fitch Ratings, told FE: "We do not foresee India's debt ratio declining to its pre-pandemic level of 73.9% in the next 5 years." Fitch had expected the FY22 debt ratio to decline by 2.5 percentage points from an estimated 90.6% in FY21. But this "will have to be reassessed" in the wake of the second wave, Zook said.

William Foster, vice-president & senior credit officer (sovereign risk) at Moody's, said: "(India's) Debt affordability will remain relatively weak with interest payments reaching about 28% of general government revenue in 2021, the highest among Baa-rated peers and more than three times the Baa median forecast of around 8%."

Foster expected debt to stabilise at around 92% of GDP by FY25, against 88.9% (Moody's estimate) in FY21. This is among the least optimistic projections of India's debt profile; some other agencies have forecast the burden to ease with a pick-up in economic growth.

Unsurprisingly, a sizeable chunk of resources goes towards interest payments, which shot up to 28.5% of general government revenue last fiscal from 22.9% in FY20. This is projected to drop to 27.5% in FY22 before rising again to 28.3% next fiscal, Moody's has said.

M Govinda Rao, a member of the 14th Finance Commission and current chief economic adviser at Brickwork Ratings, said: "Even if the 15th Finance Commission's consolidation path is strictly followed, the Centre's debt is expected to be reduced from 62.9% in FY21 to 56.6% in FY26. This implies that the interest payment will remain at elevated levels and continue to crowd out more productive expenditures."

The NK Singh-led FRBM panel had in 2017 suggested that the general government debt be capped at 60% of GDP by FY23. However, Singh, who also headed the 15th Finance Commission, recently said in interviews that given the unprecedented Covid crisis, the Centre and states can exceed their FRBM limits. But once the pandemic is dealt with, they must chart out a clear path to regain fiscal discipline, Singh said.

Any debt reduction road map, however, hinges on a spurt in economic growth. "Growth-enhancing structural reforms and addressing infrastructure gaps could boost the outlook if they are well-implemented in our view," Fitch's Zook said.

To be sure, debt ratios of economies around the world have surged in the aftermath of the pandemic. According to an IMF estimate, given the widening deficits and contraction in economic activity, debt worldwide surged to as much as 97% of GDP in 2020. It will rise to 99% in 2021 before stabilising below but close to 100% of GDP, he added.

Importantly, the Economic Survey for FY20 pointed out that India's forex reserves of $584 billion as of January 15, 2021, were greater than its total external debt (even including that of the private sector) of $556 billion as of September 2020. Forex reserves have since swelled, hitting a record $593 billion as of May 21. "In corporate finance parlance, therefore, India resembles a firm that has negative debt, whose probability of default is zero by definition."

Moreover, with an eye on growth, the government has budgeted an impressive 26.2% hike in capital expenditure, which has high multiplier effect, for FY22. Of course, the Budget math may go haywire again due to the second pandemic wave.

The government has also firmed up a road map for capital investments of Rs 111 lakh crore in infrastructure up to FY25. However, drawing large-scale patient capital into infrastructure is unlikely to be easy despite the setting up of a development finance institution.

As for the current fiscal, Sonal Varma, chief economist, India and Asia (ex-Japan) at Nomura, said revenues will likely take a hit in the June quarter due to the second wave. "However, as we expect the economic recovery to resume after June, we should see a bounce in tax collections thereafter. A key risk is any delay to disinvestment plans due to second wave disruptions that put the ambitious target of Rs 1.75 lakh crore (~0.8% of GDP) in jeopardy," Varma said.

Several agencies, including Barclays, Nomura, S&P and Moody's, recently cut their India growth forecasts for FY22, with a few slashing their projections by as much as four percentage points to just over 9%, as the second Covid wave hit businesses. This has compounded the worries of policymakers who had earlier expected a V-shaped recovery after the first wave.