ECONOMY

Farm loan waivers: Can it boost rural spending?

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The season of farm loan waivers is upon us. First UP, then Maharashtra and now Punjab & Karnataka. And, more states are likely to trip on this politically slippery slope. If the fever spreads, we envisage waivers could catapult to a ~1.5% of GDP. Having said that, its implementation raises a few pertinent issues—funding modalities, duration of implementation, among others. We believe, a scenario where waivers are funded by debt issuance (rather than expenditure cuts) and where fiscal burden is spread over 3-4 years is more likely. If so, farm households' spending ability will get a boost (70% farmers are marginal with high propensity to consume). However, banks will have to bear the brunt from spread out fiscal payments as well as associated deterioration in credit culture. Finally, debt issuance spread over 3-4 years may keep states' borrowing costs under check, especially if RBI is accommodative, which we believe is warranted given the broader state of the economy. To that extent, risk of private sector crowding out is low.

Sizing up farm loan waivers

In the 3 states which have announced loan waivers so far, Maharashtra and UP have waived nearly 30-40% of outstanding agri-bank credit and Punjab is somewhat lower at 15%. Moreover, the probability of more states—Madhya Pradesh, Gujarat, Rajasthan, Haryana, etc—joining the bandwagon is high. If this plays out and assuming 20-30% of outstanding agri-bank loans are waived, the total loan waiver could add up to a sizeable ~INR1.5-2.3tn (1.0-1.5% of FY18E GDP).

But uncertainties galore

Modalities of these loan waivers are not clear as yet even to states which have announced the write offs. Who will be the beneficiaries? over what duration will the waivers be implemented? how will states fund waivers? These will ultimately determine how the cost of rural distress is distributed among households, government and banks ***(refer our note "Rural economy: Looking beyond monsoons," dated May 3, 2017, for more details).***

Impact: Boost to farm households; banks to bear the brunt

If the government staggers the fiscal burden over 3-4 years, it will still imply annual fiscal cost of 0.3-0.5% of GSDP. However, banks, which will be compensated only over a period of time, will have to bear the brunt. Deterioration in credit culture is an added potential risk for banks. On the other hand, rural consumption could get a boost if waivers are funded by fresh debt issuance rather than expenditure cuts. It's pertinent to note that marginal propensity to consume will be high for small/marginal farmers (70% of agricultural households). Finally, debt issuance spread over a period of time will curtail rise in borrowing cost. RBI's monetary stance will be critical in this regard. We believe, it should remain accommodative given the state of the economy. Overall, in a most likely scenario, farm households will benefit even as banks bear the brunt.

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If farm loan waivers are staggered and funded by additional borrowing, then:

(1) Households will gain

(2) Banks will bear a large burden owing to delayed repayments from states

(3) Government finances will deteriorate, but not by much

Fig 1. Who will bear the cost of deteriorating farm debt dynamics?

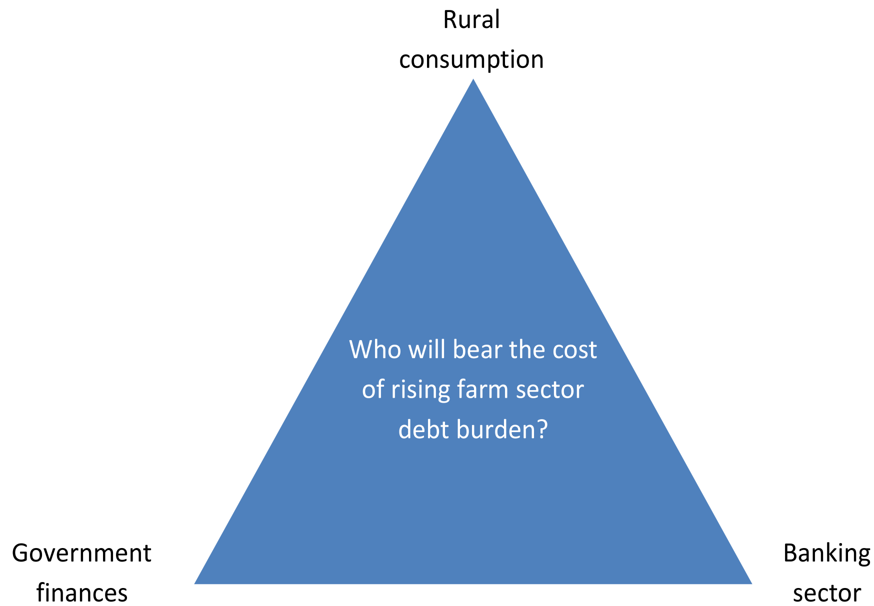


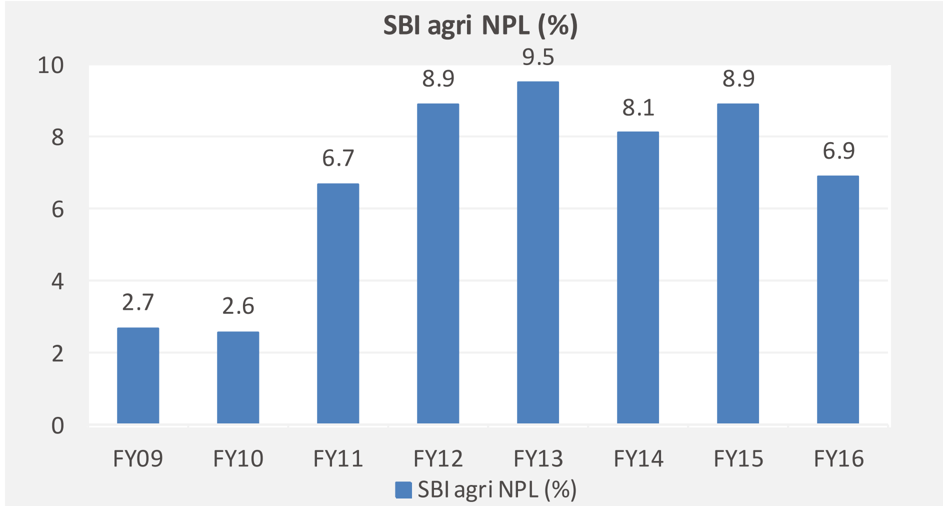
Table 1: State government finances and farm loan waiver

State Name	FY18 Fiscal deficit (BE)		Size of loan waiver		Loan waiver as % of		
	INR bn	% of GSDP	Outstanding agri loan by banks (INRbn)	Proposed size of loan waiver (INRbn)	Outstanding agri loans by bank (%)	GSDP (%)	States' Discretionary spending
States where farm loan waiver is announced			**3054**	**832**	**27**	**1.5**	**34**
Maharashtra	388	1.5	928	300	32	1.2	53
Uttar Pradesh	415	3.0	818	350	43	2.5	36
Punjab	231	5.0	591	100	17	2.1	59
Karnataka	334	2.6	718	82	11	0.6	11
States where farm loan waiver could be announced							
TN	420	2.8	1153				
Rajasthan	248	3.0	577				
MP	211	2.9	469				
Kerala	258	3.4	452				
Gujarat	232	1.8	435				
Haryana	162	2.6	355				
WB	194	1.7	249				
Bihar	181	2.9	214				
Delhi	37	0.5	123				
Odisha	144	3.5	122				
Chattisgarh	96	3.5	88				
Jharkhand	69	2.3	50				

Note:For UP the FY18 numbers are based on vote on account as actual numbers are not available. Discretionary spending of states is states' total spending minus expenditure on police, pension, wages, interest payments and grants in aid from central government.

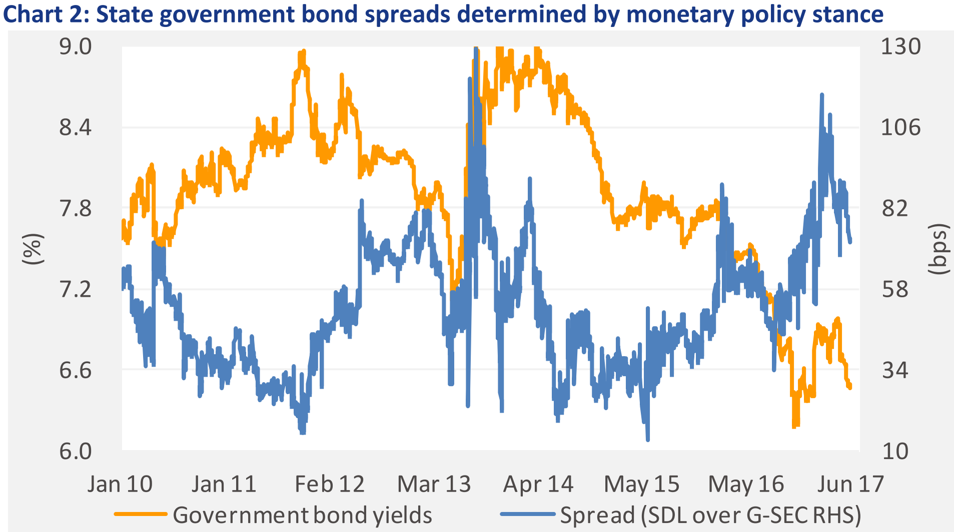
Agri NPLs rose last time post farm loan waiver despite healthy rural incomes – implying deterioration in credit culture

Chart 1: Credit culture deteriorated during previous farm loan waiver of FY09-FY10



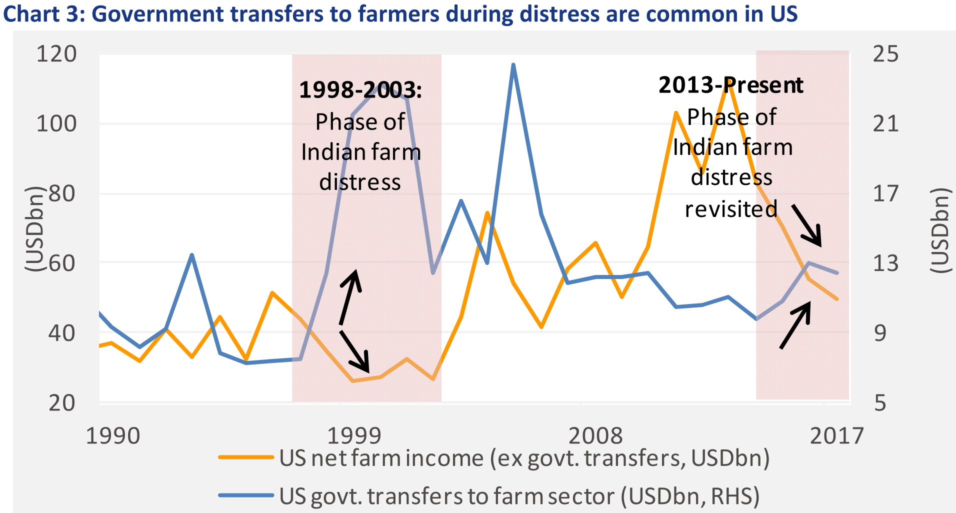
Additional government borrowing, unlikely to make spreads go higher, if monetary stance is accommodative

Chart 2: State government bond spreads determined by monetary policy stance



Government transfers to farmers during distress are not unique to India; they happen all the time in US

Chart 3: Government transfers to farmers during distress are common in US



Source: US Department of Agriculture, FAO, Edelweiss research

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