India’s budget: Aiming for a V-shaped recovery?

The Indian annual budget seems to be pursuing a v-shaped recovery but the mixed market reactions – a sell-off in the government bond market, depreciation of the Indian rupee, and a huge equity rally suggest investors aren’t entirely convinced. And neither are we

Mumbai skyline

An exemplary show of policy support for the economy

Indian prime minister Narendra Modi's budget for the fiscal year 2021-22 is aiming for a strong v-shaped economic rebound next year to 11% GDP growth from a record -7.7% contraction in the current fiscal year – both the projections are a part of the government’s annual Economic Survey for FY20-21.

Indeed, growth outweighs fiscal austerity. Though the measures would have gone some way in reviving investor confidence in the government’s economic management after a spending surge and revenue shortfall widened the budget deficit and the public debt in the current fiscal year.

The budget contained significant surprises, especially on the fiscal deficit side. The finance minister announced that the deficit as a proportion of GDP in the current fiscal year is estimated to swell to a record 9.5%, which was substantially more than our forecasts and also the broader consensus view of over 7.0% deficit.

In some display of fiscal tightening, the government is aiming to narrow the deficit down to 6.8% of GDP.

> *The mixed market reactions to the budget announcement – a sell-off in the government bond market, depreciation of the Indian rupee, and a huge equity rally suggests investors aren't quite convinced either*

That said, the INR 34.8 trillion spending budget for the next fiscal year is little changed from this year.

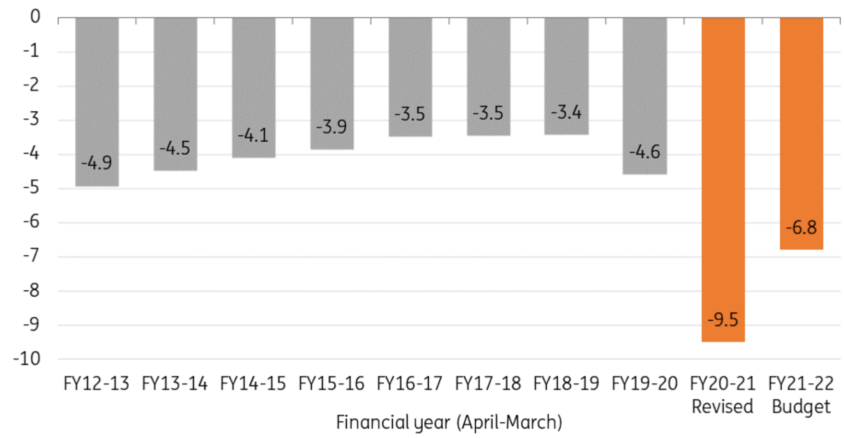
This suggests all the hopes of trimming the deficit below 7% of GDP rest on recouping revenue losses suffered in the current year and more, which in turn depends on the economy achieving double-digit growth. We are sceptical of this and we're not alone. The mixed market reactions to the budget announcement – a sell-off in the government bond market, depreciation of the Indian rupee, and a huge equity rally suggests investors aren't quite convinced either.

The current revenue receipts are projected to grow by 15% in the next fiscal year. This is slightly faster than 13.9% of nominal GDP growth underlined by the official budget projections, which appears to be a bold assumption.

Moreover, the economy isn't out of the woods yet. The pandemic may be under control currently with the authorities launching a massive vaccination driver, but the risk of the virus resurfacing remains. In the event, GDP growth falls short of the official target, so would the revenue. Leaving alone the retrograding effects of new revenue generations measures.

As such, extremely weak public finances will continue to be a key overhang on markets well into 2022, probably even beyond.

Fiscal deficit as proportion of GDP (%)



Source: CEIC, Indian Ministry of Finance, ING Bank

India's fiscal year runs from 1 April to 31 March.

Key budget assumptions

With a little-changed spending programme, it will take higher revenue to trim down the fiscal deficit.

- FY20-21 budget deficit of 9.5% of GDP - the highest since 1987 (consensus 7.3%).
- FY21-22 deficit programmed at 6.8% (consensus 5.5%).
- FY21-22 total expenditure at INR 34.8 trillion - little changed from the current fiscal year.
- FY21-22 development spending of INR 5.54 trillion, up 26% from revised estimate for FY20-21. This with little-changed total spending implies a significant cut to current spending ahead.
- FY21-22 divestment revenue of INR 1.75 trillion. These targets have hardly been met in the past.
- Additional market borrowing of INR 800 billion in FY20-21 (in the remaining two months of the financial year), on top of INR 12 trillion earlier plan.
- Borrowing planned at INR 12 trillion for FY21-22

Spending-side measures

Infrastructure continues to dominate the spending side measures.

- INR 641 billion for boosting healthcare infrastructure for over six years.
- INR 350 billion for Covid-19 vaccination programme.
- INR 1.1 trillion for 'future-ready' railway infrastructure.
- INR 3 trillion for revamping the power distribution sector over five years. Carrying on with 8,500 km of roads and highway projects announced in the past budgets.
- INR 1.97 trillion support for the production-linked incentive scheme for key sectors for five years.
- INR 1.41 trillion allocations for clean cities initiatives (13.50)
- INR 2.87 trillion for clean water programme for five years.
- INR 200 billion capital base for the proposed Development Financial Institution for infrastructure project financing.
- INR 200 billion for the recapitalisation of Public Sector Banks. Setting up an asset

management company to manage bad loans.
- INR 157 billion support for SMEs.

Revenue-side measures

Aside from revamping the customs duty structure, the real thrust of revenue generation seems to be largely missing in the new budget.

- Tax filing exemption to senior citizens above 75 years with only pension income.
- Extension of tax relief for home buyers and affordable housing projects with loans for one more year, up to 31 March 2022.
- Extension of tax holiday for start-ups by one year.
- Tax holiday for airlines and aircraft leasing companies.
- Revamping customs duty structure -- rationalisation of duties on precious metals of gold and silver; hike in duty on solar inverters; mobile phones and auto parts; withdrawing duty exemption of products supporting domestic infrastructure.
- The monetisation of assets: including rails roads, airports, sports facilities, and fuel transmission systems, warehouses, etc.
- Sale of government's ownership of two state-run banks and insurance companies.

Other measures

- Easing tax administration, reducing compliance costs.
- Voluntary vehicle scrapping policy - phasing out old vehicles (not applicable for commercial vehicles).
- Increase in foreign investment limit for the insurance sector to 74% from 49% currently.
- Developing a digital payments system.
- Review the Companies Act with a view of easing regulations for SMEs.
- Ensuring credit flows to agriculture and enhancing marketing infrastructure for this sector.
- Protecting depositors in troubled banks.
- The liberalisation of the electricity market.
- Setting up seven textile parks over three years.

FY21-22 Budget at Glance

Financial year (April to March) INR bn	FY18-19 Actual	FY19-20 Actual	FY20-21 Budget	FY20-21 Revised	FY21-22 Budget
1. Revenue receipts	**15530**	**16841**	**20209**	**15552**	**17884**
(% YoY)	**8.6**	**8.4**	**20.0**	**-7.7**	**15.0**
2. Tax revenue (Net to Centre)	13172	13569	16359	13445	15454
3. Non-tax revenue	2358	3272	3850	2107	2430
4. Capital receipts a/	**7621**	**10023**	**10213**	**18952**	**16948**
5. Recovery of loans	180	183	150	145	130
6. Other Recepits	947	503	2100	320	1750
7. Borrowing and other liabilities b/	6494	9337	7963	18487	15068
8. Total Receipts (1+4)	**23151**	**26863**	**30422**	**34503**	**34832**
9. Total expenditure (10+13)	**23151**	**26863**	**30422**	**34503**	**34832**
(% YoY)	**8.1**	**16.0**	**13.2**	**28.4**	**1.0**
10. On revenue account; of which	20080	23506	26301	30111	29290
11. Interest payments	5826	6121	7082	6929	8097
12. Grants in aid for creation of capital assets	1918	1856	2065	2304	2191
13. On capital account	3071	3357	4121	4392	5542
14. Revenue deficit (1-10)	**-4550**	**-6665**	**-6092**	**-14560**	**-11406**
% of GDP	-2.4	-3.3	-2.7	-7.5	-5.1
15. Effective revenue deficit (14-12)	**-2632**	**-4809**	**-4027**	**-12256**	**-9215**
% of GDP	-1.4	-2.4	-1.8	-6.3	-4.2
16. Fiscal deficit [9-(1+5+6)]	**-6494**	**-9337**	**-7963**	**-18487**	**-15068**
% of GDP	**-3.4**	**-4.6**	**-3.5**	**-9.5**	**-6.8**
17. Primary deficit (16-11)	-668	-3216	-881	-11558	-6971
% of GDP	-0.4	-1.6	-0.4	-5.9	-3.1

a/ Excluding receipts under Market Stabilisation Scheme
b/ Includes drawdown of Cash Balance

Source: CEIC, Indian Ministry of Finance

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