Budget 2021-22: The Queen's Gambit

The Context

- *An assessment of today's budget might want to start by listing the myriad challenges that the finance minister faced. Mercifully, the economy seems on the mend and the nominal GDP growth of 14.4 per cent assumed in the budget for 2021-22 looks impressive. However, some the fizz in the number comes from the extraordinarily low denominator of 2020-21 due to the 7.7 per cent contraction in real GDP.*

- *With a 14.4 per cent nominal growth rate, nominal GDP will return to its pre-pandemic level somewhere at the end of 2021. However, even with reasonably strong growth after 2021-22, the gap between the GDP that the pre-pandemic trend (PPT) would have produced and the current path is likely to be large. The budget's task was to squeeze the gap between the PPT and the current path as much as possible by pushing the long-term growth trajectory up.*

- *Second, as with most recoveries, the bigger firms and the better-off households tend to benefit more leaving the small and poor behind. Besides, the vulnerability of different sectors to the pandemic are markedly different. This might result in what economists describe as a K-shaped recovery with sharp inequality between different firms and households. The budget needed to address this.*

- *Spending big to buy growth has its limitations. Raising taxes to fund expenditures would nullify the expansionary effect of the spending. The only option is to keep the fiscal deficit high -- that is borrow to spend. Rising debt levels run the risk of a being a long term drag on the economy. So, the FM had to take a gamble on letting borrowings balloon in the near term in the hope that the economic growth it drives leads to sustainable consolidation of debt (reduction in the debt-GDP ratio) in the future. This gamble was not for the faint-hearted.*

- *Two other challenges remained. First, strengthening sectors like health care whose importance the pandemic has highlighted. Second, handling the likely increase in bad loans that was suppressed through moratoria and its impact on bank balance sheets.*

How does the budget fare on these counts?

- ***There should be little doubt that this is as bold budget as it could be and in many more ways than one. To begin with, it does spend big!*** *The deficit target of 6.8 per cent for 2021-22 (way higher than analyst forecasts) and indeed the amendment of the FRBM act so that the deficit finally comes below 4.5 per cent only in 2025-26 is perhaps as bold as expansionary fiscal policy can get.*

- ***Under this umbrella of fiscal expansion, the specific bet is on the infrastructure sector.*** *Capital expenditure is budgeted to rise by 34.5 per cent next year. There are some bold institutional innovations as well. A well-capitalized Development Finance Institution (DFIs) has been set up to garner and channel private (including external) funds to infra projects. A National Monetization pipeline has been set up to sell a variety of existing infra-assets to fund the creation of new assets.*

- *So far so good. However, investing in Indian infrastructure has historically been perceived as a risky bet. The erstwhile DFIs had their fair share of problems. It remains to be seen how effectively these new structures can improve the risk appetite for infra projects.*

- *The budget, predictably, relies on disinvestment and asset monetization for resources. This has always been an area of concern since actual receipts have typically fallen short of targets. Thankfully this budget provides enough detail on what the government plans to do to make the Rs.1.75 lakh crore target credible. The government, for example, now has a policy of selling all PSUs in non-strategic sectors and keeping the number of PSUS in four strategic sectors to a bare minimum. The FM seems confident that the four PSUs including Air India and BPCL that were scheduled for strategic sale this year will finally be off the block next year. Then there is the IPO for LIC and a Special Purpose Vehicle to sell surplus land that finds place in the budget speech.*

- ***A key announcement for the banking sector that addresses the issue of bad loans is the creation of an Asset Reconstruction and Management Company that will function as a "bad bank".*** *This would give banks the much needed room to focus on core activities instead of fretting over their impaired loans and also speed up the process of liquidation.*

- *The budget also ticks the right box on healthcare by launching the PM Atmanirbhar Swasth Bharat Yojana that will supplement the National Health Mission. Besides, going by our estimates the allocation of Rs 35000 crores for the COVID vaccination drive seems adequate.*

- *However, a couple of niggles remain. One can argue that that there is a marked absence of targeted support both for distressed households or sectors that lag behind in the recovery. Secondly, the unexpectedly large fiscal deficit numbers both for the current and the next year entail huge borrowings, much beyond market expectations. Government bond yields have hardened quite a bit in the wake of the recovery. The Finance ministry and the RBI will have to work closely together to check the rise in yields and ensure that the budget doesn't ultimately result in a rise in borrowing costs across the board.*

Financing of the deficit and Bond View

For the bond market, a higher than expected market borrowing estimate (INR 12 trn) in FY22 and additional borrowings of INR 80,000 crores in FY21 are likely to add pressure on borrowing costs. The 10-year yield was up by 17bps since the budget announcement crossing 6% from 5.89% before the budget announcement. Over the coming year, high market borrowings, concerns over inflation and a move towards normalising liquidity conditions by the RBI could maintain pressure on yields. That said, we do see the RBI continuing with its yield management tools (perhaps more of Operation twists compared to plain vanilla OMOs due to liquidity concerns) to keep borrowing costs under check. We see the 10 year between 5.95-6.10% by the end of H1 FY22.

- **Market Borrowing:** The government is set to borrow an additional INR 80,000 crore in the last two months of its fiscal bringing the gross market borrowings for FY21 at INR 12.8 trn (excluding switches of INR 1.6 trn). For the next year, the gross market borrowings target has been set at INR 12.05 trn with a fiscal deficit target of 6.8% of GDP. Net market borrowing is targeted at INR 9.2 trn in FY22 from INR 10.5 trn in FY21.

- **Financing Mix:** As a % of total financing, gross market borrowings are 80% of the fiscal deficit compared to 69% in FY21 and 92% in FY20. In other sources of financing, dependence on small savings funds continues in FY22 (26% of FD, INR 3.9 trn) and that on other receipts and cash balances is expected to rise.

Financing of the Fiscal Deficit

INR Trn	FY20	FY21 BE	FY21 RE	FY22 BE
Fiscal Deficit	7.7	8.0	18.5	15.1
Gross Market Borrowings (excluding switches)	7.1	7.8	12.8	12.1
% of FD	92.6	98.0	69.2	80.0
Repayments	2.4	2.4	2.3	2.9
Net Market Borrowings	4.7	5.4	10.5	9.2
Swicthes	1.7	2.7	1.6	1.8
Buyback	-	0.3	-	-
Short term borrowings	0.3	0.3	2.3	0.5
Other Financing				
External Debt	0.049	0.046	0.545	0.015
NSSF	2.4	2.4	4.8	3.9
State Provident funds	0.18	0.18	0.18	0.20
Other receipts	0.049	0.5	0.4	0.5
Draw down of cash balance		-0.3	-0.2	0.7

Fiscal Math FY22

	INR trn			%YoY	
	FY20A	FY21RE	FY22BE	FY21RE	FY22
Revenue receipts	16.8	15.6	17.9	-7.7	**15.0**
Tax revenue(net to centre)	13.6	13.5	15.5	-0.7	**14.9**
Gross tax revenue	20.1	19.0	22.2	-5.5	**16.7**
Direct tax	10.5	9.1	11.1	-13.8	**22.4**
Corporate tax	*5.6*	*4.5*	*5.5*	*-19.9*	**22.6**
Income tax	*4.9*	*4.6*	*5.6*	*-6.8*	**22.2**
Indirect Tax collections excluding GST	3.5	4.7	4.7	33.7	**-0.5**
Customs	*1.1*	*1.1*	*1.4*	*2.5*	**21.4**
Union excise duties	*2.4*	*3.6*	*3.4*	*50.8*	**-7.2**
GST collections	6.0	5.2	6.3	-14.0	**22.3**
Non- tax revenue	3.3	2.1	2.4	-35.6	**15.4**
Dividends and Profits	*1.9*	*1.0*	*1.0*	*-48.1*	**7.2**
Non-Debt Capital Receipts including disinvestments	0.7	0.5	1.9	-	-
Disinvestments	*0.5*	*0.3*	*1.75*	-	-
Total receipts ex borrowings	17.5	16.0	19.8	-8.6	**23.4**
Total Expenditure	26.9	34.5	34.8	28.4	**1.0**
Revenue Expenditure	*23.5*	*30.1*	*29.3*	*28.1*	**-2.7**
Subsidies(food, fertiliser, petroleum and others	*2.6*	*6.5*	*3.7*	*148.1*	**-43.1**
Capital Expenditure	*3.4*	*4.4*	*5.5*	*30.8*	**26.2**
Fiscal Deficit	9.3	18.5	15.1	-	-
Fiscal Deficit as % of GDP	4.6	9.5	6.8	-	-
Nomibal GDP %YoY	203.4	194.8	222.9	-4.2	**14.4**
Gross Tax/GDP ratio	9.9	9.8	9.9	-	-

Source: Budget Documents, HDFC bank

The Revenue Side: Banking on growth to push up tax collections and meeting the disinvestment target

The budget has set the revenue receipts target at INR 17.9 trn for FY22, an increase of 15% from FY21 RE. We reckon that the revenue targets set are not ambitious given the expected sharp recovery in nominal GDP growth. Gross Tax-to-GDP ratio has been kept broadly unchanged for FY22 at 9.9% as compared to 9.8% in FY21.

- **Higher tax collections:** Direct tax collections growth is budgeted to increase by 22.4% in FY22 led by both higher income tax and corporate tax collections.

Budgeted Direct Tax collections for FY22

INR bn	FY21 RE	FY22 BE
Corporate Tax	4460.0	5470.0
(%YoY)	(-19.9)	(22.6)
Income Tax	4590.0	5610.0
(%YoY)	(-6.8)	(22.2)

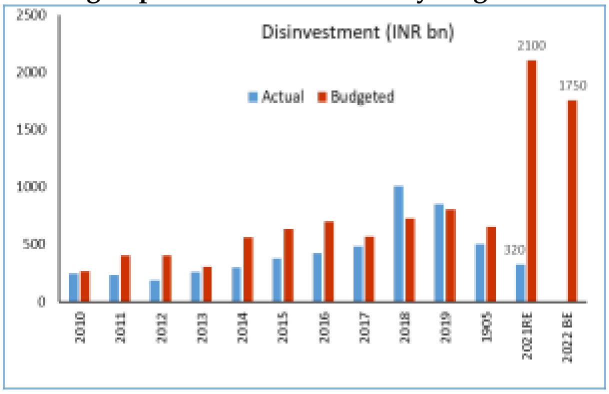
Source: Budget Documents, HDFC Bank

- **Indirect tax (excluding GST) unchanged:** Collections are expected at INR 4.72 trn in FY22, marginally lower than INR 4.74 trn received in FY21. Looking at the internals, proceeds from custom duties are likely to increase while those from excise duties are estimated to decline in FY21 compared to the RE FY21 figures.
    - *Custom Duties: Custom duties budgeted at INR 1360 bn, 21.4% higher as compared to FY21 RE. Government has raised custom duties on a host of products including mobile chargers, some sub-parts of phones, automobile parts (increased to 15%), shrimp feed (increased to 15%), etc. On the other hand, custom duty on gold and silver has been slashed.*
- **A conservative GST collection target: GST collection** target is set at INR 6.3 trn for FY22. Our calculations show that a monthly run rate of INR 966 bn/month is required to meet the target. Given recovery in growth and improvement in economic activity GST target seems conservative. GST collections have been hovering above INR 1 trn mark for the last 4 consecutive months, hitting an all-time high of INR ~1.20 trn in Jan 2021, indicating a steady pace of economic recovery post the pandemic.

- **Disinvestment**: Disinvestment target is set at INR 1.75 trn from stake sale in public sector companies and financial institutions, 2 PSU banks and one insurance company - LIC. This target is lower than the INR 2.1 trn target set in FY21 Budget. In FY21, weak market outlook delayed possible disinvestment proceedings. The intent is to complete these plans in FY22. The pipeline for FY22 disinvestment includes Air India, BPCL, Shipping Corporation, strategic sale of IDBI Bank, Neelachal Ispat Nigam Ltd, among others and IPO of LIC. The government aims to garner INR 900 bn (~51% of its disinvestment target for FY22) from the listing of LIC and stake dilution in the IDBI Bank.

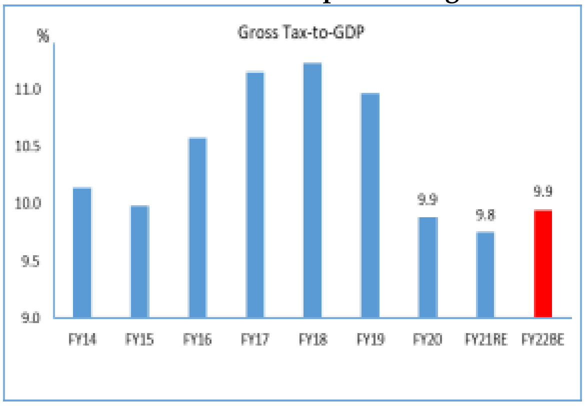
- **Dividend and Profit** from the RBI have been budgeted at INR 535 bn for FY22 compared to INR 571 bn received in FY21.

Pinning hopes on disinvestments yet again



Source: Budget documents, HDFC Bank

Gross Tax to GDP ratio kept unchanged



Source: Budget documents, HDFC Bank

The Expenditure side: Prioritising Capex

The Government revised up its FY21 expenditure target to INR 34.5 trn from INR 30.4 Bn BE, driven largely by an increase in the food subsidy bill (INR 3.1 trn) and somewhat by higher capex spending (INR 0.3 trn). While the focus in FY21 government spending was on rural sector owning to the health crisis, FY22 budget indicated an inclination towards capital spending in order to boost overall growth. The government has budgeted capex worth INR 5.5 trn for FY22, a 34.5% increase over FY21 BE (and 26.2% over FY21 RE). Revenue expenditure is projected to increase by 11.4% in FY22, lower than 28% y-o-y recorded in FY21. At the overall level, compared to FY21 budget estimates, overall expenditure is targeted to increase by 14.5% in FY22 (INR 34.8 trn).

- **From revenue to Capex:** FY22 budget targets a huge infrastructure push, with capex increasing to 2.5% of GDP compared to FY21 BE of 1.8% and revised estimate for FY21 of 2.3% of GDP. The revenue spending is budgeted lower at 13.1% of GDP (INR 29.3 trn), compared to 15.5% of GDP in FY21 RE.

    - **Looking at the revenue spending breakup,** the government plans to lower the fertilizer and food subsidy bill in FY22 vis-à-vis revised estimates, however, it still remains higher than previous years. In FY22 the government plans to spend INR 3.7 trn on the total subsidy bill (1.7% of GDP), with INR 2.4 trn just on food.
    - Besides subsidy, due to the large borrowing program, government's interest payments are estimated to increase to INR 8.1 trn compared to INR 6.9 trn (RE) and INR 7.1 trn (BE).
- **On the employment front, while FY22 MGNREGA allocation** was revised down to INR 730 Bn from INR 1.1 trn in FY21 RE, compared to previous years the allocation continued to remain high.
- **<u>Sector wise, capital and employment intensive sectors like roads, railways received an increased allocation for FY22.</u>** In addition, other sectors like health, sanitisation and urban development have also seen higher allocations. **For this year, the government has allocated INR 2.2 trn for health and wellbeing segment, which marks an increase of 137% over FY21 BE.**

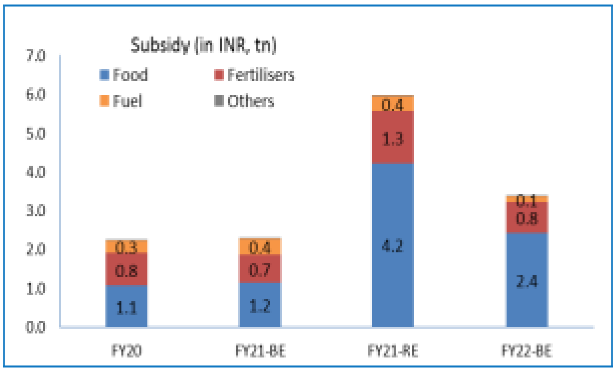
- On the capex front, the government intends to spend INR 5.5 trn through budgetary support and INR 5.8 trn (2.6% of GDP) through PSE resources.

FY22 Spending: Capex in focus

	(in INR, Bn)				YoY,%			(% of GDP)		
	FY20	FY21BE	FY21RE	FY22BE	FY20	FY21RE	FY22BE	FY20	FY21RE	FY22BE
Expenditure	30422	30422	34503	34832.4	31.4%	13.4%	14.5%	15.0%	17.7%	15.6%
Revenue	23506	26301	30111	29290	17.1%	28.1%	11.4%	11.6%	15.5%	13.1%
Interest Payments	6120.7	7082	6929	8090.01	5.0%	13.2%	14.2%	3.0%	3.6%	3.6%
Subsidy	2623	2621.1	6487.4	3698.99	17.6%	147.3%	41.1%	1.3%	3.3%	1.7%
Capex	3357.3	4120.9	4391.6	5542.36	9.1%	30.8%	34.5%	1.7%	2.3%	2.5%

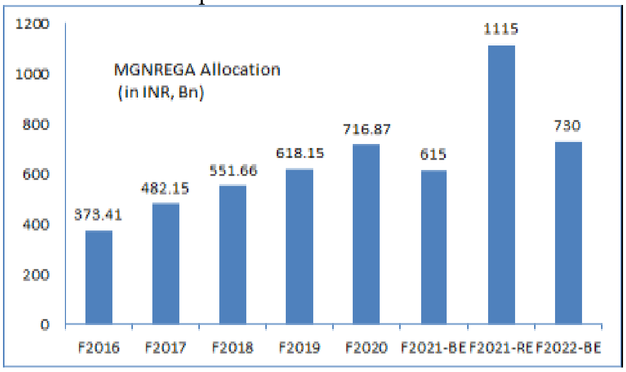
Source: Budget documents, HDFC Bank

Subsidy Bill rose in FY21, estimated to reduce in FY22



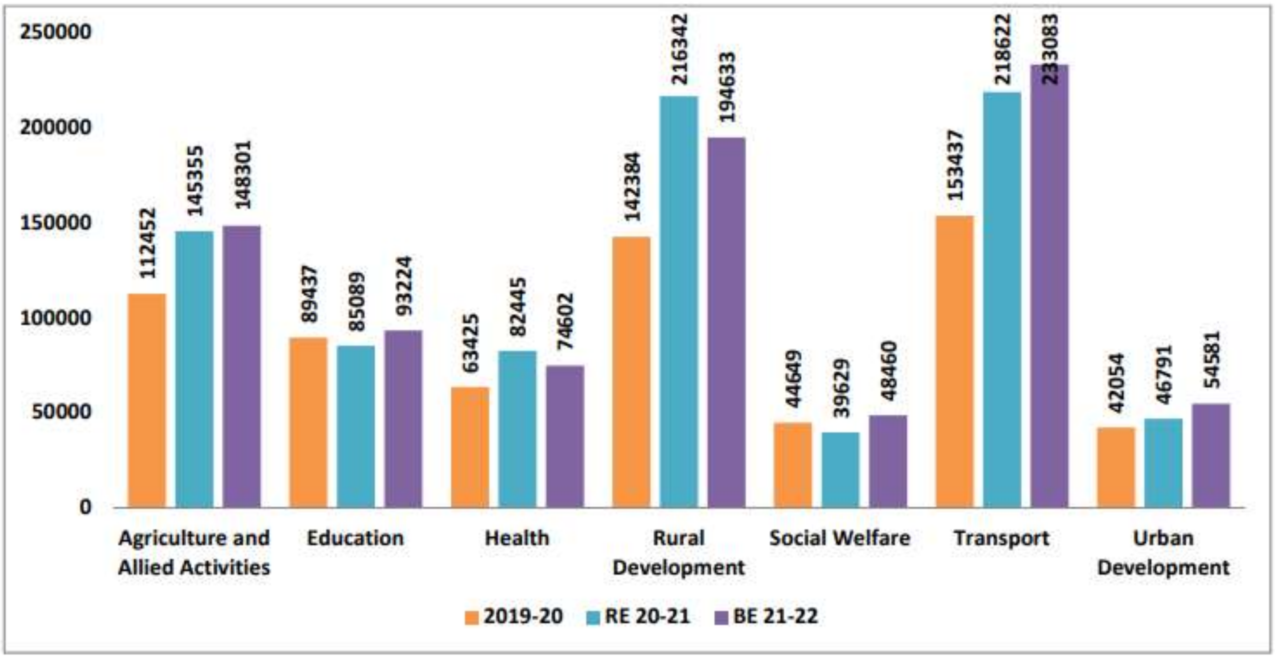
Source: Budget documents, HDFC Bank

Allocation for MNREGA higher in FY22 compared to pre-pandemic allocations



Source: Budget documents, HDFC Bank

Trend in expenditure: Focus on transport, urban development



Source: Budget documents, HDFC Bank

Treasury Economics Research Team

Abheek Barua,
Chief Economist
Phone number: +91 (0) 124-4664305
Email ID: abheek.barua@hdfcbank.com

Sakshi Gupta,
Senior Economist
Phone number: +91 (0) 124-4664338
Email ID: sakshi.gupta3@hdfcbank.com

Avni Jain,
Economist
Phone number: +91 (0) 124-4664354
Email ID: avni.jain@hdfcbank.com

Swati Arora,
Economist
Phone Number: +91 (0) 124-4664354
Email ID: swati.arora@hdfcbank.com