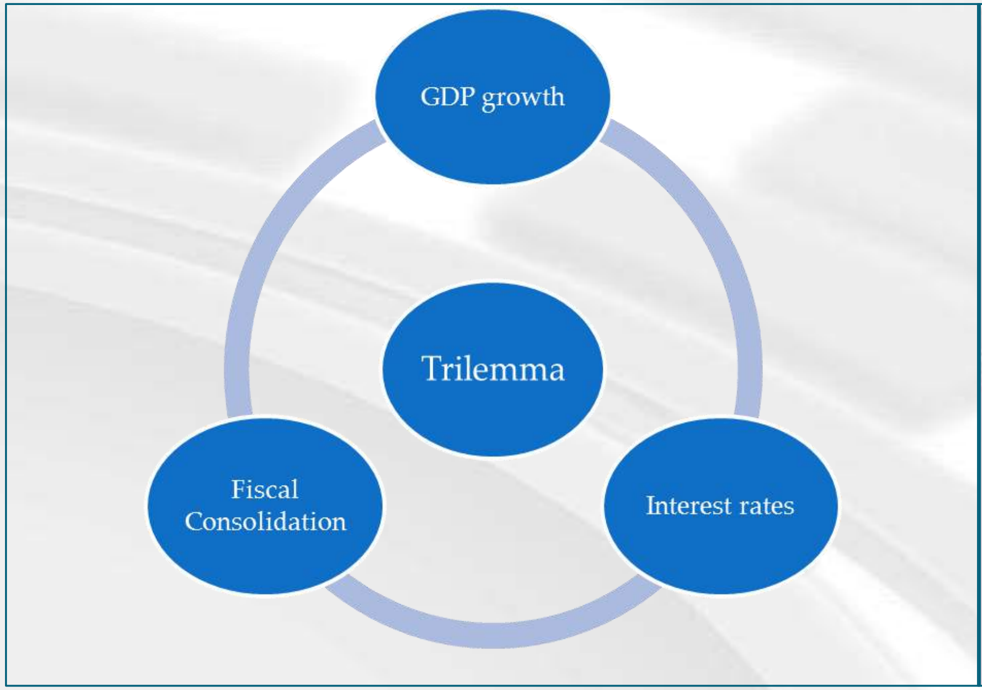
# Can the budget wave a magic wand to revive the economy?

*HDFC Bank, July 2019*

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# Dealing with the Trilemma (Summary)

- *Growth slowdown has been worse than anticipated, warranting a fiscal push to revive the economy.*
- *However, lower growth also implies downside risks to revenue targets of the government for FY20 (compared to what was pencilled in the interim budget).*
- *Given the stressed revenue situation, the government faces a tough trade-off between sticking to its fiscal consolidation path and providing fiscal stimulus.*
- *If the government decides to give a higher weightage to growth and expand its fiscal deficit target, the impact is likely to be on interest rates, in the form of higher bond yields. This is what we call the trilemma – pushing growth while keeping a check on fiscal consolidation and borrowing costs.*
- *Even if the government decides to solely focus on fiscal consolidation (to adjust for lower revenue), it may find it difficult to pull back the expenditure commitments already made under the interim budget (new schemes PM Kisan Yojna, pension scheme for the traders). The govt. would also need to set aside funds to deliver on its election promises (such as the introduction of the "Nal se Jal" scheme etc.).*
- *One way to meet its fiscal deficit target, atleast optically, is that the government could resort to other sources of financing – NSSF, off-budget expenditure through PSEs, rollover of expenditure. The probability of this scenario is high and this could provide some support to growth. But even in this case there could be some upside impact on the bond yields as the market could see through this window dressing.*
- *The joker of the pack is the transfer of reserve surplus from the RBI to the government. The most optimistic estimate for the transfer is close to Rs. 3 trillion which could help the government break the trilemma. However, in our baseline case, we think that the amount could be close to Rs 0.75 to Rs1 trillion (in the baseline) and would be staggered rather than paid as a one-time transfer.*

# What was announced in February (Interim Budget FY20)?

| Budget at a Glance (Interim, February-2019) | | | | | |
|---|---|---|---|---|---|
| *(In Rs. crores), Figures in parenthesis are as a percentage of GDP* | | | | % YoY | |
| | FY18 | FY19 R.E | FY20 B.E | FY19 R.E | FY20 B.E |
| 1. Revenue Receipts | 1435233 | 1729682 | 1977693 | 21 | 14 |
| 2. Tax Revenue (Net to Centre) | 1242488 | 1484406 | 1705046 | 19 | 15 |
| 3. Non Tax Revenue | 192745 | 245276 | 272647 | 27 | 11 |
| 4. Capital Receipts | 706742 | 727553 | 806507 | 3 | 11 |
| 5. Recovery of Loans | 15633 | 13155 | 12508 | -16 | -5 |
| 6. Other Receipts | 100045 | 80000 | 90000 | -20 | 13 |
| 7. Borrowings and Other Liabilities | 591064 | 634398 | 703999 | 7 | 11 |
| 8. Total Receipts (1+4) | 2141975 | 2457235 | 2784200 | 15 | 13 |
| | | | | | |
| 9. Total Expenditure (10+13) | 2141975 | 2457235 | 2784200 | 15 | 13 |
| 10. On Revenue Account | 1878835 | 2140612 | 2447907 | 14 | 14 |
| 13. On Capital Account | 263140 | 316623 | 336293 | 20 | 6 |
| | | | | | |
| 14. Revenue Deficit (10-1) | 443602 (2.6) | 410930 (2.2) | 470214 (2.2) | | |
| 16. Fiscal Deficit [9-(1+5+6)] | 591064 (3.5) | 634398 (3.4) | 703999 (3.4) | | |
| 17. Primary Deficit (16-11) | 62112 (0.4) | 46828 (0.2) | 38938 (0.2) | | |

The overall tax revenue receipts were budgeted to rise by 15%, lower than 19% achieved in FY19.

While the divestment target of Rs. 90,000 cr looked a bit optimistic that time, the government has been over achieving on this front.

On the expenditure front, the government penciled in an increase of 13%.

Source: MOSPI, Budget documents, HDFC Bank

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# What has changed since then?

## Slowdown worse than anticipated

- GDP growth for Q4 FY19 slowed to a 5-year low of 5.8% YoY (vs. 6.6% in Q3). This was lower than the consensus estimates of 6.1%.
- The government penciled in 11.5% growth in Nominal GDP. There is a downside risk to this estimate now.

## Low tax collections in FY19

- Direct tax collection for FY19 has been 6% lower than what the government penciled in the Interim Budget. Indirect tax collection has been lower by 10%.
- What this means is that assuming a same level of growth rate for FY20, as the government budgeted in February, the collections in absolute terms could be lower.

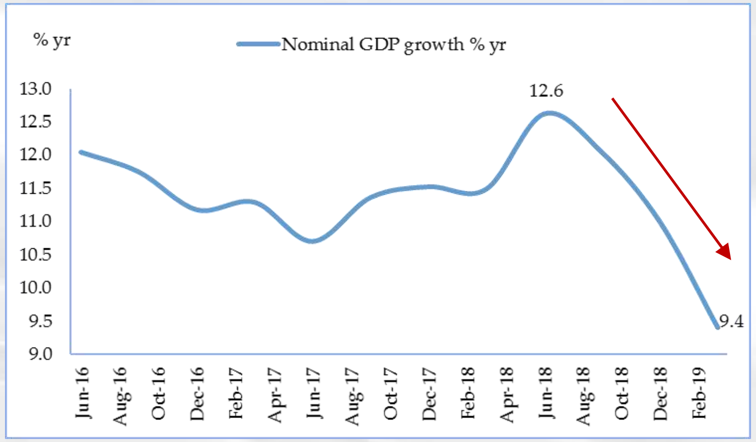
## New Commitments

- The government decided to cover all the farmers, irrespective of their land holdings, under PM Kisan scheme.
- The revised scheme envisages to cover 2 crore more farmers with an estimated expenditure of Rs. 87,217 cr in FY20. In the interim budget, the government had estimated an expenditure of Rs. 75,000 crore.
- Similarly, the new Pension Scheme for traders would require additional expenditure.

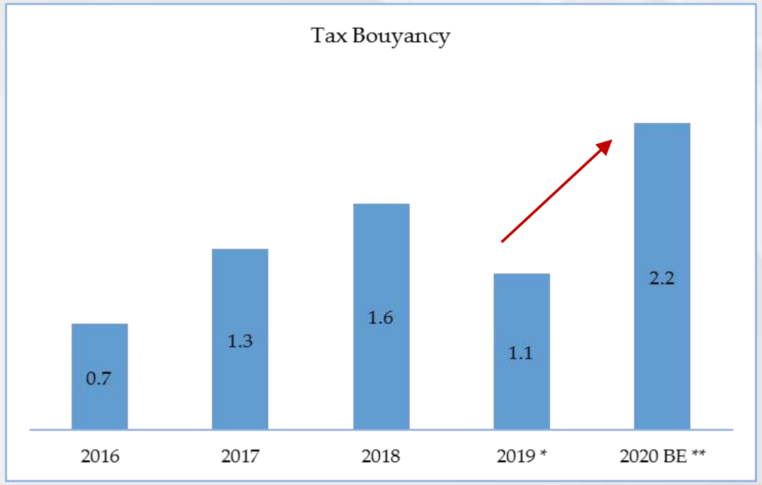
Source: CEIC, RBI, Reuters, MOF and HDFC Bank

# Lower growth could upset the fiscal optics

**Nominal GDP growth has fallen below 10%, casting doubt over the Budget's GDP assumptions**




**An implied tax buoyancy of 2.2 in the interim budget is optimistic**




Lower growth and moderate inflation could result in lower nominal growth this year. Concerns over achieving the 3.4% of GDP fiscal deficit target: Nominal Growth in Q4 2018-19 was 9.4%.

Lower nominal growth also has a bearing on tax collections: The interim budget implies a tax buoyancy of 2.2, which is optimistic even in a year with good growth. Personal income tax collections are estimated to rise by 34% and corporate tax collections by 15%. This is not in sync with the revised 10.5% growth in nominal GDP.

***Bottom-line**: The budget could make some tweaks in regards to its nominal GDP assumptions and consequently its tax collections estimates. We expect nominal GDP growth to be close to 10-10.5% in 2019-20, assuming that growth picks up in the second half of the fiscal.*

Source: MOSPI, Budget documents, HDFC Bank

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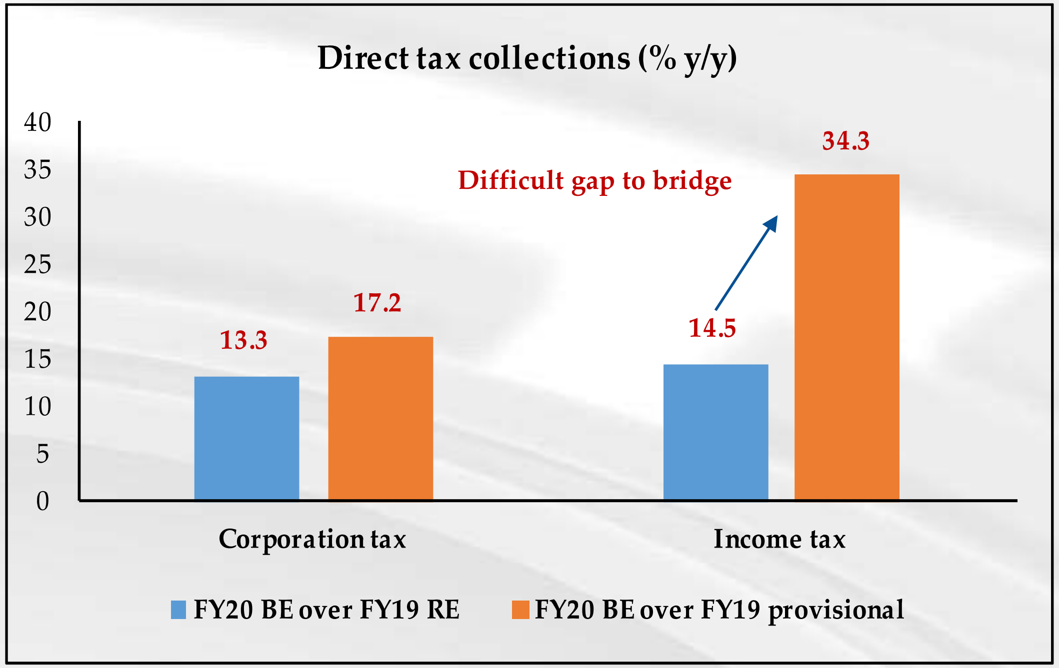
# Shortfall on tax revenues could be Rs. 80,000 cr (0.4% of GDP)




## Achieving FY20 growth targets looks like a tall order

- Given the trends of advance corporate tax collections for 1Q-FY20, we believe that the FY20 target might be achievable.
- However, the bigger problem could be in the case of personal income tax collections. Even as the tax buoyancy has improved in the recent years, there could be some shortfall on this front.
- For GST too, the average monthly run rate has been 6% lower than the budgeted amount of Rs. 1,14,000. Gross collection in May was Rs. 1,00,289 cr in May and in April was Rs. 1,13,865 cr.
- **Our calculations show that there could be a shortfall of around Rs. 80,000 crore in overall tax revenue of the government in FY20 (primarily on account of lower than expected personal tax and GST revenue)**

Any further giveaways on direct taxes unlikely and GST decisions would be outside the budget

Source: Budget Documents, CEIC, RBI, Reuters, MOF and HDFC Bank

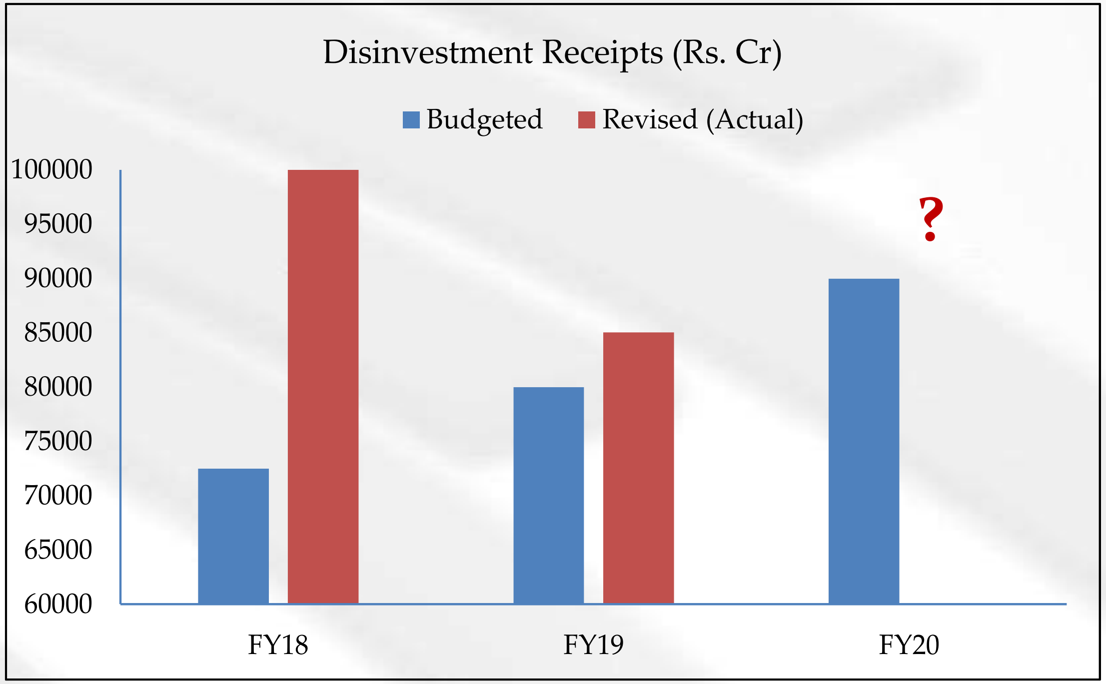
# Non tax revenue could come as a rescue but gains likely to be marginal

We expect the disinvestment target to be revised up from the current figure of Rs. 90.000 cr

Recoveries of loans and advances could also bring in some windfall gains.

RBI's dividend and profits from other PSEs, and other telecom related services (spectrum) could also bring in additional revenues.

**Overall, we expect non tax revenue to provide a cushion of 0.1% of GDP (Rs. 18,000 cr) approx.)**




Source: CEIC, RBI, Reuters, MOF and HDFC Bank

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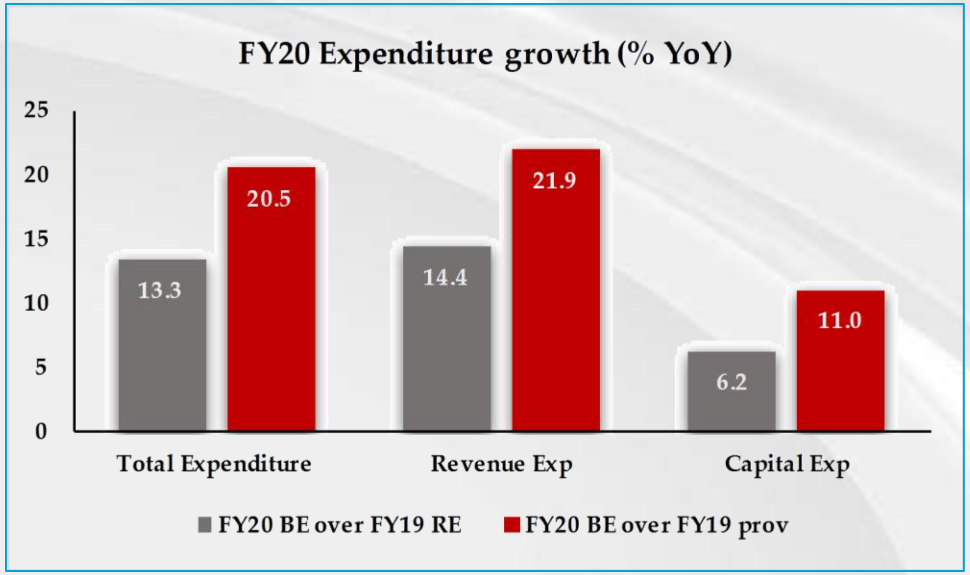
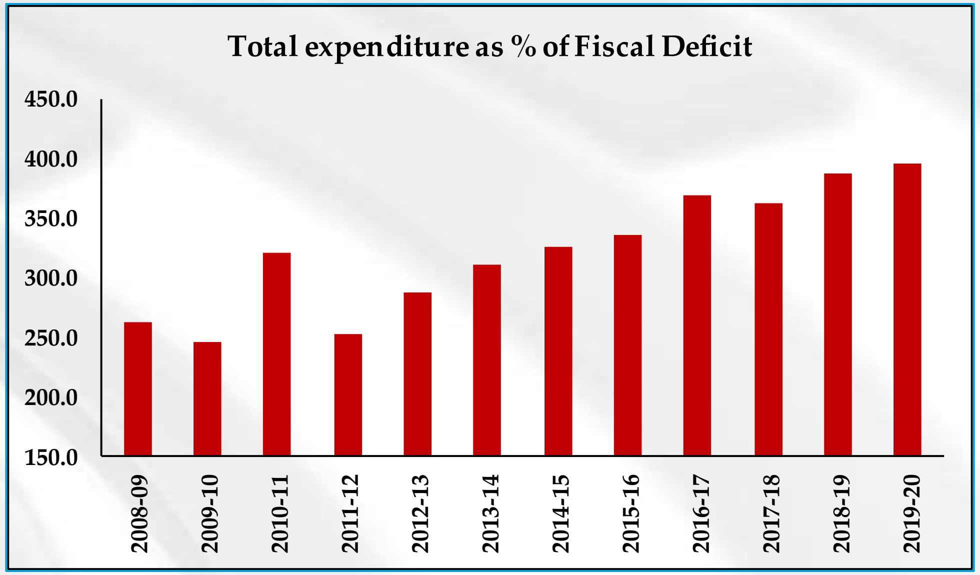
# Scope for a large expenditure plan is limited given that current commitments are already high

- Downwardly revised expenditure data in FY19 already implies a fairly high growth in spending in FY20.
- Moreover, it would be difficult to pull back the expenditure commitments already made under the interim budget by the government (new schemes PM Kisan Yojna, pension scheme for the traders).
- The govt. would also need to set aside funds to deliver on its election promises (such as the introduction of the "Nal se Jal" scheme etc.)
- Scope for any further large expenditure plan, therefore, seems limited given the revenue situation this year.




Source: Budget Documents, CMIE and HDFC Bank

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# Spending on election promises would add to the burden

**PM-KISAN SCHEME**

Expanded to all land holding farmers, providing them Rs 6,000 a year

Additional outlay to be Rs 13,000 crore over Rs 75,000 crore already allocated in 2019-20 Interim Budget

**Pradhan Mantri kisan Pension Yojana**

To cover 5 crore small and marginal farmers
Government to contribute equal amount to Pension Fund

To cost Rs 10,775 crore to the government over a period of 3 years

**Pension scheme for Retail Traders & small shopkeepers**

An assured minimum monthly pension of Rs. 3000 after 60 years of age: government to make matching contribution in account

No outlay has been provided yet!

**Control of Foot & Mouth Disease (FMD) and Brucellosis amongst livestock in the country**

Central government to bear entire cost of the programme

Total outlay of Rs 13,343 crore over the next five years

Source: Media Sources and HDFC Bank

# Instead of expenditure increase, the focus is likely to be on delivery

We could see reallocation of resources among government's various programmes/schemes

**Outlay on Major Schemes (Rs bn)**

| Schemes | FY18 Actual | FY19 BE | FY19 RE | FY20 BE |
|---|---|---|---|---|
| Income Support Scheme | -- | -- | 200 | 750 |
| Crop Insurance Scheme | 94 | 130 | 130 | 140 |
| Ayushman Bharat - Pradhan Mantri | -- | -- | 24 | 64 |
| National Health Mission | 320 | 306 | 312 | 323 |
| Mahatma Gandhi National Rural Employment Guarantee Program | 552 | 550 | 611 | 600 |
| Pradhan Mantri Krishi Sinchai Yojna | 66 | 94 | 83 | 95 |
| Pradhan Mantri Gram Sadak Yojna | 169 | 190 | 155 | 190 |
| Pradhan Mantri Awas Yojna (PMAY) | 312 | 275 | 264 | 259 |
| National Rural Drinking Water Mission | 70 | 70 | 55 | 82 |
| National Education Mission | 295 | 326 | 323 | 386 |
| National Livelihood Mission - Ajeevika | 49 | 61 | 63 | 95 |
| Jobs and Skill Development | 27 | 51 | 68 | 75 |
| Swachh Bharat Mission | 194 | 178 | 170 | 128 |
| Urban Rejuvenation Mission: AMRUT | 95 | 122 | 126 | 139 |
| Direct Benefit Transfer | 131 | 165 | 165 | 295 |
| Deen Dayal Upadhyaya Gram Jyoti | 50 | 38 | 38 | 41 |

Source: Budget Documents and HDFC Bank

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# Some of the schemes that may get a boost….

**BJP manifesto 2019**

| Jal Shakti | Roads | Infrastructure | Welfare of poor | Health | Jobs |
|---|---|---|---|---|---|
| Piped water for every household by 2024 | To build 60,000 km of national highways, connect 100% of villages with rural roads | Capital investment of Rs 100 lakh crore by 2024 | To accelerate the pace of providing access to basic amenities to every poor Indian household in the next five years | To set up one medical college in every district by 2024. 75 such medical institutes to be set up by 2022. | To create new opportunities of employment in the the 22 major 'Champion Sectors' |
| 'Nal se Jal' under 'Jal Jivan Mission', National River Conservation Programme | Pradhan Mantri Gram Sadak Yojana (PMGSY), more funds to NHAI | PMGSY, Pradhan Mantri Awas Yojana, Urban Rejuvenation Mission | All rural oriented programmes | National Health Mission, Ayushman Bharat | New scheme to provide collateral-free credit up to Rs 50 lakh for entrepreneurs, "Seed start-up Fund", Pradhan Mantri Mudra Yojana |

Source: Budget Documents, Media sources and HDFC Bank

# Fiscal optics could remain favourable: The strategies the government could resort to!

If the expenditure side is not pruned or rolled over, the fiscal deficit could reach 3.7% of GDP in FY20. This could be primarily the result of lower than expected tax revenues. **However, we believe, that the government could rely on following three strategies to stick to the fiscal deficit target of 3.4%**

1. **Resorting to off budget financing:**

   - Roll over of subsidies (Under the government's cash accounting system, deferred payments are not considered as expenses.
   - Capex expenditure through PSEs

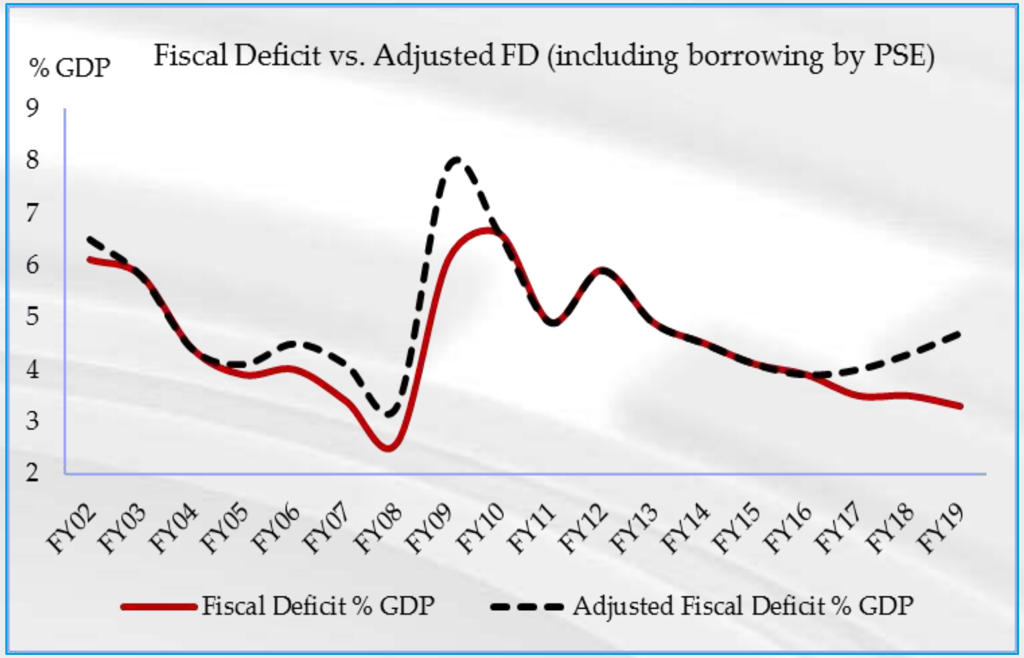
   Implication: Does not add to the fiscal deficit but adds to overall government debt and lowers confidence in fiscal soundness, crowds out private investments as PSEs borrow more from the market.

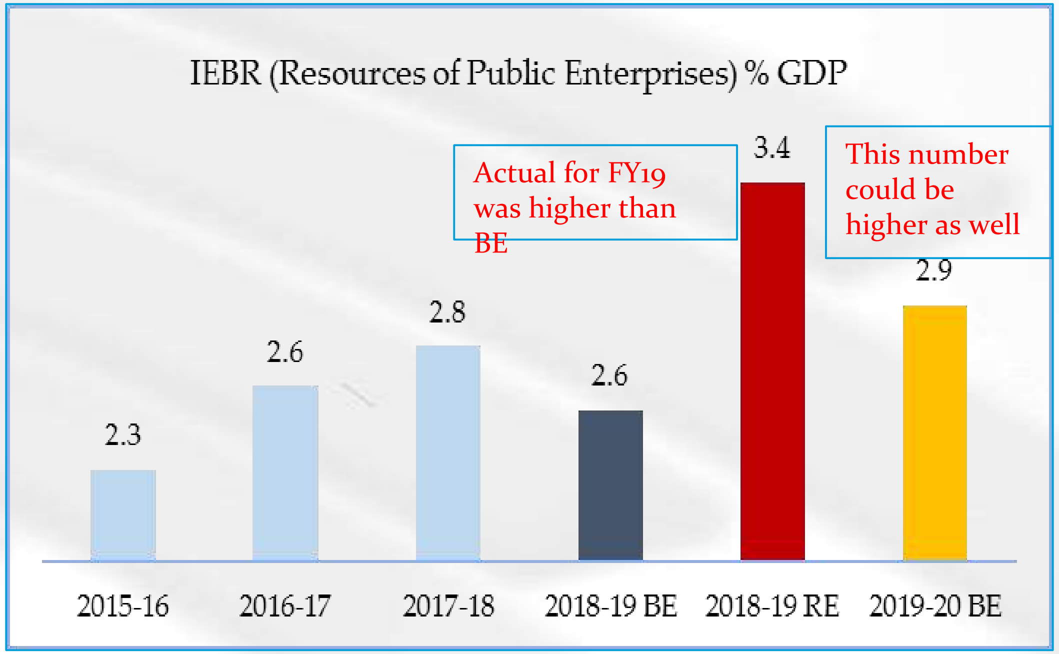
2. **Tapping the NSSF: Converting expenditure on subsidies into loans from NSSF (government reversed about ₹70,000 cr in FY19 and about ₹42,000 cr in FY18)**

3. **Surplus transfer from the RBI** (earlier, the government indicated that the RBI has excess reserves of more than Rs 3 trillion)

Source: Media Reports and HDFC Bank

# #1: Off budget financing has been on the rise, this trend could continue




The adjusted fiscal deficit calculations take into account the issuance of special bonds such as oil bonds, fertilizer bonds and Food Corporation of India (FCI) bonds till fiscal 2009 and National Small Savings Fund (NSSF) loans and government-serviced bonds issued by public sector entities in the more recent years.

- Internal and Extra Budgetary resources (IEBR) rose to 3.4% of GDP in 2018-19, higher than the budget estimate of 2.6% and 2.8% recorded in 2017-18.
- This year, the government has estimated EBR resources to be 2.9% of GDP. This number could be higher than the interim estimate as the government shifts its expenditure to PSEs.

Source: MOSPI, Media Reports, Budget documents, CGA, HDFC Bank

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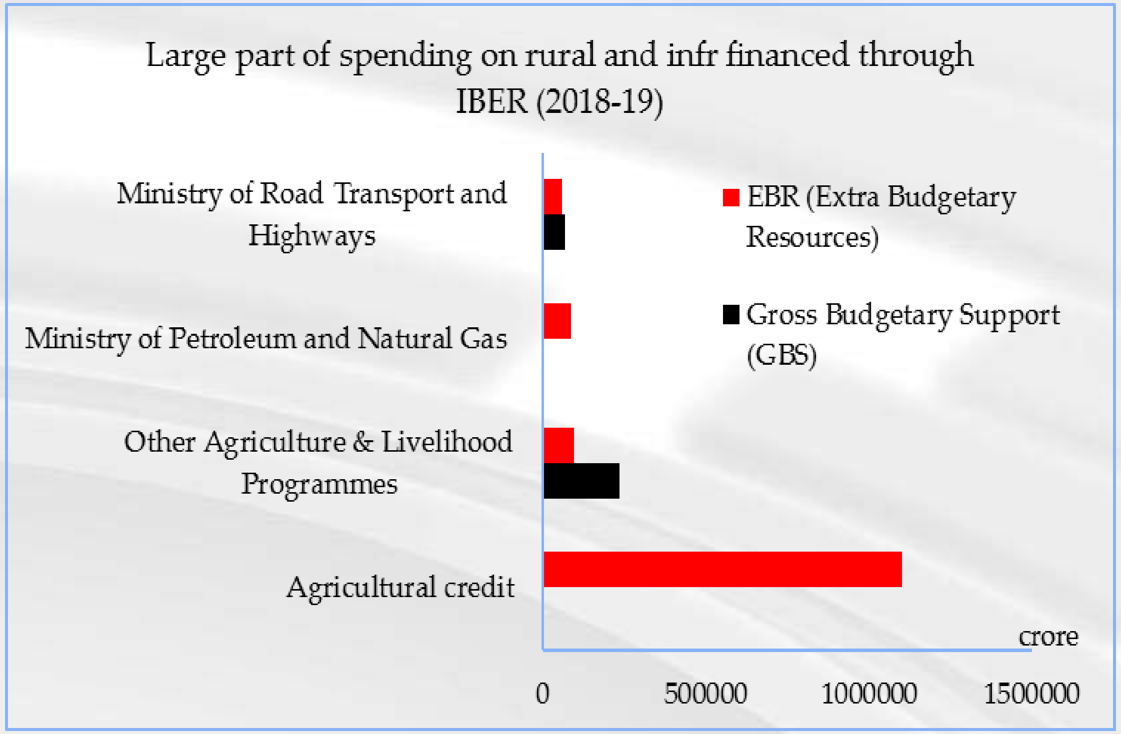
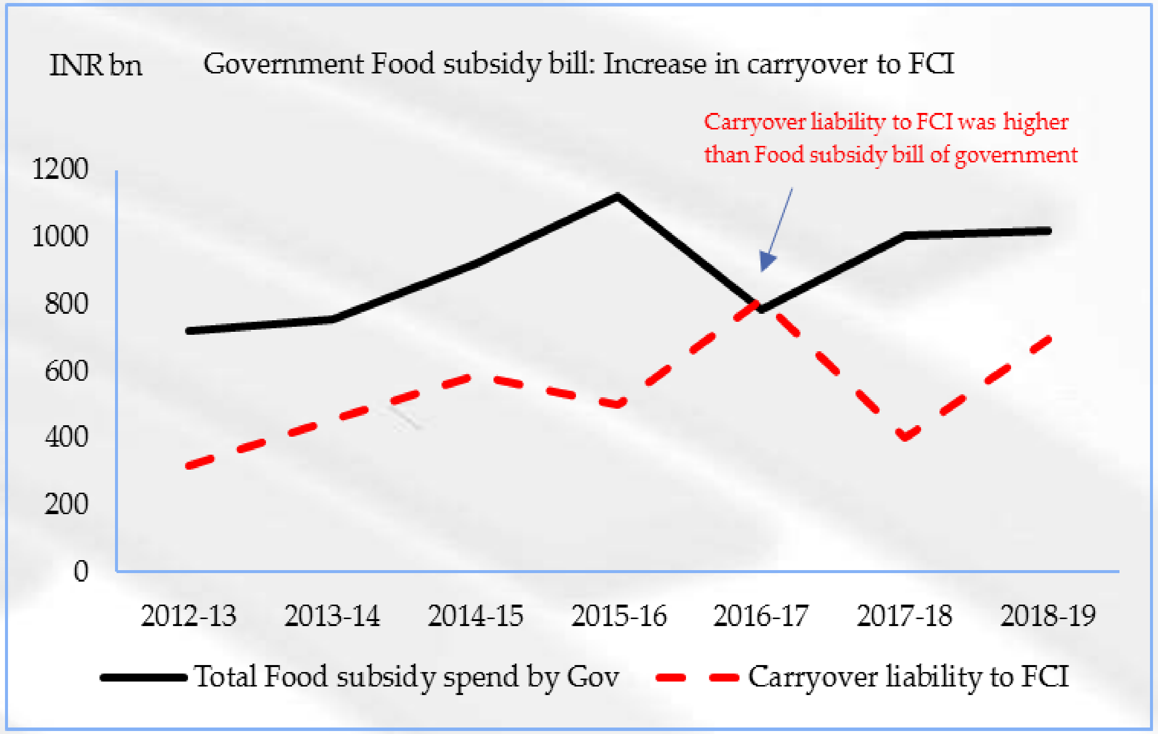
# IEBR not just for capex but also for revenue commitments



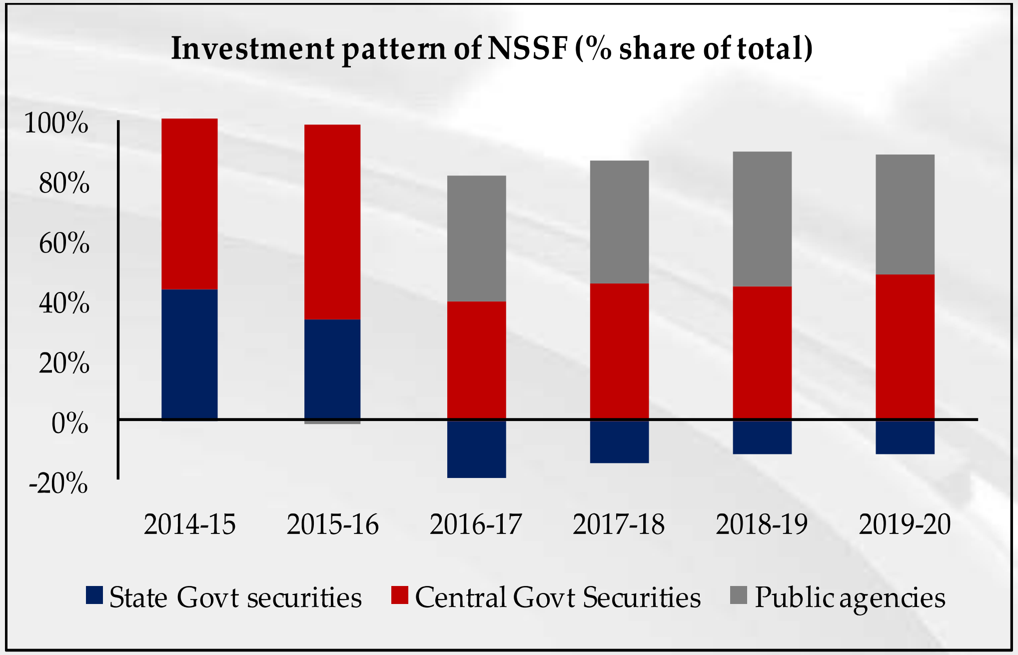




- Centre underpaid its food subsidy bill by Rs.69,394 cr in 2018-19 – 41% of the BE ( the highest in the last five years).
- Total expenditure on major subsidies was only 74% of BE in 2018-19 compared to 83% in 2017-18.

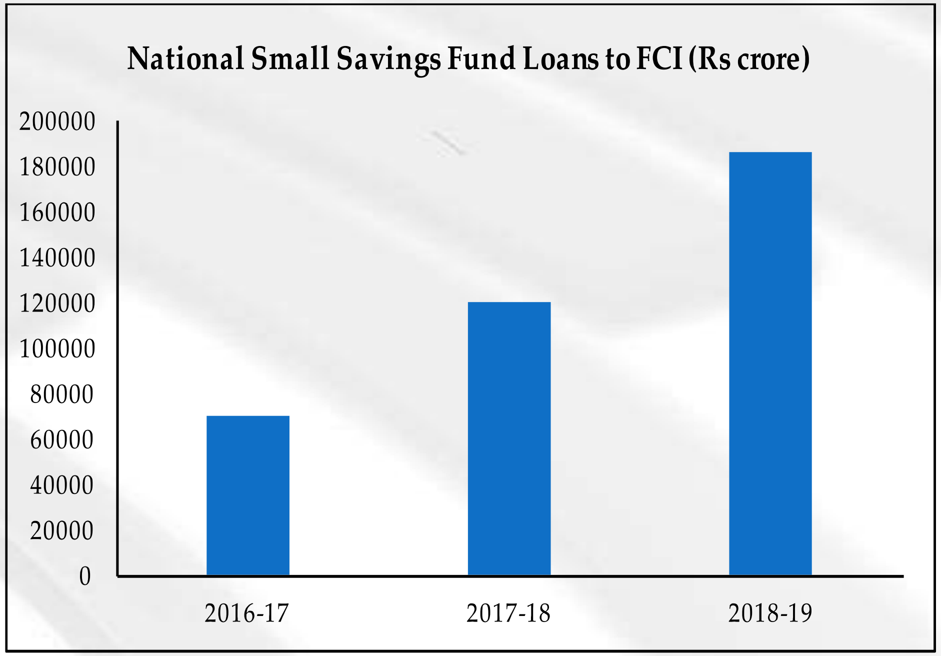
Source: MOSPI, Budget documents, CGA, HDFC Bank

A large part of revenue spending (mainly food subsidy payment) was pushed to off-budget borrowings through NSSF in FY19.

**NSSF funding:** Not just the government, but PSUs as well have been relying heavily on the small savings fund




FCI sourced more than two-thirds of its funding requirements in 2018-19 from the NSSF.




Source: Budget Documents, FCI and HDFC Bank

The Major Issue/disagreement: What constitutes reserves or transferable funds (TF) from which transfers can be made to the government?

**Transferrable funds**

- Broad definition
  - Capital and Internal reserves
  - **Revaluation gains** (including buffers such as currency and gold revaluation account, Investment revaluation account), and Asset Development Fund.
- Core capital
  Conservative definition
  - Excludes valuation changes and shrinks the funds from close to Rs 9.6 trn to Rs 2.6 trn.

Source: RBI, HDFC Bank

## The buffers of the RBI as of 30th June 2018 (Rs. Cr)

| Category | Amount |
|---|---|
| Capital | 5 |
| Reserve fund | 6,500 |
| Other reserves | 228 |
| Contingency fund (CF) | 2,32,108 |
| Asset development fund (ADF) | 22,811 |
| Total ("core capital") | 2,61,652 |
| Valuation buffer* | 7,08,188 |
| Surplus transferable to the Government of India | 50,000 |
| Miscellaneous (bills payable, gratuity, provisions for payables) | 33,197 |
| Total | 10,53,037 |

Following a uniform methodology developed globally, the RBI should hold enough reserves to take care of four kind of risks: (i) Market risk, (ii) Credit risk, (iii) Operational risk, and (iv) Contingent risk

The "give more to the government" school view is that 14 per cent of assets should be kept as buffer as against 28 per cent using the broadest measure of TF, a sum of roughly Rs. 4.5 trillion

**The most optimistic estimate of surplus transfer to the government is at Rs 3 trillion.**

**But, the amount could be lower and would be staggered rather than paid as a one-time transfer (close to Rs0.75 to Rs1 trillion).**

**Therefore, the surplus is unlikely to provide a significant cushion to the fiscal math.**

Source: RBI, HDFC Bank

# What the fiscal situation could mean for rates?

**A 3.4% of GDP fiscal deficit implies that the Central Government is likely to borrow Rs. 7.1 trn in FY20 which is around 24% higher than the borrowings last year (Rs. 5.7 trn)**

**Large supply of government bonds are likely to maintain pressure on yields this year.**

**<u>We expect the 10-year bond yield to cross the 7.2% level by September-2019. In case of a fiscal breach there could be upside risks to our call.</u>**

**Some factors that could limit the upside movement in yields**

There will be heavy redemptions (where bonds mature and money is returned to the banks) of Rs. 2.4 trn.

OMOs (bond purchases) and Dollar/INR swap could provide some liquidity cushion to the investors.

Rate cut by RBI (25bps in August-2019).

Global slowdown worries and lower global yields.

Source: CEIC, RBI, Reuters, MOF and HDFC Bank

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