Mounting Fiscal Pressures

HDFC Bank, January 2020

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Key Points

- *We expect the fiscal deficit to breach the budgeted target by 20-30 bps, coming in at 3.5%-3.6% of GDP.*

- *Fiscal balance expected to be weighed down by lower direct, indirect and GST tax collections (shortfall of Rs. 3 trn). In addition, lower than budgeted Nominal GDP to also be a pressure point. On the other hand, RBI dividend transfer and expenditure compression to provide some cushion to the Centre's finances (savings of Rs. 2.23 trn.)*

- *The major share of the cut back in expenditure is likely to come from ministries (agri, roads, health, tourism, etc.) that have underspent so far this fiscal.*

- *Despite the compression in expenditure, **the quality of expenditure has not deteriorated so far,** however Q4 might tell a different story.*

- ***Tax buoyancy to drop below the budgeted level in FY20 (Gross tax buoyancy to fall to 0.6 vs. budgeted 1.7).*** *Even after removing the impact of the corporate tax cut, buoyancy is expected to remain low, signaling the lack of an improvement in tax collection efficiency and compliance (Tax buoyancy measures the tax collected per unit of GDP and is therefore neutral to the economic growth scenario while reflecting the efficiency of collections).*

- ***Financing through NSSF to rise****: GoI's reliance on off-budget financing and resorting to NSSF funds for financing the deficit is likely to be higher than budgeted.*

- ***Additional borrowings to be limited:*** *The smaller quantum of fiscal slippage this year suggests that additional market borrowings are likely to be limited. As a result, we expect the upward pressure on bond yields to be contained. Moreover, OMO operations by the RBI are likely to support yields further. On the flipside, the high inflation prints over the coming months are likely put pressure on yields. On the balance, we expect the 10 year to trade in the range of 6.40%-6.60% by March-end.*

- ***No Big Bang!*** *FY21 Union Budget unlikely to mark a departure from past budgets. We expect the government to consolidate fiscal deficit to 3.4% of GDP in FY21 with a gross borrowing estimate of Rs 7.7 trn in FY21. There could be minor tweaks to the personal income tax slabs but the focus could be on higher allocation for DBT schemes. The amount of recap for banks could be lower in FY21 as the financial health of banks improve.*

Taking Stock: Fiscal situation so far in 2019-20

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The monthly run rate indicates mounting fiscal pressures

Fiscal run rate shows significant revenue shortfall

	FY20	FY19
Apr-Nov	**% of BE**	
Revenue Receipts	50.1	50.4
Net Tax Revenue	45.5	49.4
Gross tax Receipts	47.7	51.6
Direct tax	41.7	47.6
Income tax	*47.1*	*48.3*
Corporate Tax	*37.7*	*46.9*
Indirect Tax	54.8	55.7
GST (CGST+Cess+IGST)	*60.1*	*51.3*
Excise	*44.3*	*53.2*
Customs	*48.7*	*77.1*
Non Tax revenue	74.3	56.6
Non Debt Capital Receipts	24.2	28.5
Total Receipts	48.6	49.3
Total Expenditure	65.3	66.1
Revenue Expenditure	65.6	66.4
Subsidies	*77.9*	*82.9*
Capital Expenditure	63.2	63.8
Fiscal Deficit	114.8	114.8

The Pressures:

- *Fiscal deficit for Apr-Nov clocked 114.8% of BE, underlining fiscal concerns.*
- *The higher deficit was primarily on account of lower tax collection, as expenditure remained contained*
- *On the tax front, both direct and indirect tax collections were lower. Direct tax collections grew by 2.7% vs. a budgeted growth of 18.6% on account of lower corporate and income tax collection.*
- ***Lower Nominal Growth:** Falling nominal growth is likely to add further pressure on the fiscal math. Nominal GDP growth is expected to grow by 11% in FY20 compared to BE of 11.0%.*

The cushions:

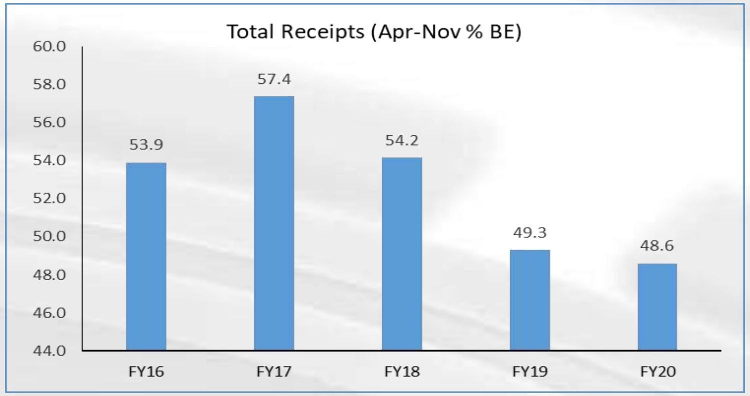
- ***Higher surplus transfers by RBI:** Non tax revenues stood at 74.3% of BE higher than 56.3% in FYTD19 on account of higher than budgeted transfer of dividends and profits from the RBI*
- ***Expenditure compression:** Total expenditure clocked 65.3% of BE, lower than 69.8% of actuals in the same period FY19. This has been driven by expenditure compression across ministries along with a lower subsidy outgo. Given the trend so far, we see a possibility of revenue expenditure roll-overs, particularly in food, in this fiscal.*

Source: CGA, Budget Documents, HDFC Bank

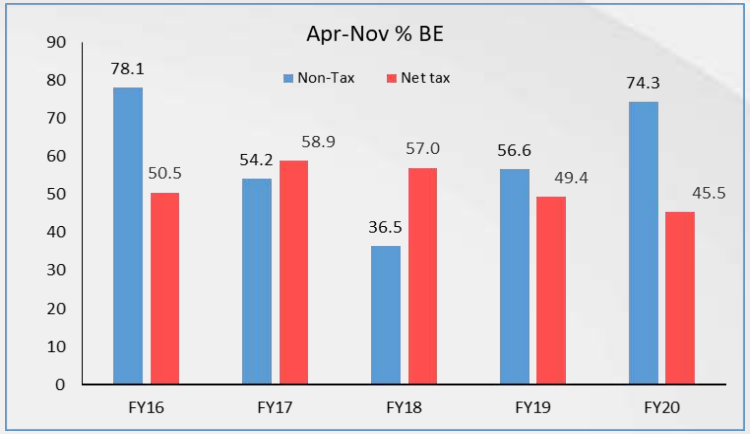
Shortfall mainly in tax receipts; non-tax revenues provide an offset

During Apr-Nov FY20, net central tax receipts grew by 2.6% well below the 25.3% growth budgeted. At this pace, total revenue receipts are expected to register a shortfall of INR 2.1 trillion or 1% of GDP, assuming some cushion from the non-tax front.

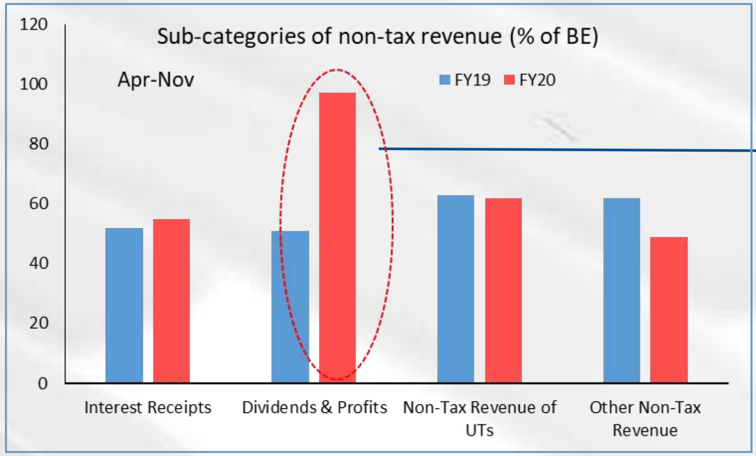
Slower pace of tax revenue growth weighs on total receipts



Higher than budgeted non-tax revenue could come as a buffer



RBI surplus transfer have raised non-tax revenues



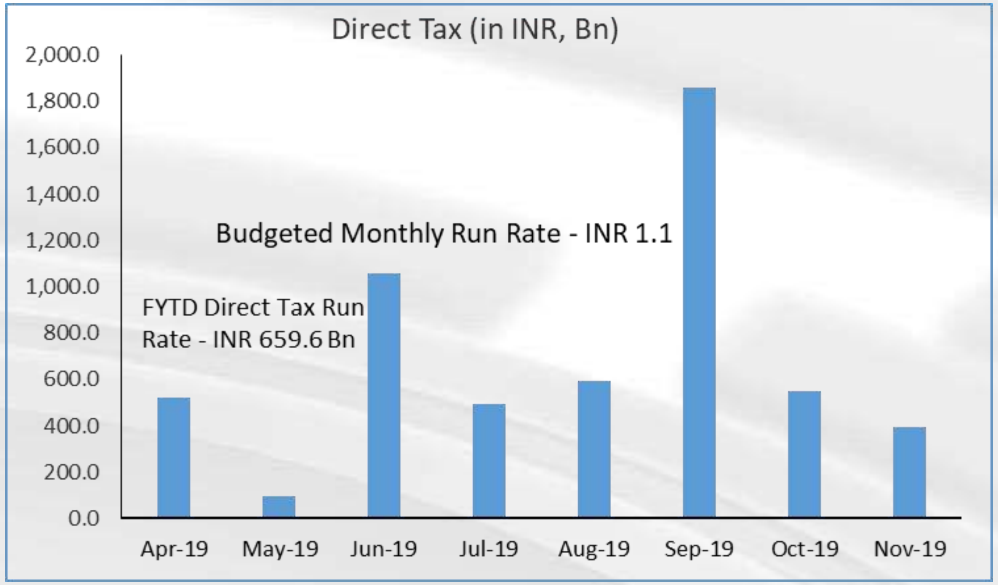
Surplus transfer by the RBI	INR bn
BE	**900**
Actual	**1761**
Dividend	*1234*
One-time transfer	*526*
Of the dividend, INR 280 bn was paid as interim dividend in Mar-19	
Surplus over budgeted number	**580**

- **As per the media reports, the government may seek to get interim dividend of INR 250-300 bn from the RBI. The exact buffer on this category, however, remains uncertain at this stage.**
- Estimated surplus (taking into account additional interim dividend) on non-tax revenue front: INR 0.9 trn.

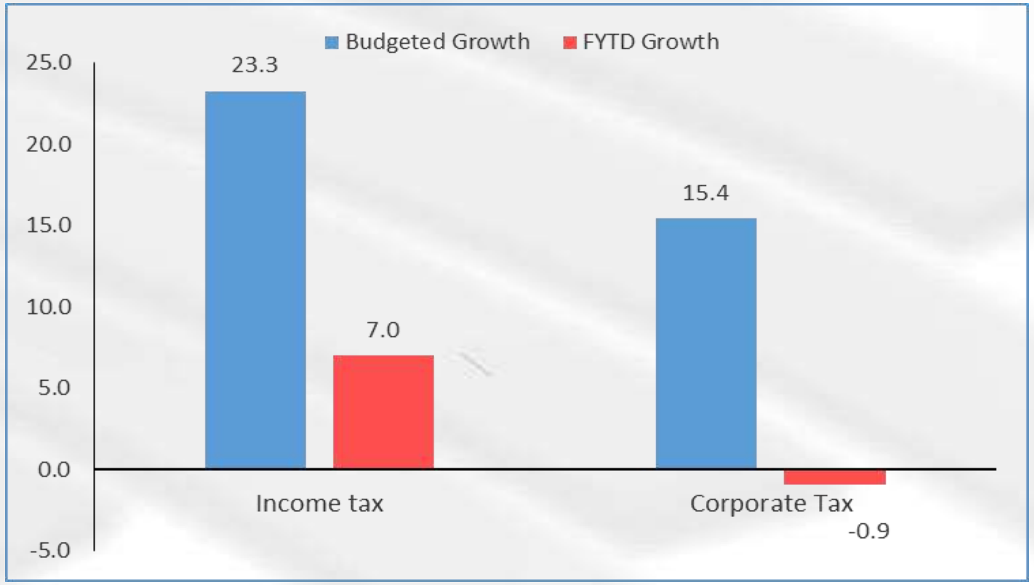
Source: CGA, Budget Documents, HDFC Bank

#1 Pressure Points: Direct tax collection lags behind budgeted growth

Direct tax collections have been low so far….



…led by both lower income and corporate tax collections



- **Direct tax collections** have grown by a mere 2.7% so far as against a budgeted target of 18.6% for the fiscal year.
- In this, **corporate tax collections** contracted by 0.9% vs. a budgeted growth of 15.4%. Corporate tax collections stood at INR. 2.9 trn between Apr-Nov 19 (registering a monthly run rate of INR 361 bn) in comparison to a required monthly run-rate of INR. 638 bn, reflecting the impact of both the corporate tax cut and the economic slowdown.
- **Income tax collections** stood at INR 2.7 trn over Apr-Nov FY20 (registering a monthly run rate of INR 335 bn) vs. a required monthly run-rate of INR 474 bn
- Estimated shortfall on account of direct tax receipts – INR 2.0 trn

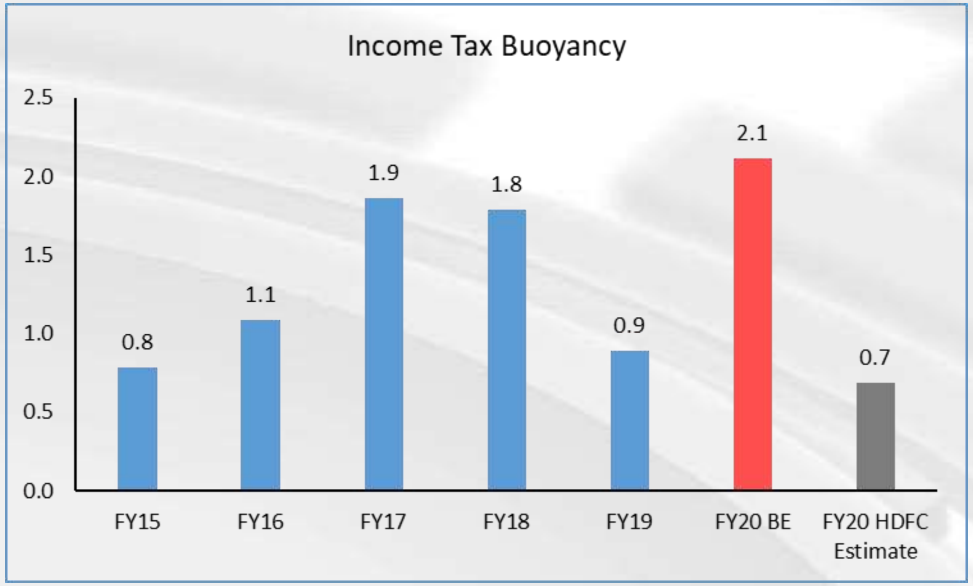
Source: CGA, Budget Documents, HDFC Bank

Direct Tax buoyancy lower than budgeted: Not just a corporate tax cut effect

Tax buoyancy is essentially the collections by the government for every unit of growth. It is influenced by changes in the tax rate, efficiency in tax collections and compliance. While the corporate tax cut this year has lowered tax buoyancy, even after excluding its impact, tax buoyancy remains lower than budgeted, signaling that compliance or efficiency has not shown any significant improvement.

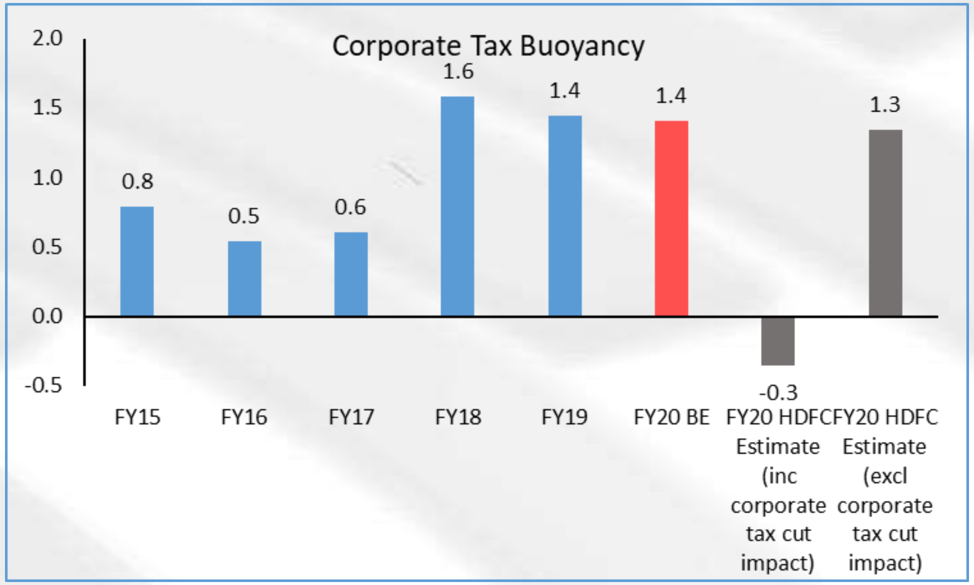
Tax buoyancy = % change in taxes/% change in GDP

Income tax buoyancy estimated to be lower than the budgeted number



Income tax buoyancy is expected to moderate to 0.7 (lower than the budgeted 2.1) and lower than 0.9 recorded in FY19

Corporate tax cut weighs on buoyancy



Even after removing the impact of corporate tax cut, corporate tax buoyancy is expected to remain below the budgeted number, reflecting that efficiency has not picked up considerably.

To recall, the government lowered the corporate tax to 25.2% from 35% (which includes all surcharges)

Source: CGA, Budget Documents, HDFC Bank

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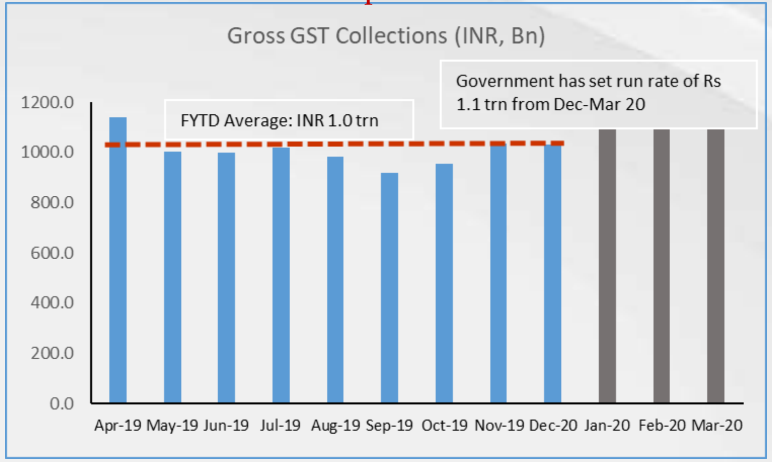
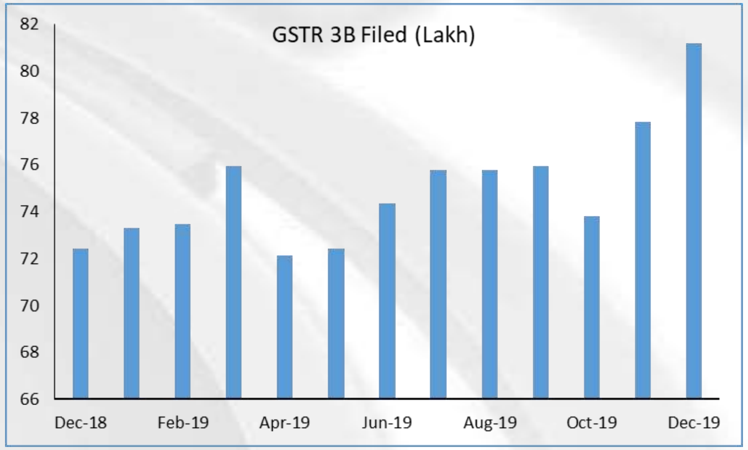
#2 Pressure Points: Lower than targeted GST collection; likely to fall short of the target

- The targeted growth rate for FY20 in GST collections is budgeted at 13.6% while so far this fiscal the growth has been close to 4.1%.
- Assuming the same run rate, collection shortfall could be closer to INR 600 bn. However, improved compliance (as can be seen from Nov-19) may partly come to the rescue.
- Government has set Gross GST (which includes the share of both Centre and the states) run rate at INR 1.1 trn/month from Dec-Mar 2020.
- On a FYTD basis, average gross GST collection stands at INR 1 trn. Gross GST collection crossed INR 1 trn mark in 5 out of the 9 months in this fiscal year and crossed INR. 1.1 trn only once in Apr-19.
- **Compensation cess to likely to add to fiscal stress:** cess released to the states stands at INR 652.5 bn (including INR 350 bn as pending compensation cess released on 16th Dec) until October 2019 higher than the collection of INR 645.3. To recall, *States were guaranteed a 14% tax revenue growth in first 5 years after GST implementation. Any shortfall against it is supposed to be compensated by the Centre using funds collected under compensation cess*

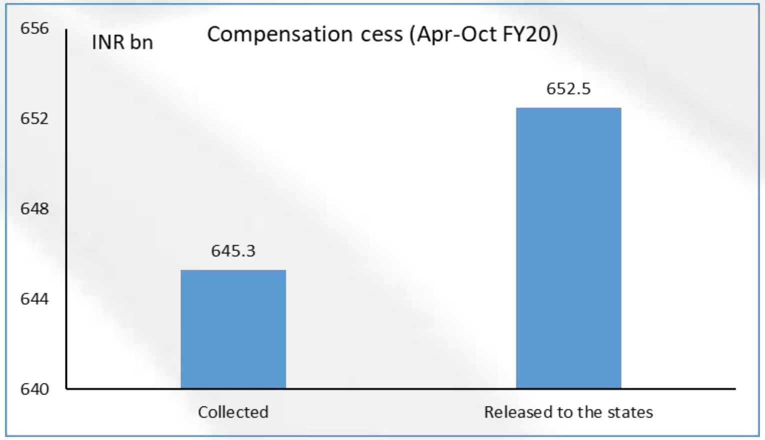
GST collections expected to fall short....



.....some cushion due to increased compliance



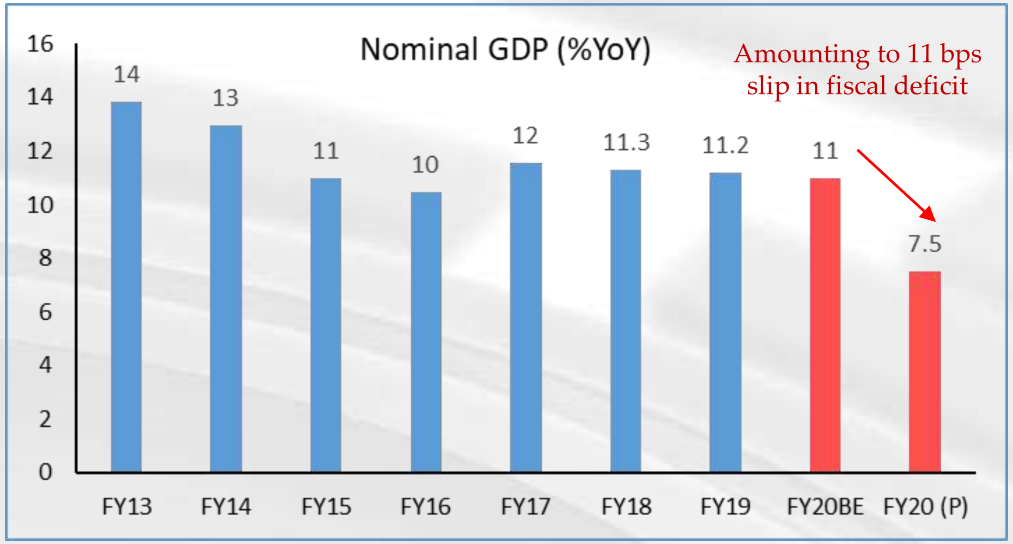
Stress on centre as revenue collected is lower than released to the states.



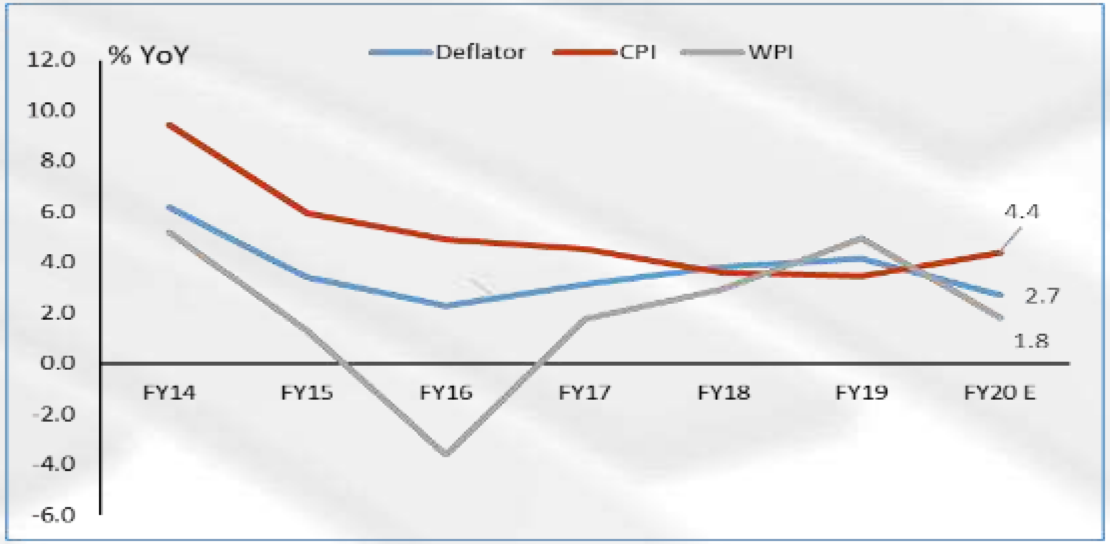
Source: PIB, CGA and HDFC Bank

#3 Pressure Point: Growth Blues

Nominal GDP growth expected to slip to 7.5% in FY20



Besides lower real GDP growth, easing inflation has also lowered Nominal GDP



- Nominal GDP dropped to 6.1% in Q2 FY20 from 8.0% in Q1 FY20, driven by a combination of both lower real GDP growth and moderating inflationary pressures.
- The Budget penciled in 11.0% growth in Nominal GDP. However, we expect nominal GDP to register a growth of 7.5% in FY20. A fall in nominal GDP growth alone amounts to a 11bps slip in the fiscal deficit ratio.

Source: CGA, Budget Documents, HDFC Bank

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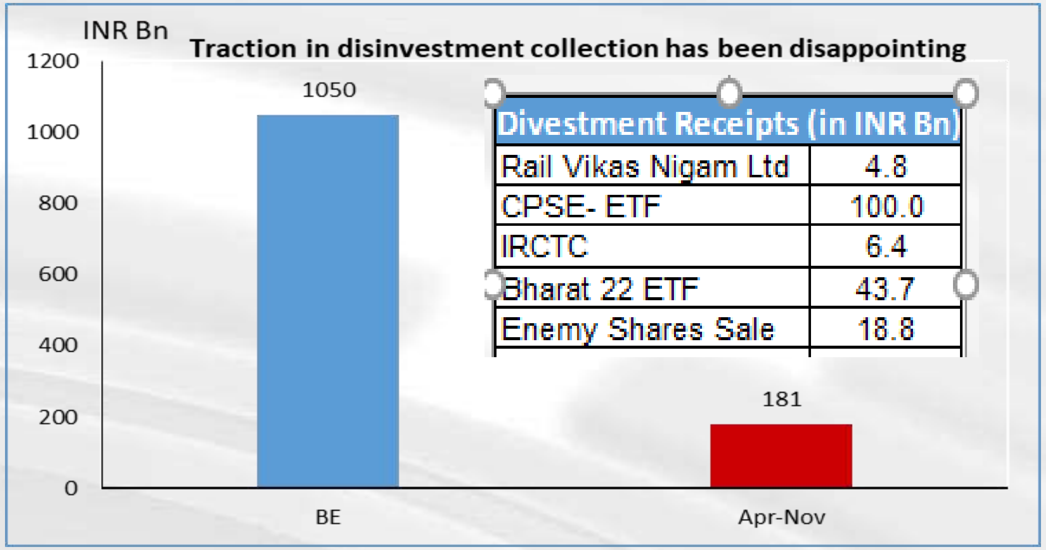
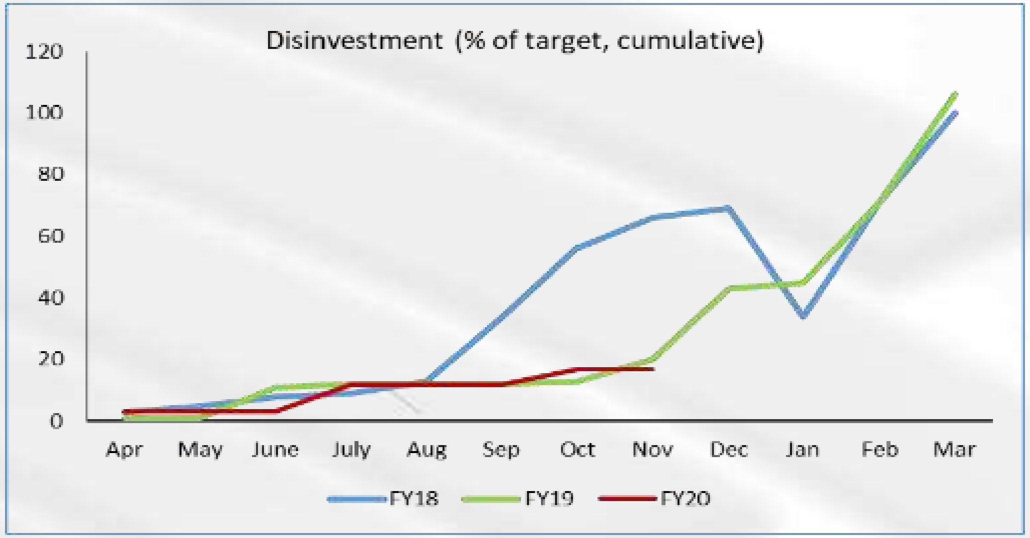
Disinvestments: Will Government meet the target in FY20?

While the current trend in disinvestment receipts is disappointing, collections could go up if they follow previous years' trend





Proposed strategic stale sales (%)

Air India	100
BPCL	53.3
ConCor	30.8

Expression of interest documents likely to get released in Jan-Feb 20

Potential bidders may seek time for due diligence

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Hence, a high probability of a delay (beyond Mar 20) in disinvestment of Air India, BPCL and ConCor

- Finance Ministry weighing 'offer for sale" (OFS) for few profit making public sector firms which is expected to garner INR 400 bn.
- According to the news reports, these could include *National Aluminium, Coal India, NTPC, NMDC, NBCC, Bharat Electronics and National Fertilizers* where the government's shareholding is in the range of 52-82%.
- **Our base case: We expect a shortfall of INR 400-500 bn** on account of delay in privatization of the proposed stake sales (Disinvestment target of Rs. 1.1 trn in FY20.)

Source: DIPAM, CGA and HDFC Bank

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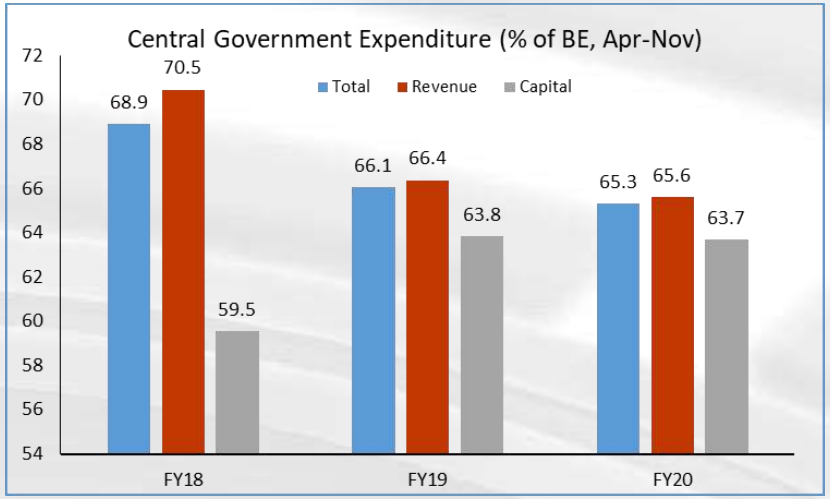
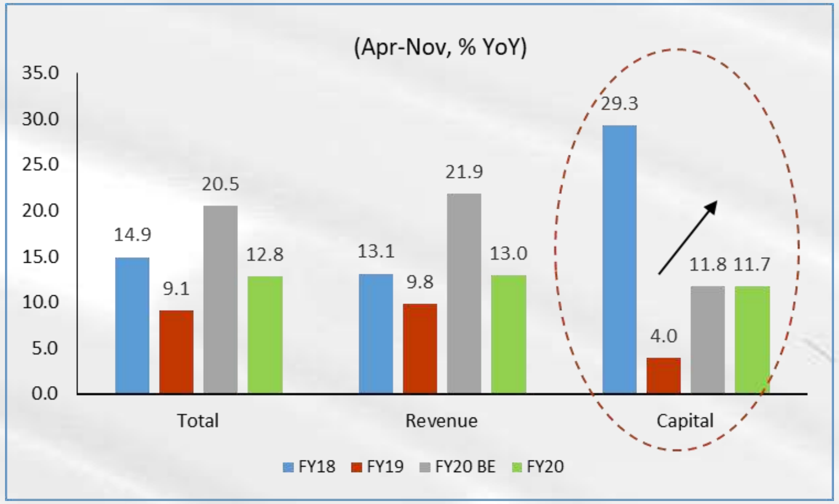
Government cuts back on expenditure but not in capex

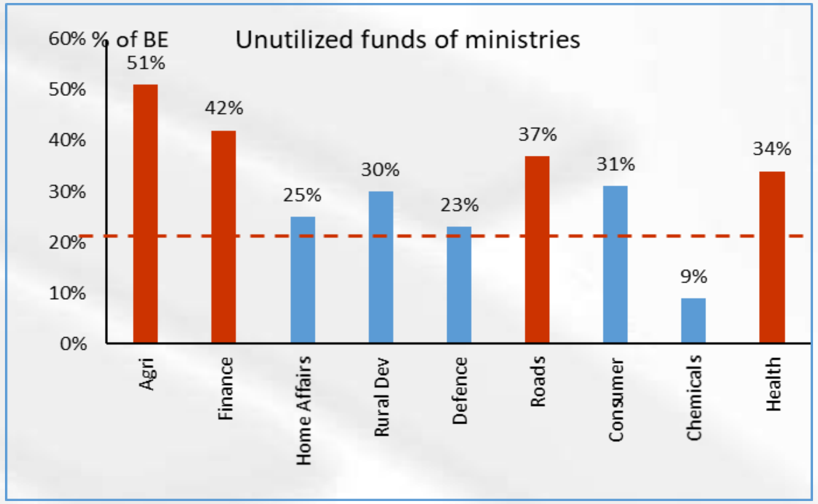
Total expenditure looks comfortable, remains broadly in line with the BE



Capital expenditure growth in line with budgeted growth and higher than FY19



Finance Ministry has capped spending by ministries in Q4 FY20 to25% of BE (vs. 33% earlier)

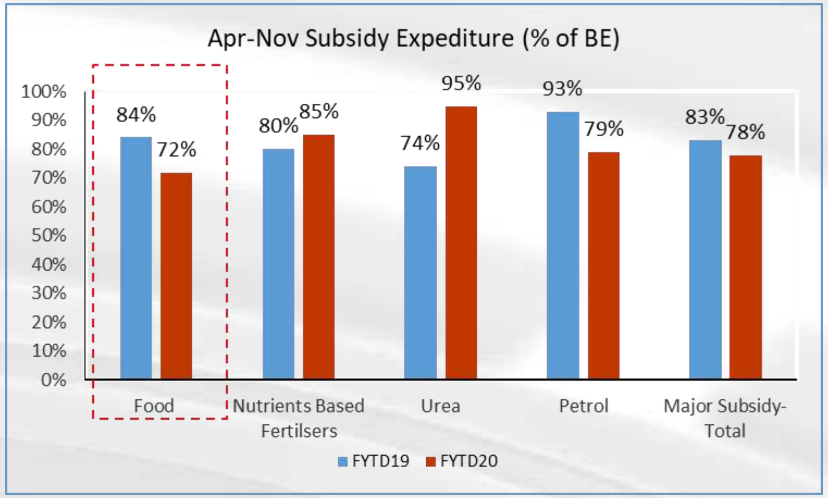


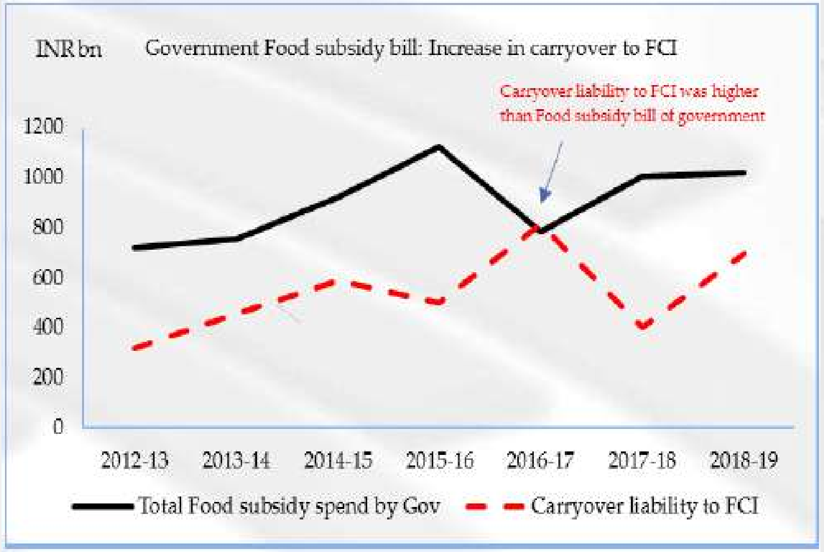
- **The Finance Ministry took a decision to cap the expenses of all ministries to 25% of the BE in Q4 FY20 vs. 33% earlier.**
- **Our calculations show that restricting expenditure could amount to savings of INR 2.23 trn**
- **No cut in productive expenditure?:** Assuming the current run rate of capital expenditure to continue to be the same for the remaining 4 months of FY20, we expect the government to meet the targeted level
- Our base case: Given the limited fiscal space and government's recent announcement to cap the spending, we reckon the brunt is likely to be borne on the revenue side. We expect revenue expenditure roll over of INR 2.2 trn.

Source: CGA, Budget Documents, HDFC Bank

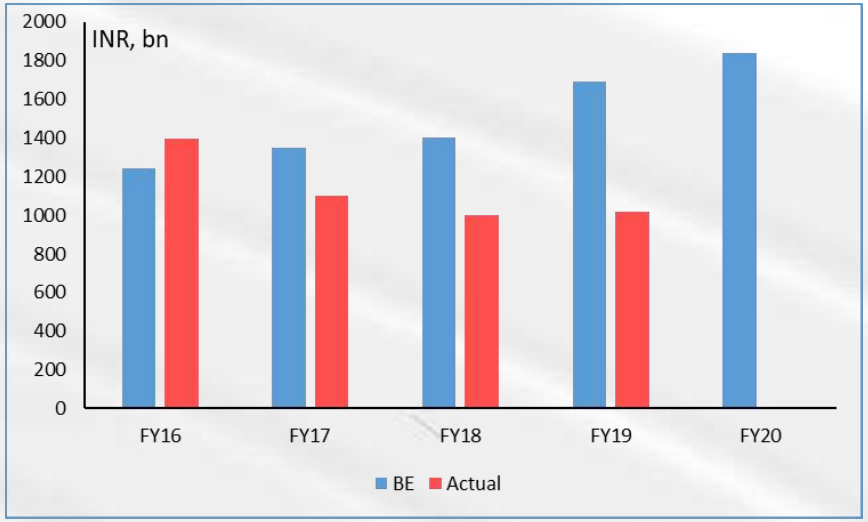
Food subsidy roll-over likely to provide cushion to the fiscal math

Food subsidy pay-out remains low; likely to provide some cushion to the fiscal math





Food subsidy bill: Budgeted vis-à-vis actual



- Centre's unpaid food subsidy bill stood at INR 694 bn in 2018-19 ~ 41% of 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
- For FY20, we expect a similar trend as last year with the subsidy roll-over to the tune of INR 600-700 bn.
- FCI to source INR 500 bn from NSSF

Source: FCI, Budget Documents, HDFC Bank

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Fiscal Deficit for FY20: To slip to 3.5%-3.6% of GDP

Overall, we expect the government to overshoot the fiscal deficit target by 20 -30bps at 3.5%-3.6% of GDP (vs. 3.3% budgeted)

Slippages

INR 250 bn shortfall in indirect tax collections (excluding GST collections)

INR 500-600 bn shortfall in Centre's GST collections

INR 2.0 trn shortfall in direct tax collections

INR 400 bn shortfall from disinvestments

Nominal GDP at 7.5% in FY20 vs. budgeted 11% in the Union Budget

Offsets

An expected INR 250-300 bn. in interim dividend by the RBI

RBI surplus: INR 580 bn. over budgeted

Expenditure compression to the tune of INR 2.3 trn.

Trillion	FY18 A	FY19 P	FY20 BE	FY20 YTD	FY20 HDFC Estimate	Shortfall(BE-Forecast)
I. Revenue Receipts (A+B)	14.4	15.6	19.6	9.8	17.5	2.09
A. Net tax receipts (net to centre)	12.4	13.2	16.5	7.5	13.5	2.95
Gross tax receipts (1+2+3)	19.2	20.8	24.6	11.7	21.7	2.95
1. Direct tax	10.0	11.3	13.4	5.6	11.3	2.03
Income tax	-	4.6	5.7	2.7	4.9	0.84
Corporate tax	-	6.6	7.7	2.9	6.5	1.20
2. Indirect tax excluding GST	4.7	3.7	4.6	2.2	4.3	0.24
3. GST	4.4	5.8	6.6	4.0	6.0	0.60
B. Non-Tax	1.9	2.5	3.1	2.3	4.0	-0.86
II. Capital Receipts ex borrowings	1.2	1.0	1.2	0.3	0.8	0.40
Disinvestments	1.0		1.1	0.2	0.7	0.40
Total Receipts (I + II)	15.5	16.7	20.8	10.1	18.3	2.49
Total Expenditure	21.4	23.1	27.9	18.2	25.5	-2.33
Revenue			24.5	16.1	22.3	2.19
Fiscal Deficit	5.9	6.5	7.0	8.1	7.2	-0.16
Fiscal Deficit % GDP	3.5	3.4	3.3	-	3.5-3.6	-
Nominal GDP % yr	11.0	11.2	11.0	7.0	7.5	-
Tax Bouyancy (Direct Tax)	1.6	1.2	1.7	0.5	0.1	-

Note: A negative number in the shortfall column denotes a surplus

Source: CGA, Budget Documents, HDFC Bank

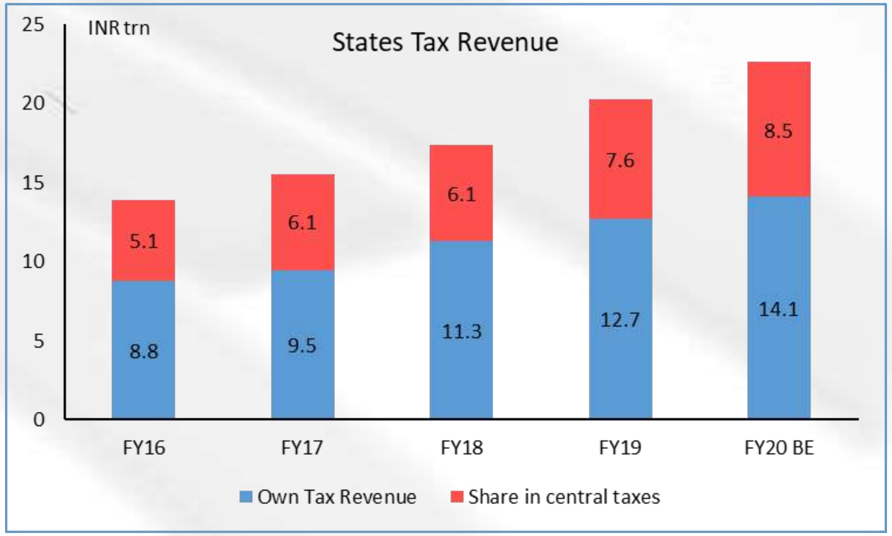
States fiscal situation also remains under stress

Combined revenue expenditure (of 24 states) is less than 50% of BE in H1. Scope exists for higher expenditure in H2 but to a limited extend as fiscal condition of the states remain challenged as well.

Traction in revenue collection at the state level as also been under stress

Budgetary Position of States suring Apr-Sep, 2019	(INR bn) Actuals		(Per cent) % of BE		% YoY	
	H1 FY20	H1 FY19	H1 FY20	H1 FY19	H1 FY20	H1 FY19
REVENUE RECEIPTS	10581	10077	38.9	40.7	5.0	16.4
a) Tax revenue	7895	7701	39.7	42.5	2.5	13.7
b) Non-Tax Revenue	693	703	31.7	34.7	-1.4	25.6
c) Grant in aid and Contribution	1993	1673	39.0	36.2	19.1	26.5
CAPITAL RECEIPTS	124	80	21.7	15.3	55.0	272.2
a) Recovery of Loans and Advances	124	72	22.3	14.2	72.2	244.8
b)Other Receipts	1	8	3.1	65.4	-87.5	1272.6
Revenue Expenditure	11054	10097	40.0	40.5	9.5	11.1
Oh which, interest payments	1233	1079	40.1	39.0	14.3	8.8
Capital Expenditure	1562	1503	30.3	30.8	3.9	23.1
a) Capital Outlay	1375	1346	28.7	29.8	2.2	20.8
b) Loans and advances disbursed	187	158	50.9	43.9	18.4	46.9
Revenue Deficit	473	20	107.7	11.9	2265.0	-95.4
Fiscal Deficit	1910	1444	38.0	31.9	32.3	-11.2

Own tax revenue of the states forms a major portion of its total revenues



Source: RBI, Budget Documents and HDFC Bank

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Financing of fiscal deficit: Market borrowings & Yields

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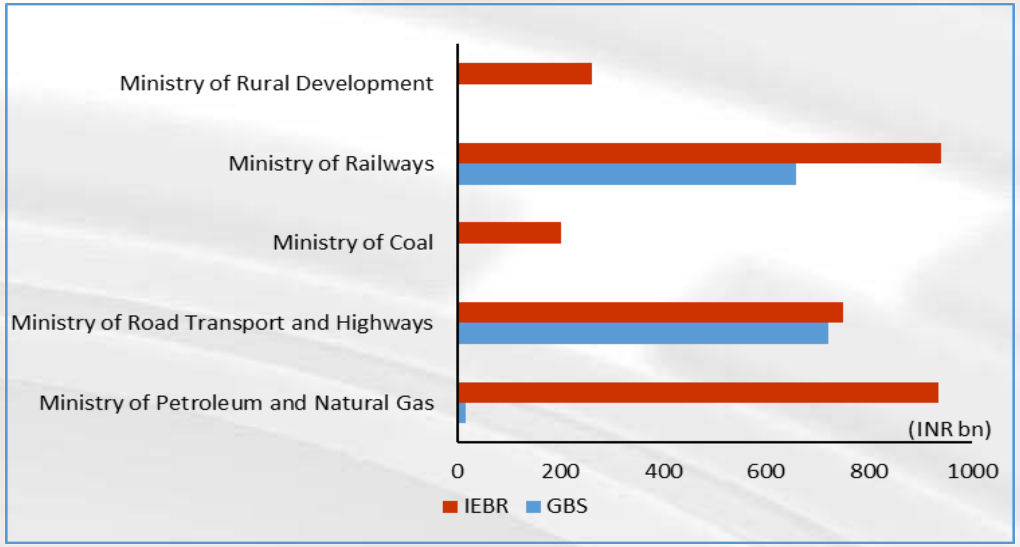
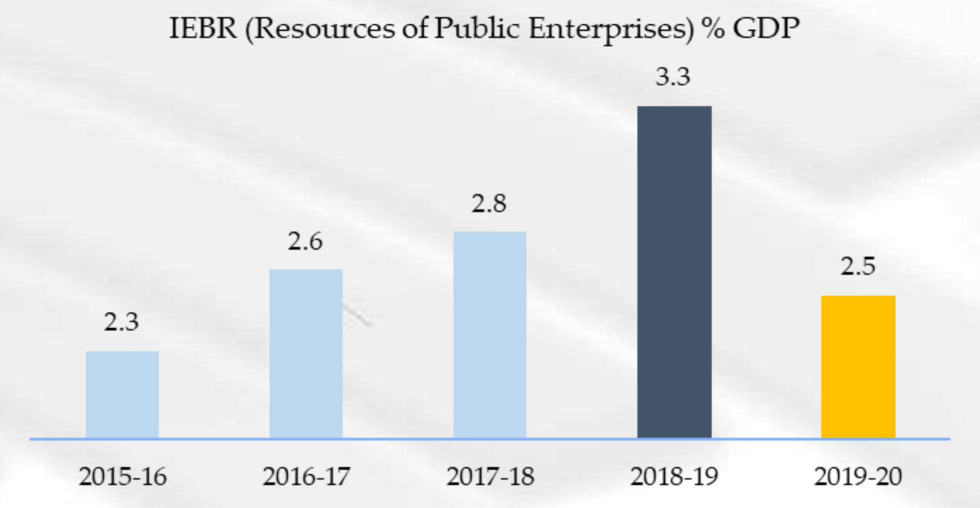
Off budget financing has been on the rise, this trend could continue

Large part of spending on rural and infra to be financed through IBER (2019-2020)



This year, the government has estimated extra budgetary resources to be 2.5% of GDP. This number could be higher as the government shifts its expenditure to PSEs



In Sep-19, finance ministry urged PSEs to boost their capital expenditure. Finance ministry decided to constantly monitor the progress of larger infra PSE projects.

NHAI's demand for extra resources of ~INR 240 Bn. for current fiscal year was denied. To complete Bharatmala targets and meet debt obligations NHAI's borrowing limit is likely to be revised upwards from current ceiling of INR 750 bn.

ONGC which has the highest capital outlay for FY20 (INR 329 Bn.) raised $300 Mn. in the forex market.

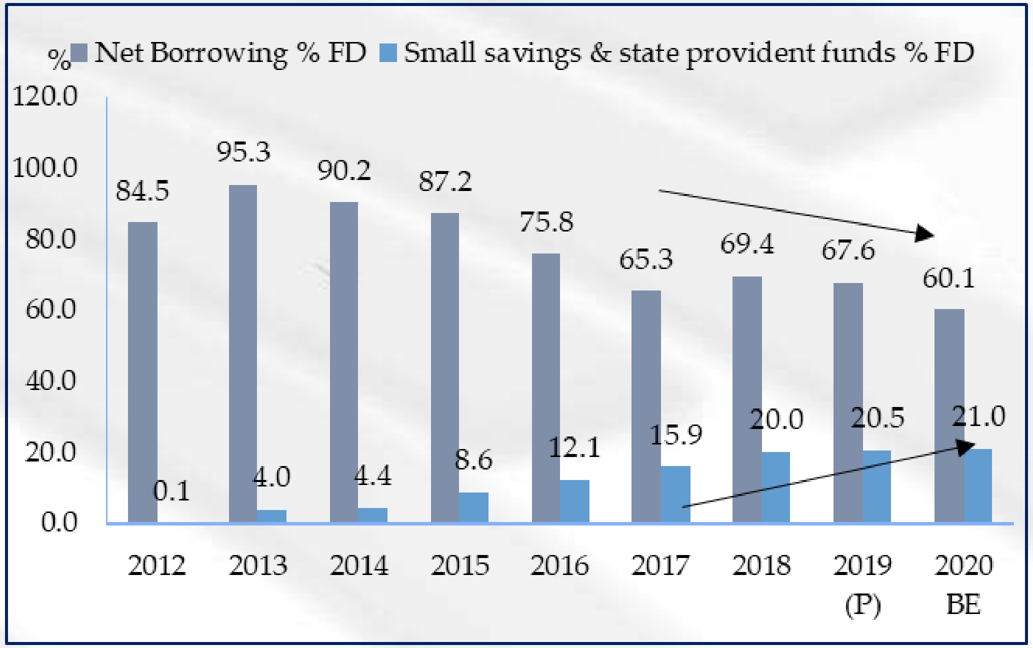
Source: CGA, Budget Documents, HDFC Bank

Centre's deficit financing: Reliance on small savings fund on the rise…

Financing of Fiscal Deficit via small savings rose to 12.5% of Fiscal Deficit in Apr-Nov FY20 vs. 6.3% in the same period FY19

	INR bn		as % ofGFD	
	2018-19	2019-20	2018-19	2019-20
	Apr-Nov			
Fiscal Deficit	7166.3	8078.3		
External Financing	-34.5	71.0	-0.5	0.9
Domestic Financing	7200.8	8007.4	100.5	99.1
a) Market Borrowings	4294.0	5515.3	59.9	68.3
b) Securities against Small Savings	454.0	1011.6	6.3	12.5
c) State Provident Funds	50.5	31.2	0.7	0.4
d) Special Deposits	-4.1	-2.5	-0.1	0.0
e) Others	-80.4	-666.6	-1.1	-8.3
f) Cash Balance {Decrease (+)/Increase (-)}	9.4	49.9	0.1	0.6
g) Investment (-)/Disinvestment (+) Surplus Cash	1625.6	1226.9	22.7	15.2
h) Ways and Means Advances	0.0	385.8	0.0	4.8

Rising share of small savings in financing fiscal deficit



Source: CGA, Budget Documents and HDFC Bank

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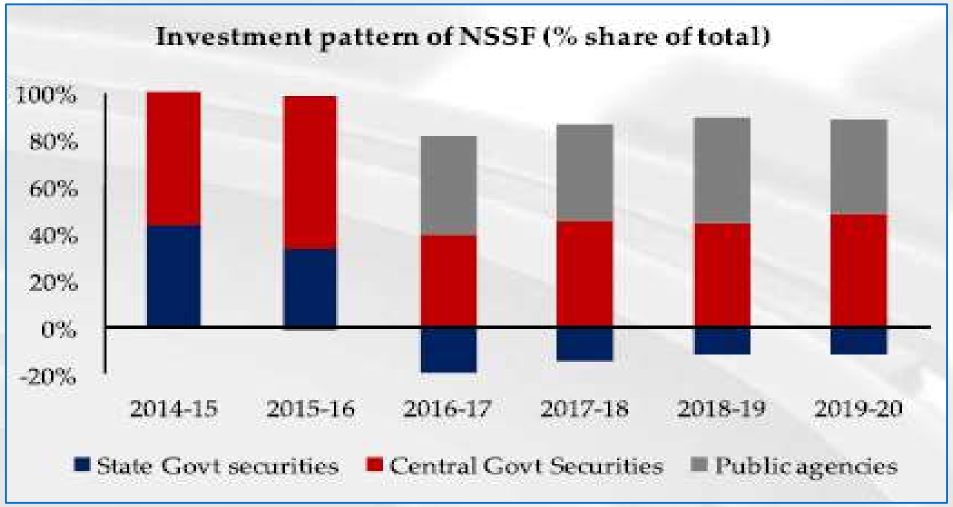
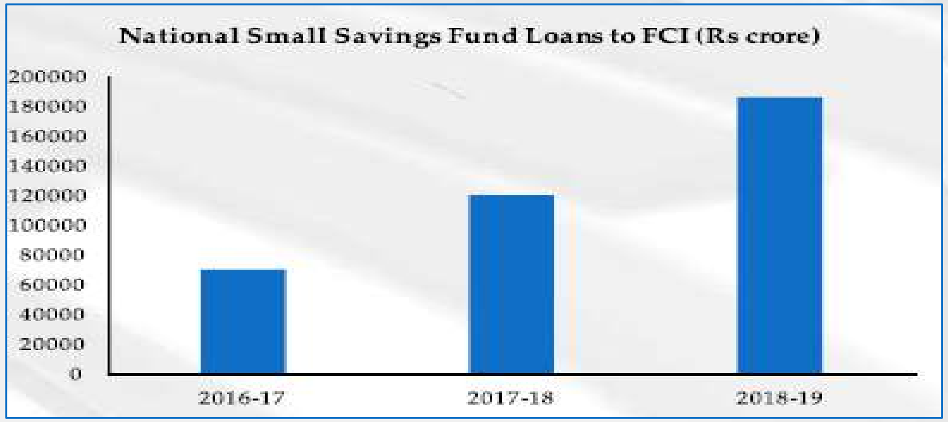
…not just of the Centre but also of the PSUs

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 FY19 from NSSF



Small saving rates higher than banks deposit rates

Schemes	Rate
Sukanya Samidhi Scheme	8.4
Public Provident Fund	7.9
5Y National Savings Certificate	7.9
Senior Citizen's Savings Scheme	8.6
5Y Recurring Deposit	7.2
Kisan Vikas Patra	7.6
5Y Monthly Income Scheme	7.6
Post office Time Deposit	
5Y	7.7
3Y	6.9
2Y	6.9
1Y	6.9
Weighted Average Domestic Term Deposit Rates (WADTDR) for nov-19	
PSBs	6.65
Private Sector Banks	6.91
Foreign Banks	5.38
Scheduled Commercial Bank	6.68

Source: CGA, RBI, Budget Documents, HDFC Bank

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Moderate fiscal slippage to limit additional market borrowings in FY20

Fiscal slippage to be limited, reducing the need for additional borrowings

Rs Trillion	FY18	FY19	FY20 (BE)	FY20 F	FY21 F
Fiscal Deficit % GDP	**3.5**	**3.4**	**3.3**	**3.5**	**3.4**
Fiscal Deficit	5.9	6.5	7.0	7.2	7.7
Gross G-sec Supply	5.9	5.7	7.1	7.1	7.7
Net Market Borrowings	4.1	4.2	4.2	4.5	4.6
Redemptions (-)	1.37	1.48	2.4	2.4	2.6
Buybacks (Net -)	0.42	-	0.5	0.2	0.5
Nominal GDP % yr	11	11.2	11	7.5	10.5
Securities against Small Savings	1.03	1.25	1.3	1.8	1.5

- *We do not expect significant additional market borrowings in the current fiscal as the fiscal deficit is estimated at 3.5%-3.6% of GDP amounting to a fiscal slippage of Rs. 15,000-30,000 crores.*
- *Government expected to reduce its buybacks from the budgeted Rs 50,000 crores to Rs 20,000 crores as fiscal space is constrained.*
- *For FY21, redemption pressures remain high and we see a gross borrowing number of Rs 7.7 trn and a fiscal deficit of 3.4% of GDP.*

GoI has done a switch of Rs. 42,000 crore for bonds maturing in FY21, thereby reducing the redemption pressure from Rs. 3 trn to Rs. 2.6 trn for FY21.

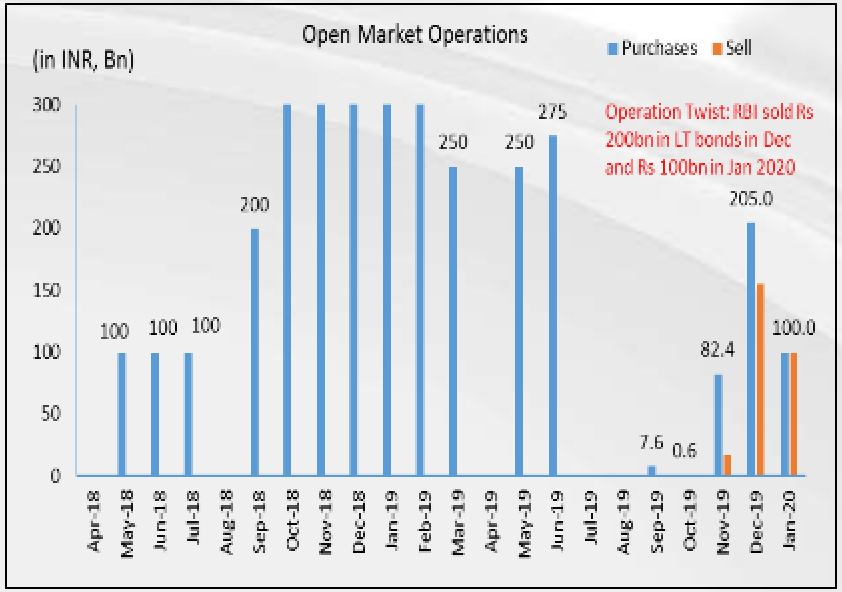
The government is likely to reduce the buybacks from the budgeted Rs 500bn

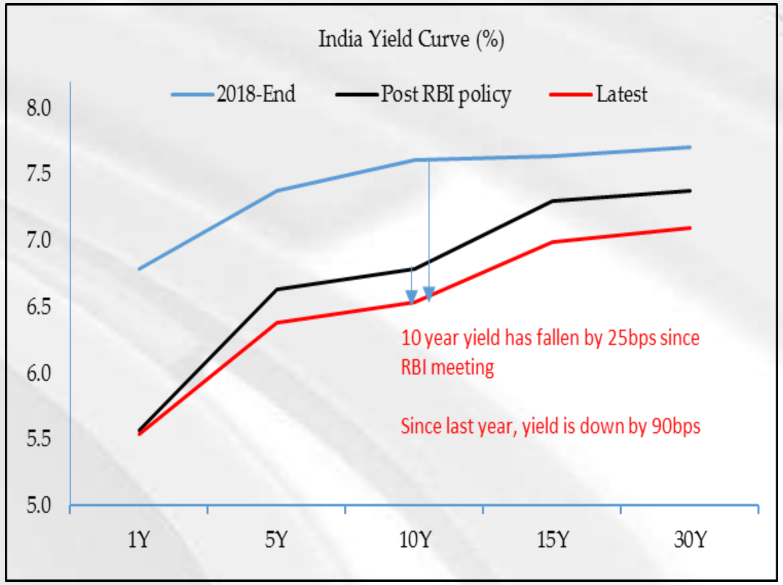
Rs Trn	FY20 (BE)	YTD
Gross Borrowings	**7.1**	**6.2**
Redemptions	2.4	1.0
Buybacks	0.5	-
Switches	0.5	0.6
Net Borrowings	**4.23**	**5.17**
NSSF	1.3	1.0

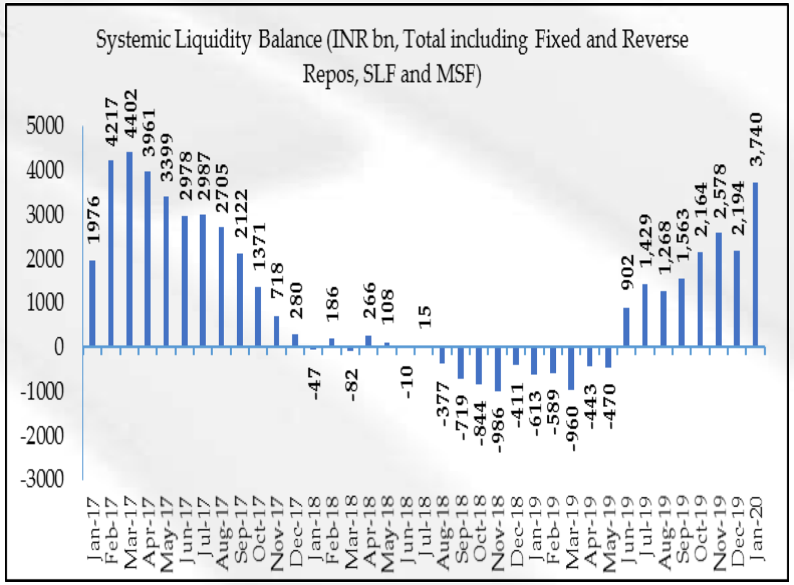
Expected to be Rs 0.2 trn

Source: RBI, CEIC, HDFC Bank

- RBI conducted operation twist to manage the yield curve and improve transmission: Bought Rs 200bn of LT bonds in Dec 19 and Rs 100 bn in Jan 20. Simultaneously, it sold Rs 153 bn bonds at the short-end of the curve in Dec 19 and Rs 100 bn in Jan 20.
- The 10 year yield has dropped by 26bps since the post RBI policy spike in December. The cumulative fall since the beginning of 2019 stands at 90bps.
- Liquidity conditions remain in surplus, averaging at Rs 3.7 trn in January up from Rs 2.2 trn in December.
- We expect bond yields to remain contained between 6.4%-6.6% till March-end as geopolitical tensions and oil prices cool off. Additionally, we do not expect the government to announce significant market borrowings as they reign in the deficit through expenditure compression. On the flip side, higher inflation prints could maintain some pressure on yields.





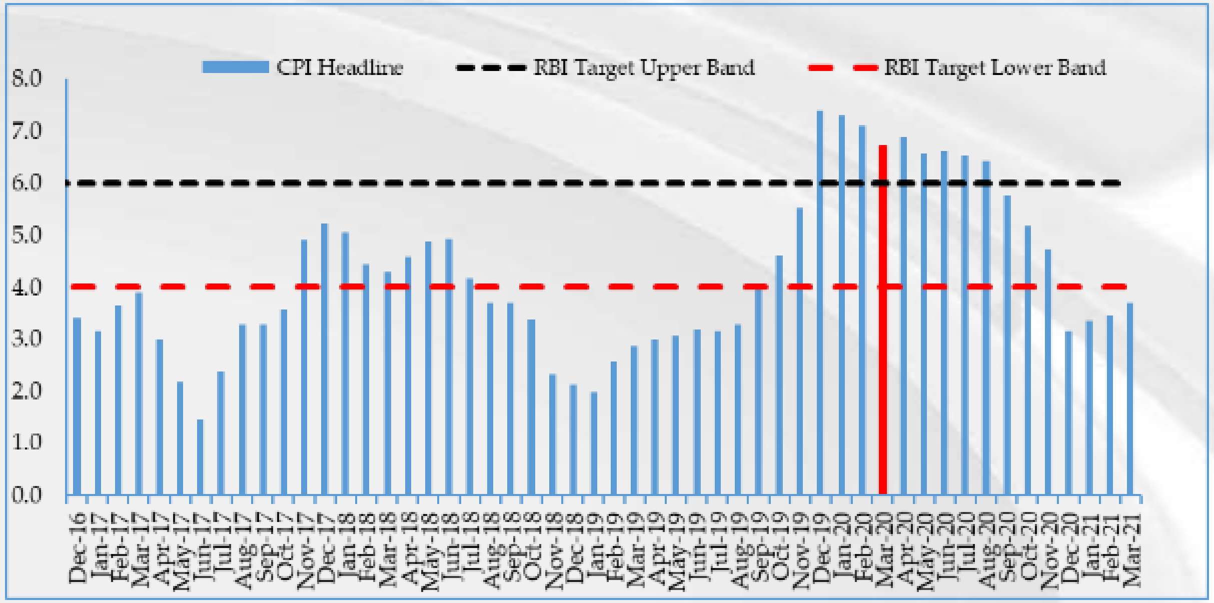


Source: RBI, Reuters, CEIC, HDFC Bank

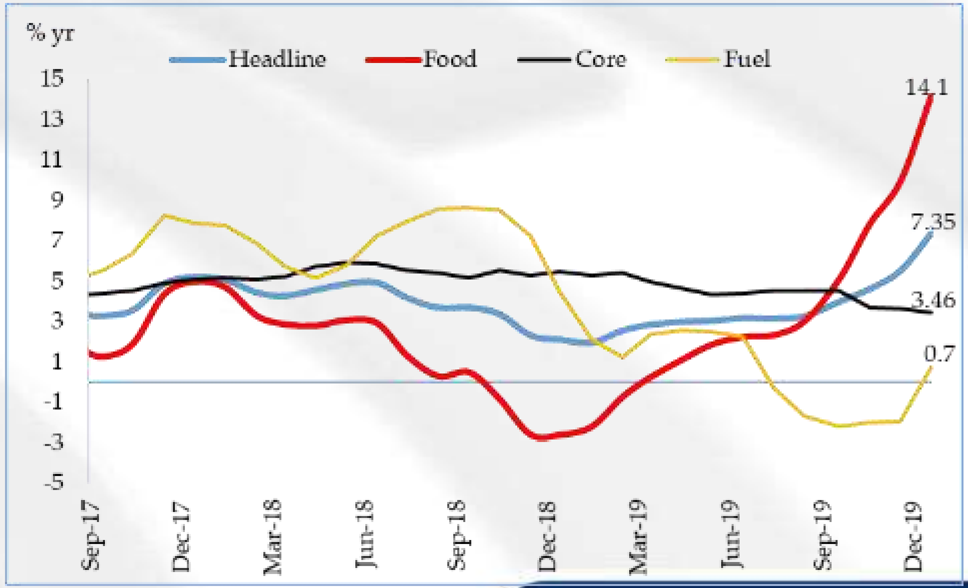
Inflation spikes could put a floor to yields

- *We expect inflation to peak in January 2020 above 7%, driven by the increase in food prices (vegetables and protein inflation), change in telecom tariffs and LPG price increases. This is likely to keep the pressure on bond yields.*
- *For FY21, we expect inflation to average at 4.2%, march-end 2021 close to 4% as food inflation spikes wear-off and oil prices are expected to remain contained ($65/bbl. average for FY21). In addition, a high base effect is also likely to bring down the annual growth figures, especially in the second half of the fiscal.*
- *We expect the RBI to keep rates on hold in its February meeting. Beyond that, as inflation is expected to cool down and come in close to the RBI's target by H2 between 3.2%-5.2% range, the space for another rate cut cannot be ruled out. This could put some downward pressure on yields in H2 (expected range of 6.40%-6.50%).*

HDFC Bank Inflation Forecasts (%yr)



Food inflation: The key driver of surge in inflation



Source: RBI, Reuters, CEIC, HDFC Bank

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Progress on Flagship Schemes

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Budget allocation for MGNREGA and PM Awas Yojana was reduced in FY20

Farmer income support. Water Mission, DBT received rise in allocation while MGNREGA's allocation was reduced in FY20

Outlay on major schemes (in INR Bn)		
Schemes	**FY19RE**	**FY20BE**
Income Support Scheme/PM Kisan	200	750
Crop Insurance Scheme	130	140
Ayushman Bharat	24	64
National Health Mission	312	337
MGNREGA	611	600
PM Krishi Sichai Yojna	83	97
PM Gram Sadak Yojna	155	190
PM Awas Yojna	264	259
National Rural Drinking Water Mission	55	100
National Education Mission	323	385
National Livelihood Mission-Ajeevika	63	98
Job and Skill Develeopment	68	73
Swachh Bharat Mission	170	126
AMRUT and Smart Cities Mission	126	138
Direct Benefit Transfer	165	295
Deen Dayal Upadhyaya Gram Jyoti Yojana	38	41

Schemes highlighted in green received increased budgetary allocation while those in red received less budgetary support.

Source: Budget Documents, HDFC Bank

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Progress on Key flagship schemes: Performance remains mixed

Swachh Bharat Mission/Clean India Campaign

- Number of open defection free (ODF) villages increased to 603.1K in FY20 from 46.96K in FY16.

Ayushman Bharat/ PM Jan Arogya Yojana

- PM-JAY success is limited as only 7.41 Mn patients (as of 9th Jan 2020) have been admitted under PMJAY vs. the target of ~500 Mn.

PM Kisan / Farmer Income Support Scheme

- As of 30th November 2019, only 50% of beneficiaries have received the funds. Furthermore, out of allocated INR 750 Bn, less than half (INR 360 bn) has been disbursed. Verification and uploading of beneficiaries' data emerged a major constraint in the implementation of the scheme .

MGNREGA/ Employment Guarantee Scheme

- **<u>In the fiscal year till date, 54.7 Mn household demanded for work while only 47.4 Mn household were offered work, indicating large demand and supply gap.</u>**
- Average wage rate per day per person remained largely flat at INR 181.53 vs. INR 179.13 in FY19.
- **<u>Govt might link MGNREGA wages to CPI index of agricultural labour, which is likely to result in 8-10% increase in MGNREGA wages and put pressure on fiscal math/</u>**
- FY20 budget allocation was decreased at the margin to INR 600 Bn (vs. INR 611 Bn in F2019). The budget allocation for FY21 can increase to INR 700 Bn.

Government is likely to consolidate all farmer welfare related schemes on account of dwindling resources.

Source: Swachh Bharat, Ayushman Bharat Dashboards, HDFC Bank

What is UDAY?

- UDAY or Ujwal Discom Assurance Yojana was rolled out in 2015 to revamp debt ridden power distribution PSUs.
- Under this scheme, state governments took over 75% of discom debt while 25% of debt remained with discoms.

Targets

- As a part of package, certain efficiency parameters related targets were set for discoms.
- In particular, discoms were expected to reduce their aggregate technical & commercial losses (AT&C) to 15% by FY19.
- Reduction in gap between average cost of supply and realizable revenue (ACS-ARR Gap) to zero by F2019 was the another target. .

Progress

- Discom loses which reduced from INR 515.62 Bn in FY16 to INR 151.32 Bn rose to INR 280.4 Bn in Q3FY19.
- Only 10 out of 30 states who have opted for UDAY have reduced their losses or registered a profit in FY19.
- Many states have missed 15% target of AT&C losses. At all India level, AT&C losses are targeting at 21.35%. <u>In pre UDAY years, AT&C losses were ~24%</u>.
- There is a wide disparity across states for ACS and ARR Gap. On national level, ACS-ARR Gap is at INR 0.38/month vs. target of INR 0/month .
- **<u>The government has hinted at the possibility of revamping the scheme on account of mounting losses.</u>**

Union Budget 2020-21: Expectations

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What to expect from FY21 Union Budget

FY21 Union Budget is unlikely to mark a radical departure from past budgets

Fiscal Deficit	Government unlikely to provide a significant fiscal boost. We expect fiscal deficit at 3.4% of GDP in FY21
Fiscal Stimulus	Major fiscal stimulus to ramp up growth ruled out basis finance ministry's decision to cap government spending by different ministries in Q4 FY20 (at a time where government spending seems critical to support growth)
Non-Tax Revenue	Expected to increase assuming additional revenue from 4G and 5 G spectrum auctions
Income Tax	Minor tweaks in personal income tax slabs
Disinvestment	Disinvestment targets to be set higher as proceeds from stake sale in ConCor, BPCL (pipeline for FY20) likely to accrue post Mar 20
DBT	Higher allocation expected for DBT schemes to boost consumption, First tranche of Food DBT??
UDAY 2	Government might consider a UDAY 2.0 to address the issue of losses of discoms

Source: Budget Documents, Media Reports and HDFC Bank

Industry's expectations from FY21 Union Budget

Auto

Formalize monetary incentives for scrappage of vehicles

Start-ups

•Faster processing of tax refunds and tax ESOPs only at time of sale (not upfront)

•Set up a INR 30 bn deep-tech venture fund

•Let start-ups carry forwards losses for up to 15 years

Gems & Jewellery

Lowering of import duty on gold from the current 12.5%

Healthcare

Tax break for pharma companies for research and development

Information Technology

Rebooting SEZs to make the export process seamless

Tax holiday for firms for research and development in areas like AI and robotics

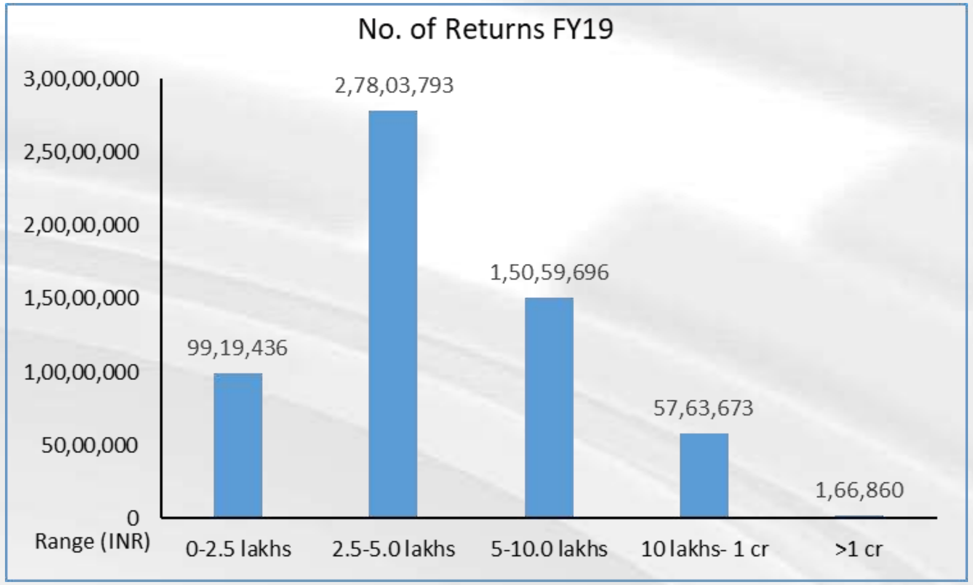
Tourism

Higher allocation of funds in tourism and cultural heads

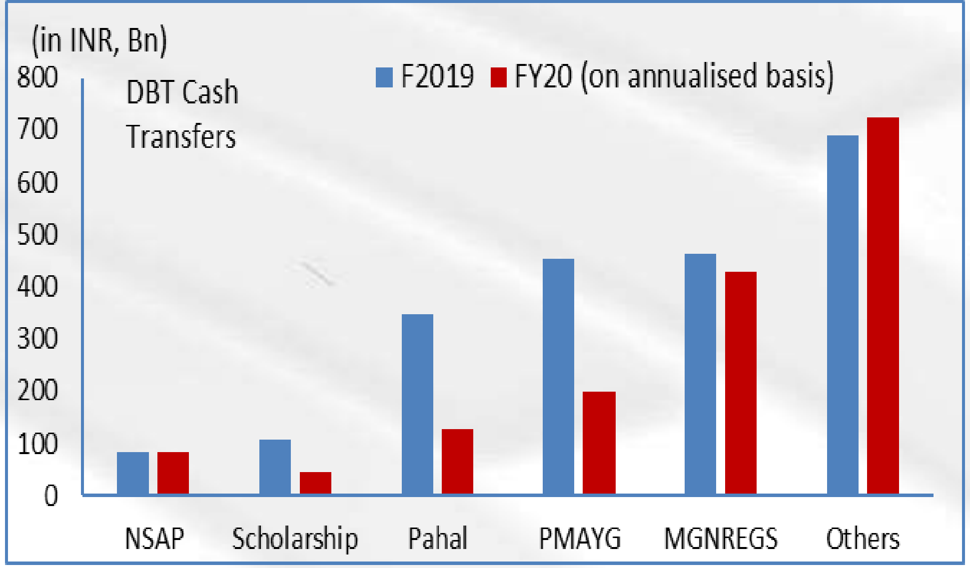
Source: Media Reports and HDFC Bank

A cut in income tax would benefit only a small section of people as only ~ 5.7% of India's population paid income tax in FY19.

A cut in income tax is unlikely to have a signifiant impact on growth, instead..



…further strengthening the schemes (DBT) could provide the needed impetus to the growth



- A cut in income tax is unlikely to be enough to boost consumption given the narrow tax base (only 5.7% of India's population paid income tax in FY19)
- There might be some tweaks in personal income tax slabs or perhaps even the rates in the Union Budget but they are likely to be minor. The government might attempt to increase the amount of cash transfer – perhaps supplement PM Kisan—but while these measures would be played up in the budget speech the amounts allocated under these heads are expected to be small.

Source: CGA, CBDT, Budget Documents, HDFC Bank

FY21 Projections: Fiscal deficit of 3.4%

	FY20 BE	HDFC Estimate for FY20	HDFC Estimate for FY21
Tax Buoyancy (Gross, INR trn)	1.7	0.6	1.2
Direct Tax Revenue (% YoY)	18.6	0.6	11
Indirect Tax Revenue (excl. GST, INR trn)	22.9	16.3	16
Nominal GDP (% YoY)	11.0	7.5	10.5
Fiscal Deficit (as % of GDP)	**3.3**	**3.5-3.6**	**3.4**
Net Market Borrowings (INR trn)	4.2	4.5	4.6

Source: CGA, Budget Documents, HDFC Bank

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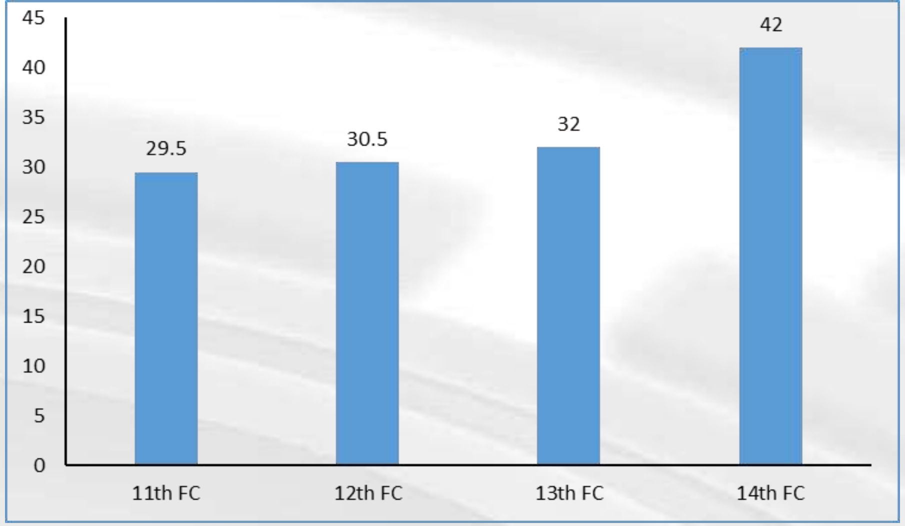
15th Finance Commission: Not likely to increase the devolution to states

Devolution of taxes from the centre to states increased considerably to 42% by the 14th Finance Commission



Weight of criteria used by 11th to 14th FC

Criteria	11th	12th	13th	14th
Income Distance	62.5	50.0		50.0
Population 1971	10.0	25.0	25.0	17.5
Population 2011				10.0
Index of infrastructure	7.5			
Fiscal discipline	7.5	7.5	17.5	
Tax effort	5.0	7.5		
Fiscal Capacity Discipline			47.5	
Area	7.5	10.0	10.0	15.0
Forest Cover				7.5

15th Finance Commission

- **Interim report for FY21 submitted**
- **The report will give recommendation on devolution of taxes from the centre to states starting FY22 till FY26.**
- **Devolution formula to be applied in the upcoming Union Budget, thus the award has not been made public**
- **Devolution of taxes to states unlikely to increase in FY21**

Source: CGA, Budget Documents, HDFC Bank

Case for fiscal stimulus:

- **The fiscal deficit and the low growth loop:** *Elmeskov and Sutherland (2012) point that high debt levels have a negative impact on growth but they argue that correlation is not the same as causation. While high levels of public debt could be detrimental to growth, low economic growth could itself lead to high levels of public debt i.e., reverse causality as the primary deficit expands (low revenue collections etc.)*
- **There are no fixed debt thresholds that are associated with a debt crisis. External debt is a more relevant metric to judge the vulnerability to a debt crisis.**
- **In this regard, India's debt levels remains low by international standards.**
- **The external debt metrics also remain contained and do not point to any fiscal stress.**

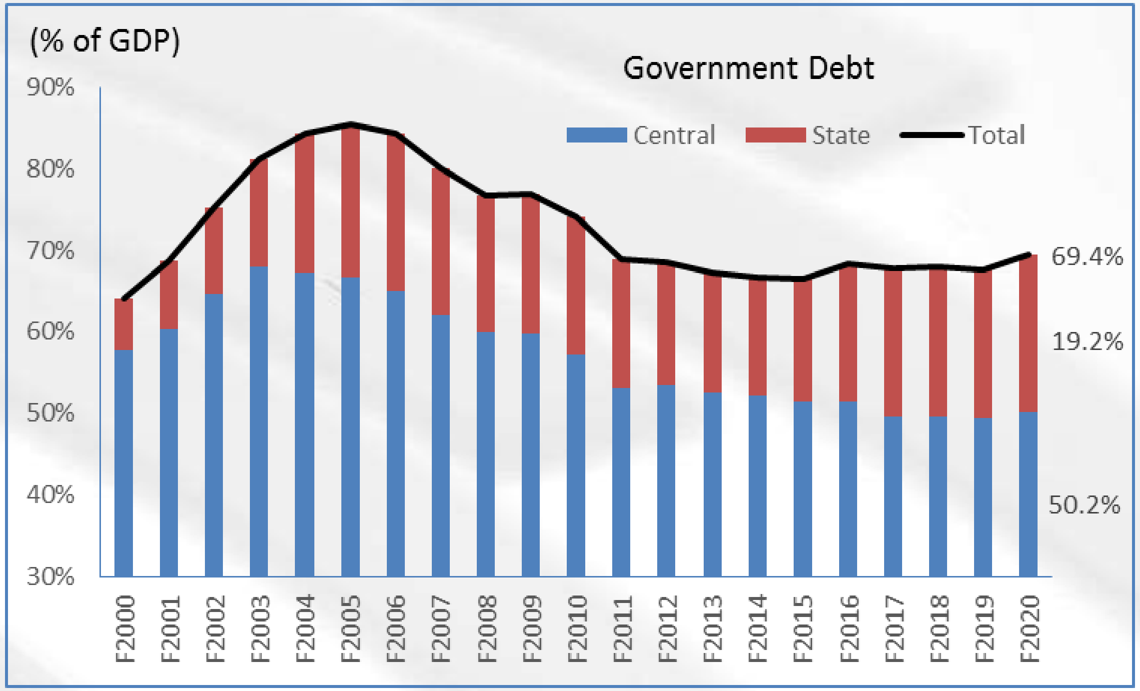
Case against:

- **Interest payments as a % of net revenues** are expected to shoot up to 49% in FY20 from 43% in FY18.
- **Long term borrowing costs have been higher than the nominal GDP growth** in recent quarters, raising the pressures on debt sustainability.
- Keeping the fiscal deficit in check could **reduce the risk of a rating downgrade.**
- **Internal debt pile up could effect the flows into external debt** and the assessment of rating agencies that takes into India's internal metrics for ratings.

India's total government debt remains low compared to international standards

India's debt to GDP ratio stands at 68% - lower than the UK, US and Japan

Share of central government in gross debt is reducing while that of state government is rising



Source: IMF Data Mapper, CEIC, HDFC Bank. Note: India debt figures for F2019 are revised estimates while F2020 are budget estimates

India remains comfortable in terms of its external debt dynamics

High external levels are usually the conventional metric to judge the risk of a debt crisis for a country. In India's case, the external debt metrics remain in a comfortable position.

External Debt levels

- **Insolvency:** Manasse and Roubini (2009) find that the risk of default is particularly high in case of a high stock of external debt (in excess of 50% of GDP). India seems to be safe on this count.

- **Liquidity:** Manasse and Roubini (2009) shows that the risk of default due to illiquidity is especially high if short-term debt exceeds 130% of reserves. For India this ratio currently stands at 26.3%.

India's Key External Debt Indicators

	1991	2008	2019 P
External Debt (USD bn)	83.8	224.4	543
Ratio of External Debt to GDP (%)	**27.7**	**18**	**19.7**
Debt Service Ratio (%)	35.3	4.8	6.4
Ratio of Foreign Exchange Reserves to Total Debt (%)	7	138	76
Ratio of Concessional Debt to Total Debt (%)	45.9	19.7	8.7
Ratio of Short-Term Debt to Foreign Exchange Reserves (%)	**146.5**	**14.8**	**26.3**

Source: Reuters, Central Bank, Budget Documents, CEIC and HDFC Bank

Cross Country Comparison: External Vulnerability

Economic Indicators	China	Argentina	Mexico	Phillipines*	Indonesia	Russia	South Africa	India
Inflation (%)	2.7	57.3	4.0	2.7	3.3	4.7	4.5	3.1
GDP Growth (%)	6.4	-5.8	1.2	5.7	5.1	0.5	0.0	5.8
Current Account Balance (% of GDP)	0.4	-5.4	-1.8	-2.4	-3.0	7.0	-3.5	-2.3
Budget Balance (% of GDP)	-2.6	-5.5	-2.1	-3.2	-1.8	2.7	-4.4	-3.4
External Debt (% of GDP)	14.4	51.8	36.5	23.9	36.2	27.4	46.8	19.7
Sovereign External Debt (% of GDP)	1.8	32.0	18.0	12.0	12.0	3.2	18.3	3.8
10-Year Bond Yield (%)	3.19	6.22	7.60	6.88	7.34	7.33	8.13	6.55
FX Reserves (USD bn)	3119	45	174	75	118	408	41	394
Currency (% CYTD appreciation/depreciation)	-0.1	-10.5	3.4	2.6	2.6	9.6	2.6	1.5

*Philippines Sovereign External Debt represents overall Public sector debt. NB: External Debt figures are approximates based on GDP and External Debt data

Source: Reuters, Central Banks, Media Reports, CEIC and HDFC Bank

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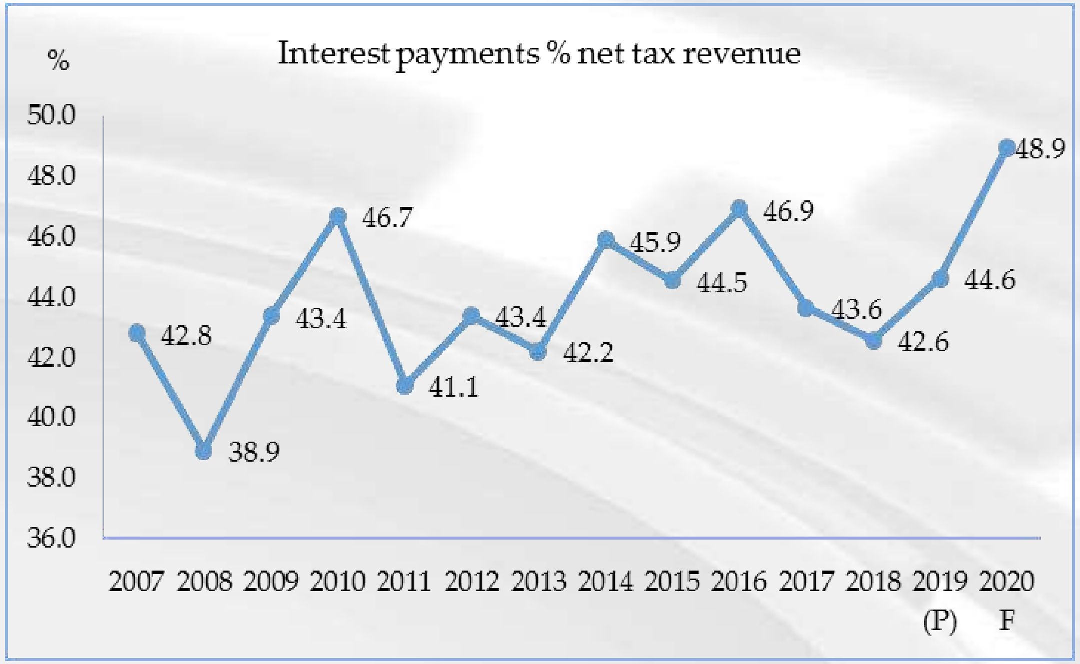
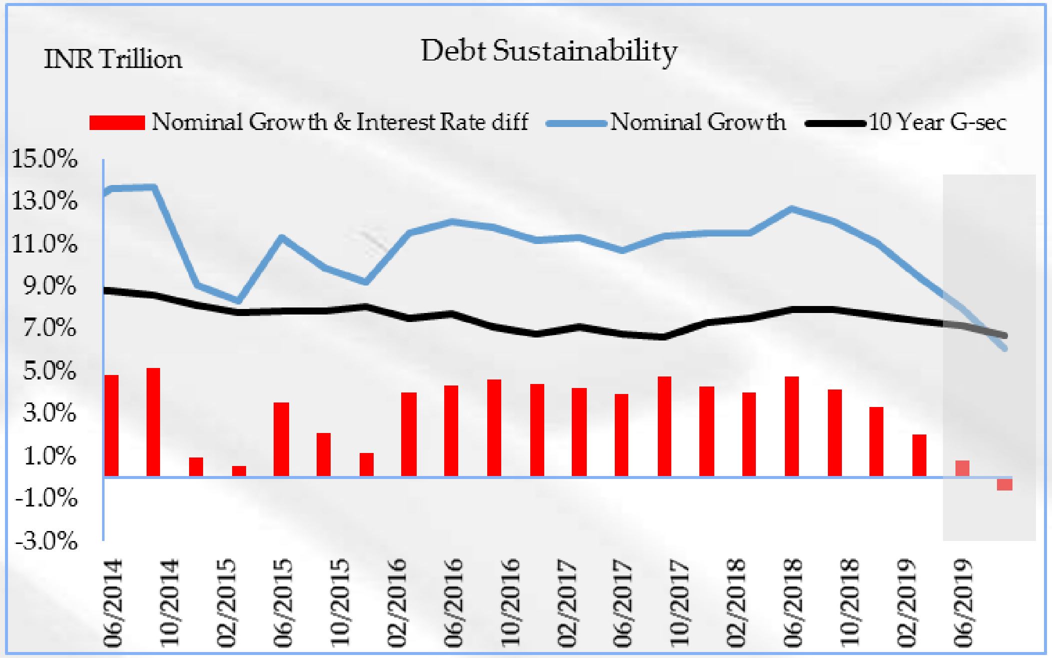
Rising internal pressures could have ripple effects

Burden of Interest payments has been on the rise. Interest payments as a % of net tax revenues expected to jump to 49% in FY20 as revenue growth falls short of BE.



Debt sustainability under stress as nominal growth falls below long term borrowing costs in Q2.



- Thumb-rule: When nominal GDP growth is higher than the long term interest rate, the burden of existing debt shrinks over time and it is easier to achieve debt sustainability. However, a sustained period of higher interest rates compared to nominal growth could lead to pressure on the debt situation even if the primary deficit is equal to zero.

Source: Reuters, Central Bank, Budget Documents, CEIC and HDFC Bank

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