Economist's Views: Union Budget Preview

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Economy Update

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Fiscal prudence over populism

We expect fiscal prudence over excessive populism in Union Budget 2019, with the BJP government's focus on bringing down the cost of capital. Fiscal deficit for FY20 is likely to be pegged at 3.5% of GDP, a tad higher than the 3.4% of GDP targeted in the Interim Budget. This is due to revenue collection falling short of optimistic targets set in FY19. Revenue collection was short of the revised estimates by Rs1665bn in FY19, as GST and income tax collection missed the targets. Expenditure cuts led by revenue expenditure of nearly an equivalent amount helped meet the fiscal deficit target of 3.4% of GDP in FY19. Consequently, while growth in revenue is unlikely to be significantly different from that budgeted in Feb'19, the absolute revenue target will be lower. While we do expect some cut back in revenue expenditure from the target set in Feb'19, the government's commitment under the PM Kisan Samman Nidhi Yojana will limit the ability to curtail revenue expenditure. Moreover, we expect measures to boost rural consumption. At the same time, the government's thrust on infrastructure and capital spending will prevent them from cutting back on capital expenditure. We also expect some tax sops for the middle class in order to boost consumption. This may be in the form of a higher exemption limit or introduction of a 10% tax bracket between the current 5% and 20%. However, given the significant shortfall in revenue collection, the move to reduce corporate tax rate for large corporations may be put on the back burner. We expect divestment of public sector undertakings (PSUs) and non- core assets to receive a significant push. Nevertheless, the divestment target for FY20 is likely to remain unchanged at Rs.900bn. We do not expect excess capital from the Reserve Bank of India (RBI) to figure in the budget calculations. We expect the Jalan Committee to recommend a rules based economic capital framework rather than a one-off transfer. Please read our earlier report. Any excess capital received from the RBI is likely to be oriented towards capital expenditure. With the government's focus on the cost of capital, we do not anticipate any change in the net borrowing target. However, unrealistic revenue assumptions could keep the bond market jittery. Reliance on small savings as a source of funding will continue, although small savings rates are likely to be adjusted downward, to at least partially reflect the decline in bond yields.

Measures to support rural consumption in the offing: We expect measures to boost rural consumption at the margin which may include higher spending on rural development and employment generation schemes. However, we do not expect excessively populist measures, given that the PM Kisan Samman Yojana, which promises Rs6000 per annum to farmers with less than 2 hectares of land, was announced in Feb'19, and has now been extended to all farmers irrespective of land holding. This implies that the allocation under the scheme may be marginally increased from the Rs750bn announced in the Interim Budget.

Consumption boost for the middle class likely: We expect some tax sops for the middle class in order to boost consumption. This may be in the form of a higher exemption limit or introduction of a 10% tax bracket between the current 5% and 20%. Currently, the exemption limit stands at Rs250,000 with a higher exemption limit for senior citizens at Rs300,000. Income between Rs250,000 and Rs500,000 is taxed at 5% while a rebate for those with net taxable income below Rs500,000 introduced in the Interim Budget. Income between Rs500,000 and Rs1mn is currently taxed at 20%. Some sops are also expected for micro small and medium enterprises (MSMEs), particularly in labour intensive sectors.

Corporate tax rate may remain unchanged: In Budget 2015, the government had promised to bring down the corporate tax rate from 30% to 25%. Consequently, the tax rate for enterprises with turnover up to Rs2.5bn was reduced to 25%. However, the tax rate on large enterprises is likely to remain unchanged at 30%, given the pressure on revenues.

Capital spending to be in focus: Infrastructure (national highways and railways) and affordable housing will continue to remain key areas of focus. FY19 ended with a 6.9% YoY increase in revenue expenditure against the revised estimate of 13.9%, while capital expenditure rose by 14.9%YoY against a revised estimate of 20.1% YoY. We expect capital expenditure to rise by a healthy 11% YoY in FY20, higher than the originally budgeted 6.9%YoY. However revenue expenditure is expected to grow at a slightly faster pace of 14.5% YoY, mainly on account of the expenditure under the PM Kisan Samman Nidhi Yojana.

Exhibit 1: 3.5% fiscal deficit likely in FY20

	Item (Rsbn)	FY17	FY18A	FY19BE	FY19RE	FY19A	FY20BE	FY20E (new)
1	**Revenue Receipts (2+3)**	**13,742.0**	**14,351.2**	**17,257.4**	**17,296.8**	**15,631.7**	**19,776.9**	**17,844.5**
	% YoY	*15.0*	*4.4*	*20.3*	*20.5*	*8.9*	*14.3*	*14.2*
2	*Tax Revenue (net to centre)*	*11,013.7*	12,426.0	14,806.5	14,844.1	13,169.5	17,050.5	15,118.0
	% YoY	*16.6*	*12.8*	*19.2*	*19.5*	*6.0*	*14.9*	*14.8*
3	*Non-Tax Revenue including spectrum sale*	2,728.3	1,925.2	2,450.9	2,452.8	2,462.2	2,726.5	2,726.5
	% YoY	*8.8*	*(29.4)*	*27.3*	*27.4*	*27.9*	*11.2*	*10.7*
4	**Non-debt capital receipts (5+6)**	**653.7**	**1,158.2**	**922.0**	**931.6**	**1,028.9**	**1,025.1**	**1,087.3**
	% YoY	*43.4*	*77.2*	*(20.4)*	*(19.6)*	*(11.2)*	*10.0*	*5.7*
5	*Recoveries of Loans*	*176.3*	156.2	122.0	131.6	178.4	125.1	187.3
	% YoY	*(15.4)*	*(11.4)*	*(21.9)*	*(15.8)*	*14.2*	*(4.9)*	*5.0*
6	*Other Receipts includes disinvestment*	*477.4*	1,002.0	800.0	800.0	850.5	900.0	900.0
	% YoY	*93.0*	*109.9*	*(20.2)*	*(20.2)*	*(15.1)*	*12.5*	*5.8*
7	**Total Receipts (1+4)**	**14,395.8**	**15,509.4**	**18,179.4**	**18,228.4**	**16,660.6**	**20,802.0**	**18,931.8**
	% YoY	*16.0*	*7.7*	*17.2*	*17.5*	*7.4*	*14.1*	*13.6*
8	**Total Expenditure (9+10)**	**19,751.9**	**21,426.7**	**24,422.1**	**24,572.4**	**23,114.2**	**27,842.0**	**26,356.4**
	% YoY	*11.4*	*8.5*	*14.0*	*14.7*	*7.9*	*13.3*	*14.0*
9	*Revenue Expenditure*	*16,905.8*	18,789.6	21,417.7	21,406.1	20,084.6	24,479.1	22,993.5
	% YoY	*9.9*	*11.1*	*14.0*	*13.9*	*6.9*	*14.4*	*14.5*
10	*Capital Expenditure*	*2,846.1*	2,637.0	3,004.4	3,166.2	3,029.6	3,362.9	3,362.8
	% YoY	*21.0*	*(7.3)*	*13.9*	*20.1*	*14.9*	*6.2*	*11.0*
11	**Fiscal Deficit {7-8}**	**(5,356.2)**	**(5,917.3)**	**(6,242.8)**	**(6,344.0)**	**(6,453.7)**	**(7,040.0)**	**(7,424.5)**
	% of GDP	*(3.9)*	*(3.5)*	*(3.3)*	*(3.4)*	*(3.4)*	*(3.4)*	*(3.5)*
12	**Net borrowings including buyback**	3,496.6	4,484.1	3,901.2	4,227.4	-	4,240.0	4,240.0
	% of GDP	*2.5*	*2.6*	*2.1*	*2.2*	-	*2.0*	*2.0*

Source: Government of India, Nirmal Bang Institutional Equities Research.

3.5% fiscal deficit target for FY20: The fiscal deficit for FY20 is likely to be pegged at 3.5% of GDP, a tad higher than the 3.4% of GDP targeted in the Interim Budget. This is due to revenue collection falling short of optimistic targets set in FY19. Revenue collection was short of the revised estimates by Rs1665bn in FY19, as GST and income tax collection missed the targets. Expenditure cuts led by revenue expenditure of nearly an equivalent amount helped meet the fiscal deficit target of 3.4% of GDP in FY19. We expect the divestment target to be retained at Rs900bn, although divestment of PSUs and non-core assets are likely to receive a renewed push in the second term of the Modi Government.

Exhibit 2: Revenue shortfall in FY19 will demand revisions in FY20 target

Item (Rsbn)	FY17A	FY18A	FY19BE	FY19RE	FY19A	FY20BE	FY20E (new)
Corporation Tax	4,849.2	5,712.0	6,210.0	6,710.0	6,635.7	7,600.0	7,631.1
% YoY	*7.0*	*17.8*	*8.7*	*17.5*	*16.2*	*13.3*	*15*
Income Tax	3,646.0	4,082.1	5,290.0	5,290.0	4,616.5	6,200.0	5,216.7
% YoY	*26.8*	*12.0*	*29.6*	*29.6*	*13.1*	*17.2*	*13*
Direct taxes	**8,502.3**	**9,811.9**	**11,508.7**	**12,000.0**	**11,252.3**	**13,800.0**	**12,847.8**
% YoY	*14.8*	*15.4*	*17.3*	*22.3*	*14.7*	*15*	*14.2*
Customs	2,253.7	1,369.3	1,125.0	1,300.4	1,179.3	1,453.9	1,238.3
% YoY	*7.1*	*(39.2)*	*(17.8)*	*(5.0)*	*(13.9)*	*11.8*	*5.0*
Excise duties	3,817.6	2,586.4	2,596.0	2,596.1	2,310.0	2,596.0	2,310.0
% YoY	*32.5*	*(32.3)*	*0.4*	*0.4*	*(10.7)*	-	-
Service tax	2,545.0	812.3	-	92.8	68.8	-	-
% YoY	*20.4*	*(68.1)*	*(100.0)*	*(88.6)*	*(91.5)*	*(100.0)*	*(100.0)*
Other taxes	44.8	267.4	52.4	53.4	152	59.4	152
% YoY	-	*496.5*	*(80.4)*	*-80*	*(43.2)*	*11.3*	*0*
GST	-	3,720.8	7,439.0	6,439.0	5,839.7	7,612.0	6,890.8
% YoY	-	-	*99.9*	*73.1*	*56.9*	*18.2*	*18*
Indirect taxes	**8,661.1**	**8,756.1**	**11,212.4**	**10,481.8**	**9,549.8**	**11,721.3**	**10,591.0**
% YoY	*22*	*1.1*	*28.1*	*19.7*	*9.1*	*11.8*	*10.9*
Gross Tax revenue	17,158.2	18,568.0	22,721.1	22,481.8	20,802.0	25,521.3	23,438.8
% YoY	*17.9*	*8.2*	*22.4*	*21.1*	*12.0*	*13.5*	*12.7*
Net tax revenue	11,013.7	12,426.6	14,806.5	14,844.1	13,169.5	16,588.9	15,118.0
% YoY	*16.7*	*12.8*	*19.2*	*19.5*	*6.0*	*11.8*	*14.8*

Source: Government of India, Nirmal Bang Institutional Equities Research.

Excess capital from RBI unlikely to figure in budget math: We do not expect the transfer of excess capital from the RBI to figure in the budget calculations. The presentation of the Jalan Committee report is now further delayed from the end-June deadline. We expect the Jalan Committee to recommend a rules based mechanism for transfer of excess capital rather than an ad-hoc one time transfer. As we pointed out in our report in Nov'18, the currency and gold revaluation reserves are akin to family wealth built over generations, which has not been realised. For the sake of prudence, such gains are not to be squandered away in any particular year or by one government. Any excess capital received from the RBI is likely to be oriented towards capital expenditure.

Small savings to remain important, but rates may see a slight decline: Flows into small savings were budgeted at Rs1300bn in the Interim Budget and are likely to be maintained at that level. However, we expect small saving rates for 2QFY20 to be revised downwards at least by ~20bps. Small savings are supposed to be linked to the average 10 year G-sec yield in the preceding quarter. However, while bond yields are down by ~100bps since Oct'18, small savings rates have been maintained at the same level. A reduction in small savings rate is also consistent with the Modi government's focus on reducing the cost of capital and encouraging the transmission of rate cuts by the RBI by enabling lower deposit rates and consequently lending rates. Nevertheless, political compulsions also prevent a drastic cut in small savings rates as the middle class populace is likely to be impacted.

Exhibit 3: Interest rates on small savings were increased in 3QFY19 and remain unchanged

Scheme / Interest rate (%)	1QFY 17	2QFY 17	3QFY 17	4QFY 17	1QFY 18	2QFY 18	3QFY 18	4QFY 18	1QFY 19	2QFY 19	3QFY 19	4QFY 19	1QFY 20	Current Comparable Bank deposit rates (SBI retail)	Current Comparable Bank deposit rates (HDFC retail)	Limit on investment
1 Year time deposit	7.1	7.1	7.0	7.0	6.9	6.8	6.8	6.6	6.6	6.6	6.9	6.9	6.9	7.0	7.3	No limit
2 Year time deposit	7.2	7.2	7.1	7.1	7.0	6.9	6.9	6.7	6.7	6.7	7.0	7.0	7.0	6.75	7.3	No limit
3 Year time deposit	7.4	7.4	7.3	7.3	7.2	7.1	7.1	6.9	6.9	7.4	7.8	7.8	7.8	6.7	7.4	No limit
5 Year time deposit	7.9	7.9	7.8	7.8	7.7	7.6	7.6	7.4	7.4	6.9	7.2	7.2	7.2	6.6	7.25	No limit
5 Year recurring deposit	7.4	7.4	7.3	7.3	7.2	7.1	7.1	6.9	6.9	6.9	7.3	7.3	7.3	6.6	7.25	No limit
5 Year Senior Citizens	8.6	8.6	8.5	8.5	8.4	8.3	8.3	8.3	8.3	8.3	8.7	8.7	8.7	7.1	7.75	Rs. 15 lakh
5 Year Monthly Income Account Scheme	7.8	7.8	7.7	7.7	7.6	7.5	7.5	7.3	7.3	7.3	7.7	7.7	7.7	6.6	7.25	Rs 4.5 lakh single account and RS. 9 lakh joint account
5 Year National Savings Certificate	8.1	8.0	8.0	8.0	7.9	7.8	7.8	7.6	7.6	7.6	8.0	8.0	8.0	6.6	7.25	No limit
PPF	8.1	8.0	8.0	8.0	7.9	7.8	7.8	7.6	7.6	7.6	8.0	8.0	8.0	-	-	Rs 1.5 lakh per year
Kisan Vikas Patra	7.8	7.8	7.7	7.7	7.6	7.5	7.5	7.3	7.3	7.3	7.7	7.7	7.7	-	-	No limit
Sukanya Samriddhi Account Scheme	8.6	8.5	8.5	8.5	8.4	8.3	8.3	8.1	8.1	8.1	8.5	8.5	8.5	-	-	No limit
Average 10 yr G- sec yields in the past quarter	7.6	7.5	7.0	6.5	6.7	6.7	6.6	7.1	7.5	7.8	7.9	7.6	7.3	-	-	Rs 1.5 lakh per year

Source: Government of India, State Bank of India, Nirmal Bang Institutional Equities Research

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