



BUDGET IN CHARTS

INDIA: FISCAL TARGETS ARE QUESTIONABLE

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July 2019

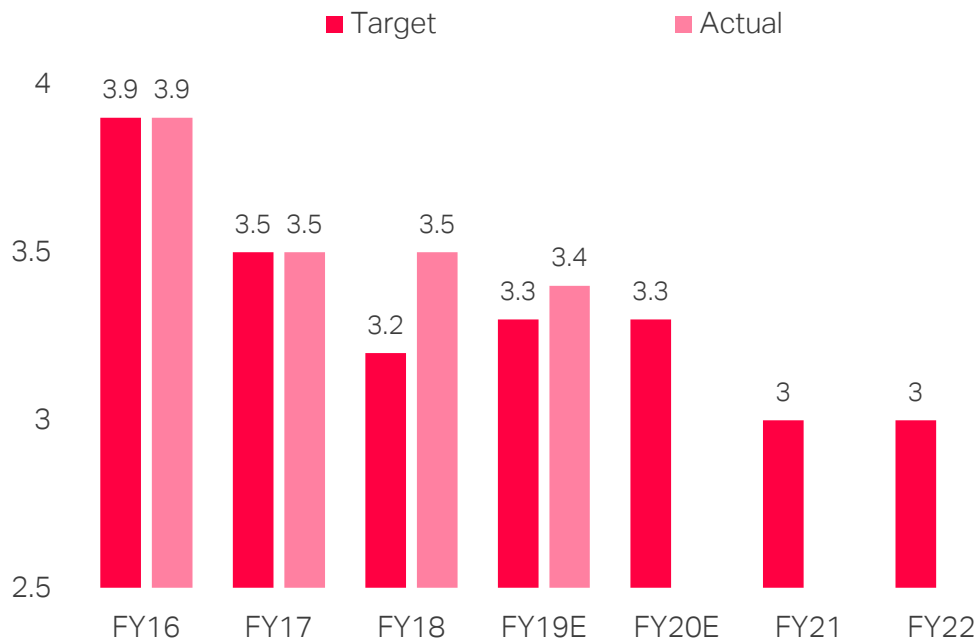
OPTIMISTIC GOALS AND RISING WELFARISM

- Finance Minister Nirmala Sitharaman surprises with a lower-than-expected headline fiscal deficit, but the math behind the ambitious revenue targets is questionable even as welfare spending has been significantly increased.
- Equity investors give the budget a thumbs down partly owing to higher proposed taxes for foreign portfolio investors and the lack of a substantial countercyclical demand stimulus.
- But bond yields have fallen to a two-year low amid a bond rally following the government's proposal to issue India's first sovereign bond overseas, which will reduce pressure in local debt markets.
- A record disinvestment aim will depend heavily on Air India's privatization; the government's track record on state asset sales has so far been patchy.
- The budget's reliance on a larger transfer of the capital reserves of the Reserve Bank of India signals an increasingly pliant central bank; the late June resignation of the often dissenting Deputy Governor Viral Acharya has sparked fresh worries about the RBI's independence.
- Another RBI policy rate cut is likely in August, lowering the repo rate by a cumulative 100 bps; the monsoon's progress in July will be key to watch for inflation trends going ahead.
- Extra budgetary resources and the budgets of states are additional risks to the credibility of the government's efforts towards overall fiscal consolidation.

FISCAL DEFICIT TARGET IS LOWERED ...

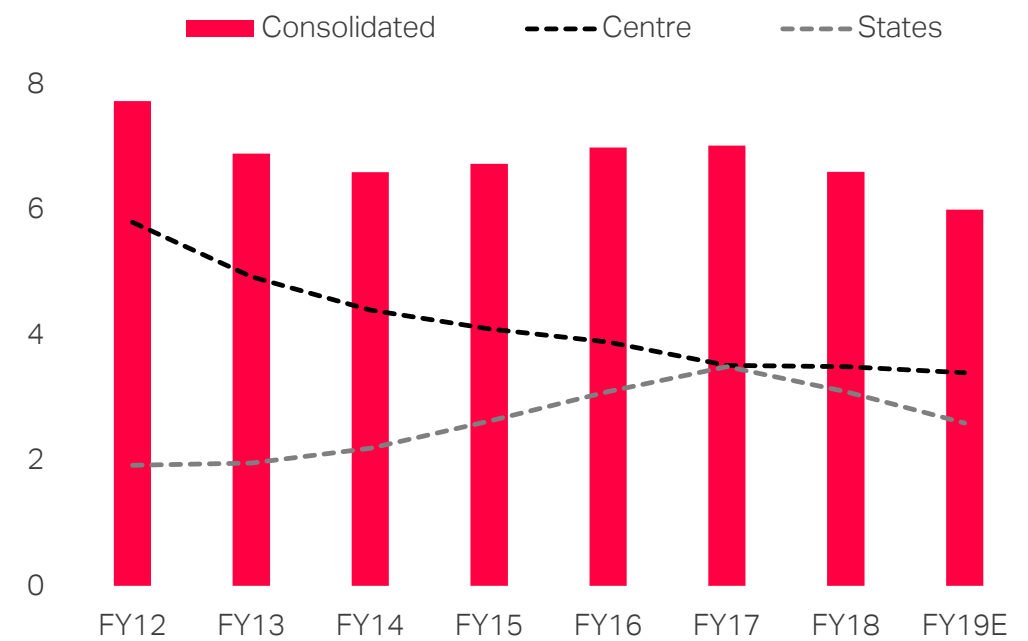
- The lower fiscal deficit target of 3.3% of GDP was a positive surprise and confounded market expectations of a fiscal slippage amid the current domestic economic slowdown.
- But targets have been missed in recent years. The Finance Ministry's Economic Survey, released one day before the budget, listed several fiscal risks for FY20: the impact of slow growth on tax revenues, the shortfall in GST revenues, expanded welfare spending and the expected volatility in oil prices.
- The consolidated fiscal deficit is estimated to narrow in FY19; final data on state deficits are awaited.

Central fiscal deficit (% of GDP)



Sources: Budget documents.

Consolidated fiscal deficit (% of GDP)

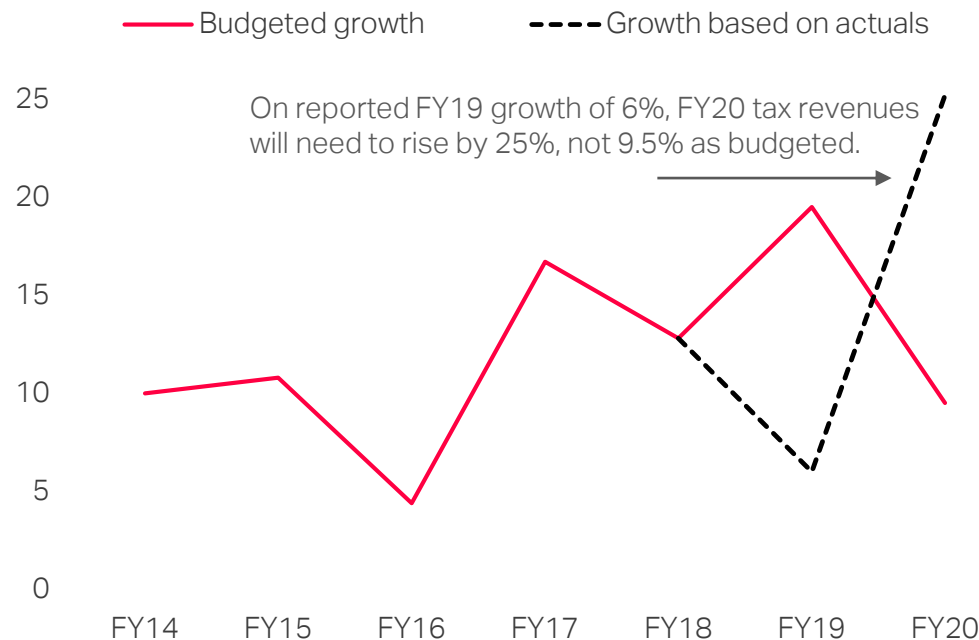


Sources: Budget documents, Finance Ministry's Economic Survey.

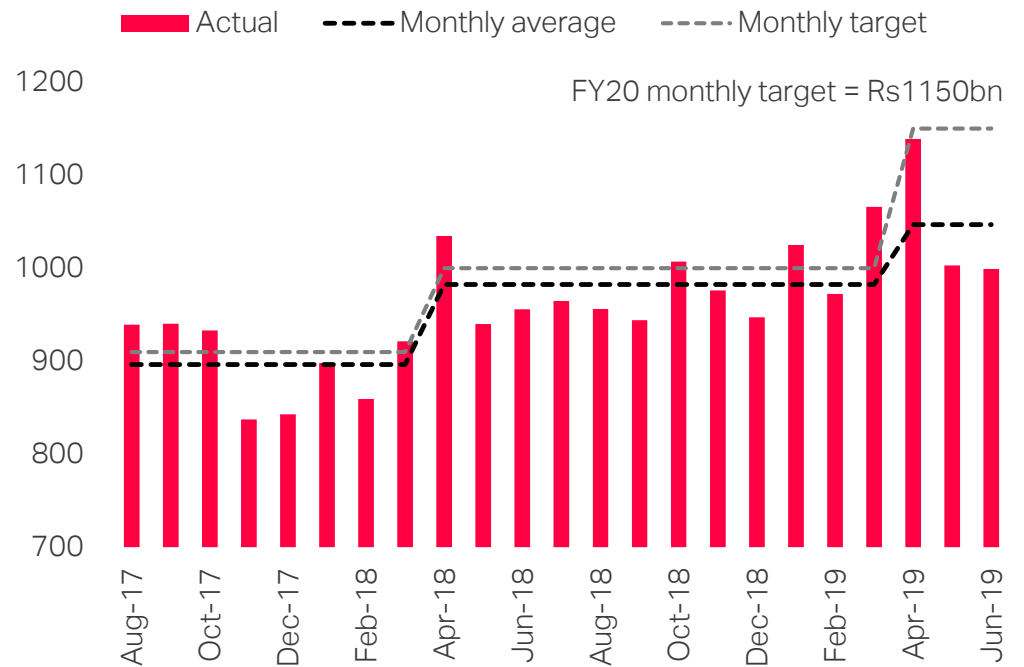
... BUT DOES THE BUDGET MATH ADD UP?

- The FY20 revenue growth targets appear optimistic if the actual reported data for FY19, and not the FY19 budget estimates, are taken into account: the Controller General of Accounts reported a 6% growth in tax revenues vs the FY19 budget estimates of 19.5%.
- GST tax revenues continue to fall short of the monthly targets, and the FY19 GST shortfall was a huge Rs1 trillion. Finance Minister Sitharaman has projected a modest 3% rise in GST revenues for FY20.

Growth in net tax revenue of the centre (%)



GST revenues vs target (Rs bn)



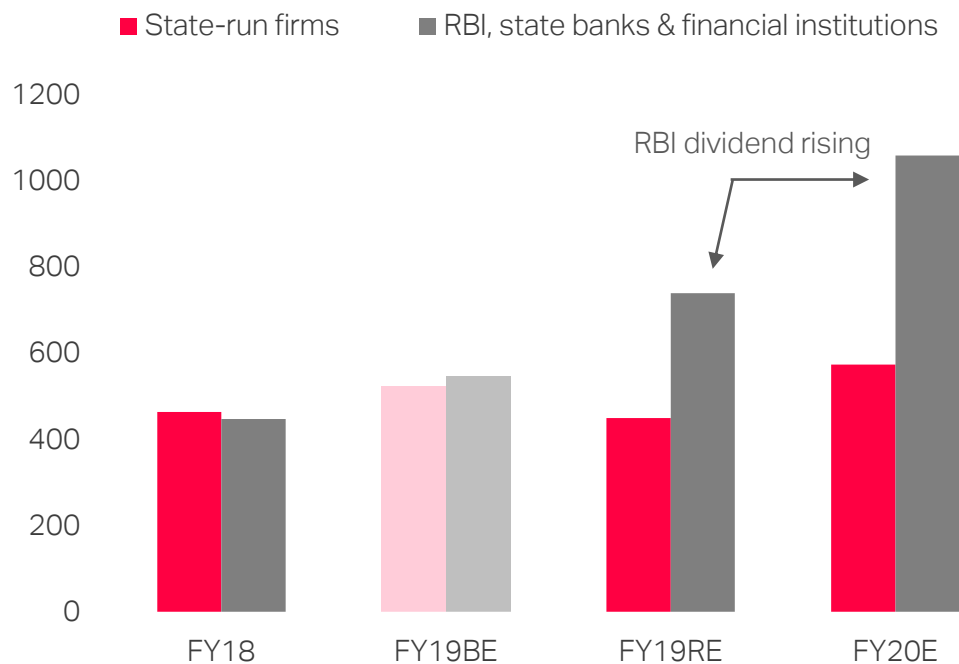
Sources: Controller General of Accounts, Economic Survey, budget documents.

Sources: Ministry of Finance, media reports.

RBI DIVIDEND, OFF-BUDGET FINANCING UP

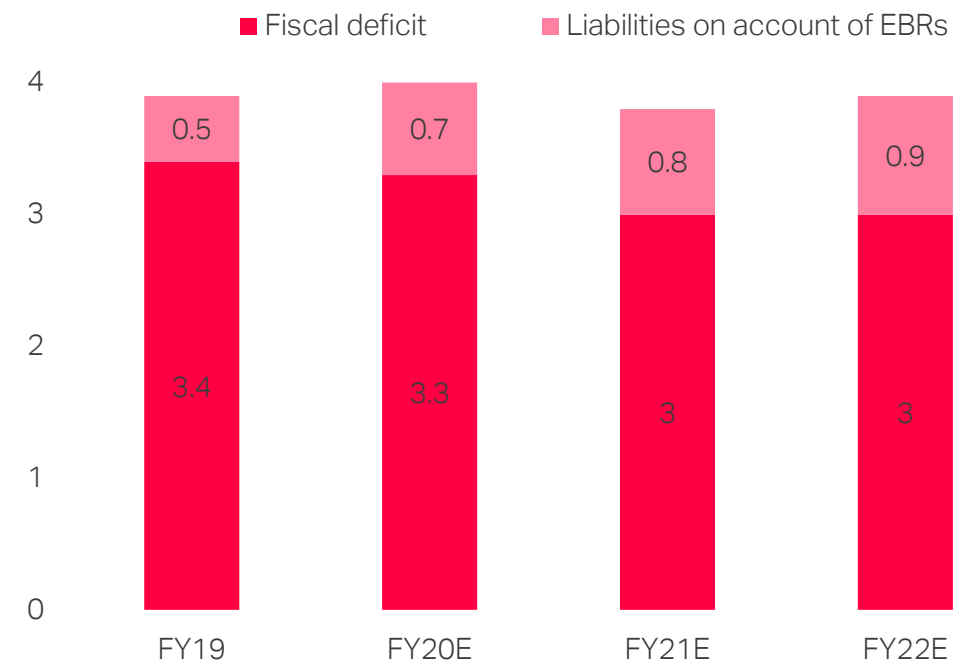
- The government expects the RBI to pay Rs900bn in dividends in FY20; the budgeted FY20 dividends from the RBI and other financial institutions are up 43% yoy.
- It plans to cut the accretion to its stock of Extra Budgetary Resources (liabilities raised by state firms and repaid from the budget) to zero by 2024; but it has raised the budgeted amount for EBRs.
- According to some estimates, the actual FY19 fiscal deficit could be more than 100 bps higher than stated if loans from the National Small Savings Fund and bonds issued by state-run firms are included.

Dividends from RBI, state-run firms (Rs bn)



Source: Budget documents

Fiscal deficit vs EBRs (% of GDP)

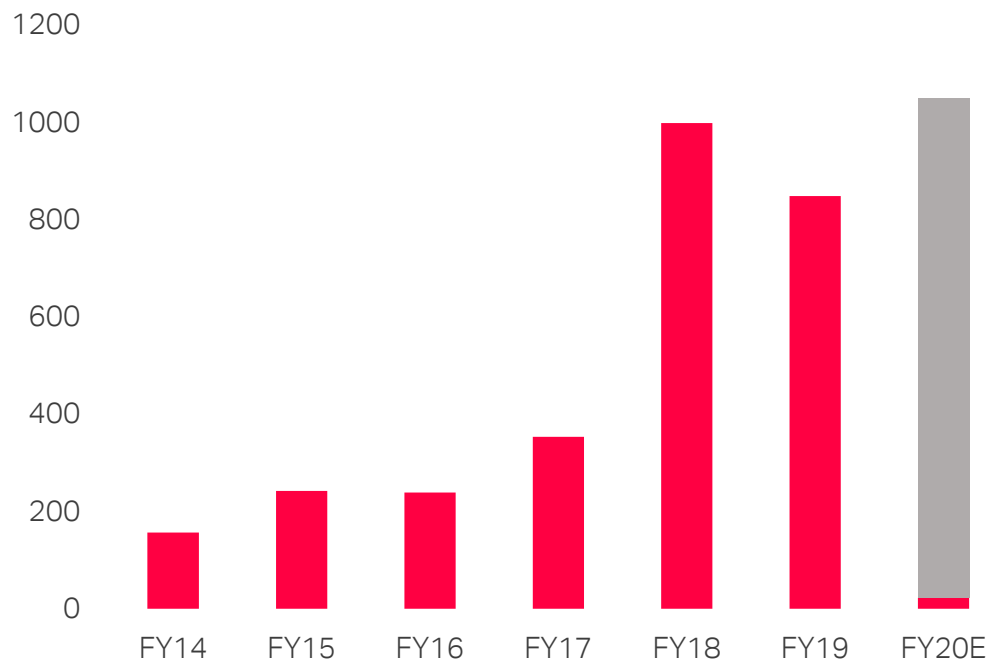


Source: Budget documents.

A RECORD DISINVESTMENT TARGET

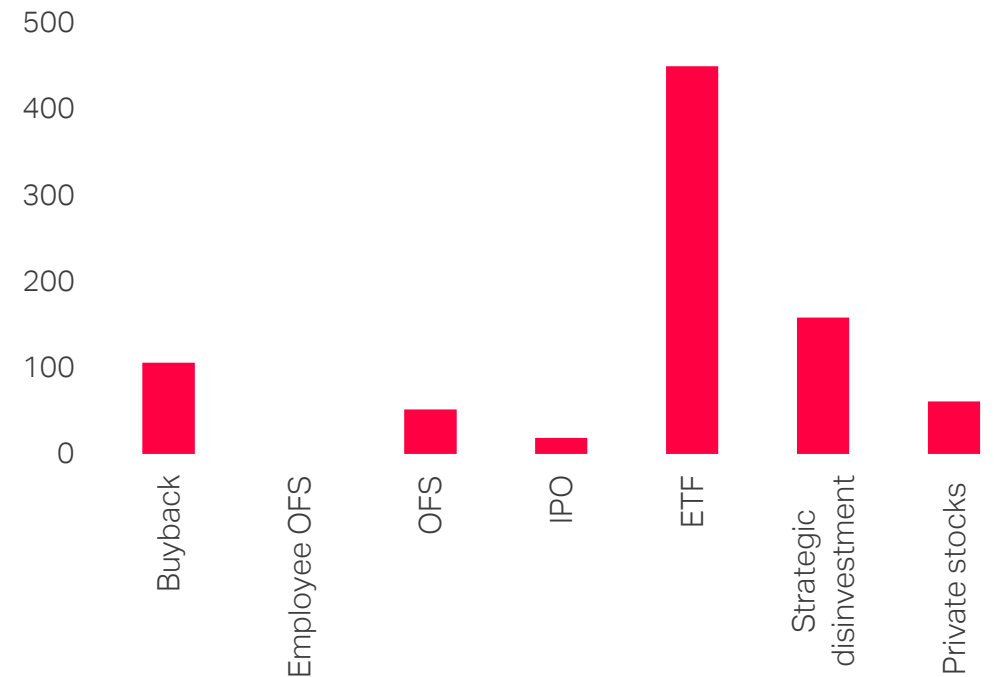
- Of the budget's record disinvestment target of Rs1050bn, just Rs23.6 bn of state-run assets have been sold so far in FY20. The government has only 8 months to achieve its ambitious full-year target.
- The government plans to try once again to sell Air India, and Sitharaman has promised more state-run firms will be offered to private bidders; there are also government plans to sell land and property (non-core assets) of state-owned firms.
- During its first term, the Modi government relied more on selling minority stakes to the public.

Disinvestment revenues (Rs bn)



Sources: Budget, Department of Investment & Public Asset Management.

Breakup of disinvestment revenues (Rs bn)

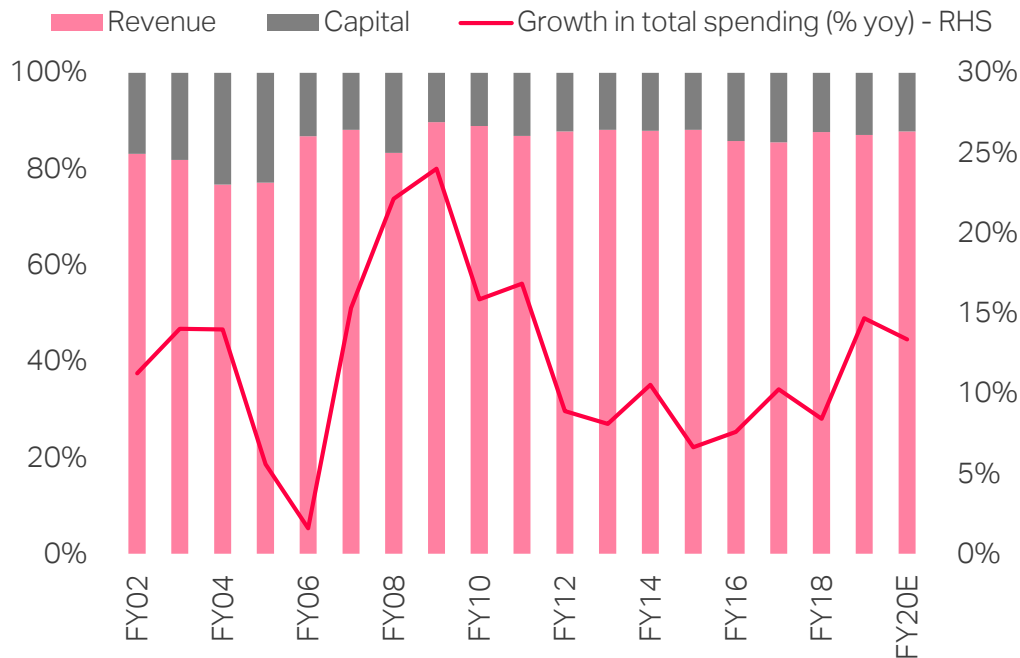


Source: Department of Investment & Public Asset Management.

CAPEX TAKES A HIT AS WELFARISM GROWS

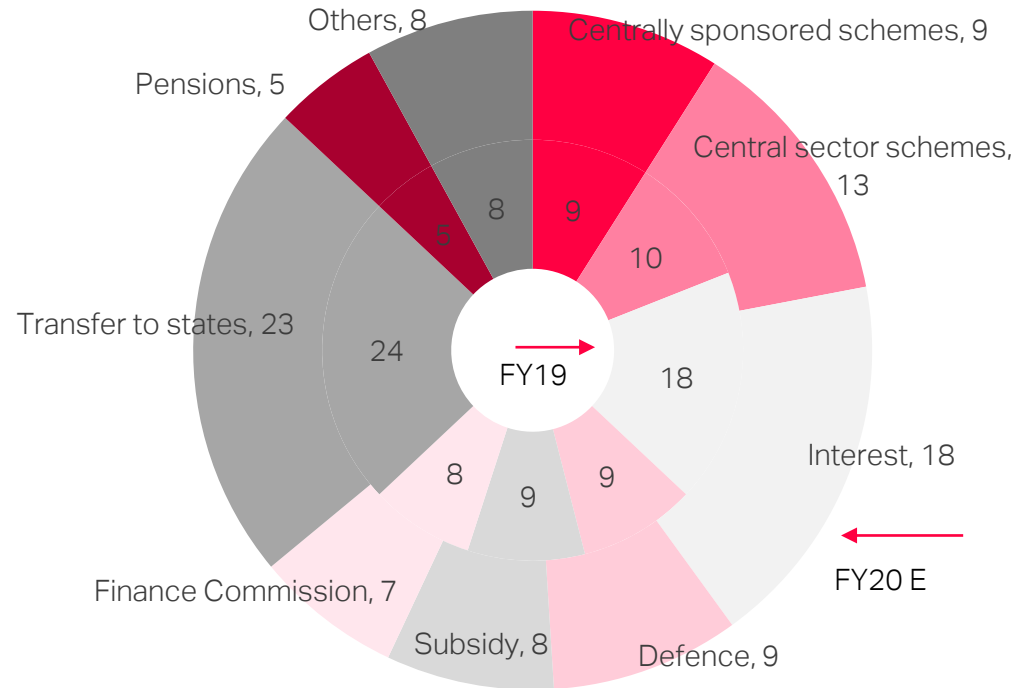
- The growth of total spending is still relatively high compared with trends in recent years.
- The distribution between revenue expenditure and (more productive) capital expenditure remains the same; the budgeted 14.3% yoy increase in revenue spending is, in fact, twice the projected growth in capex.
- The government has sharply increased welfare spending (see “Central sector schemes” under major spending heads in right-hand chart immediately below).

Revenue vs capital spending (% of total)



Sources: Budget documents, TS Lombard.

Major spending heads, FY19 vs FY20 (%)

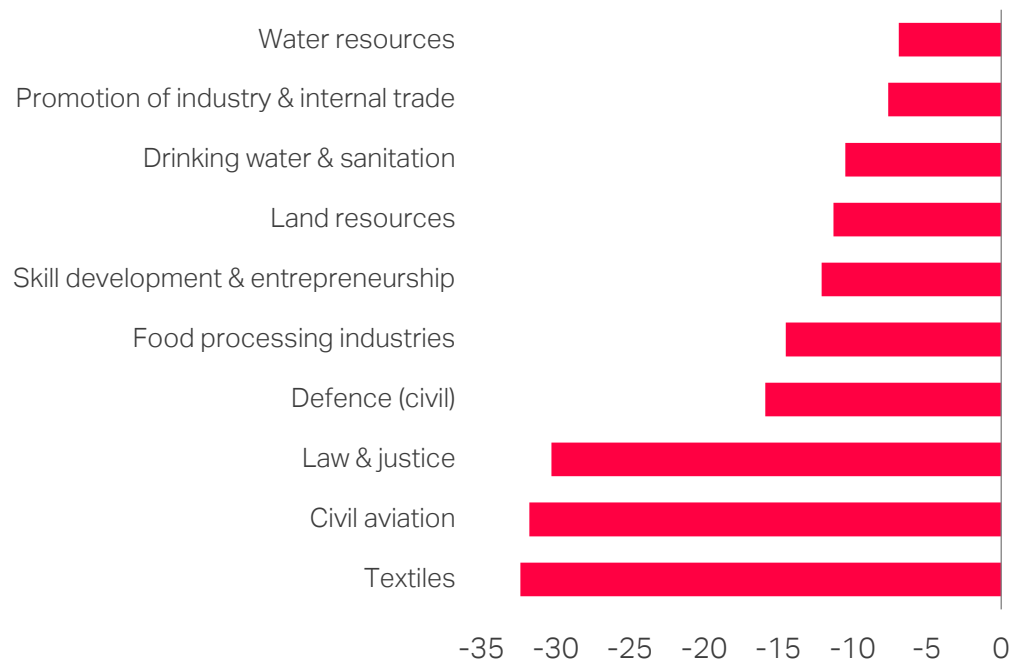


Source: Budget documents.

INCREASING FOCUS ON FARMER WELFARE

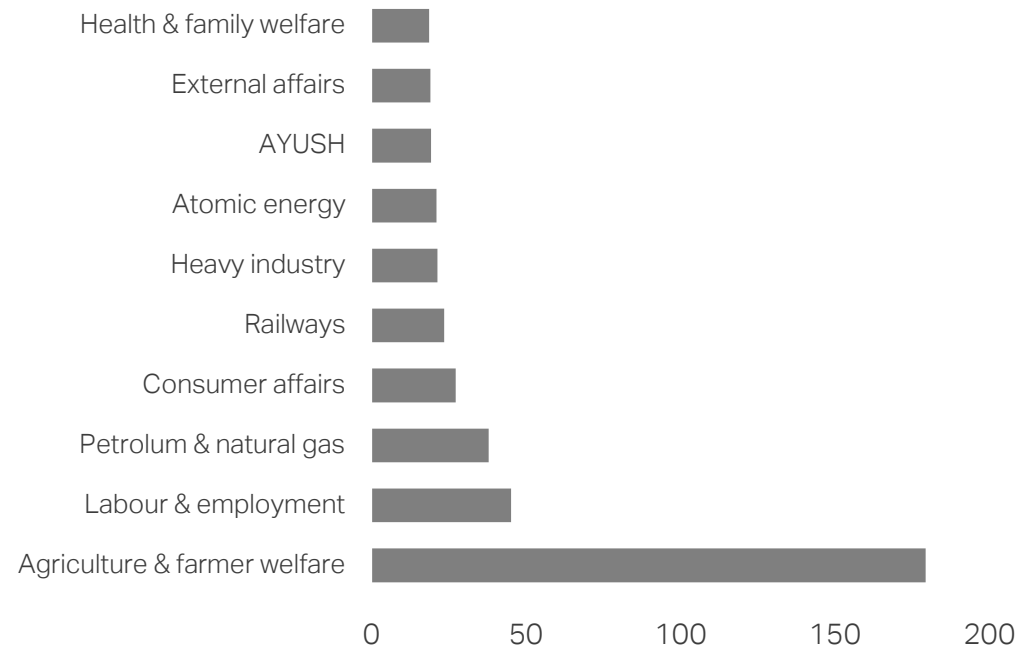
- The allocations for 80 ministries and departments (with budgets of more than Rs10bn) increased in the FY20 budget compared with that for FY19; 17 ministries saw a drop in funds allocated.
- The allocation for agriculture and farmer welfare rose a staggering 180%, mainly owing to the annual farm income support of Rs6,000, which the Modi government had promised in February 2019.
- The other largest increases in allocations included those for labour, health and family welfare as well as AYUSH (health and Indian medicine).

Ministries with biggest drop in allocation (%)



Sources: Budget documents, TS Lombard.

Ministries with biggest rise in allocation (%)

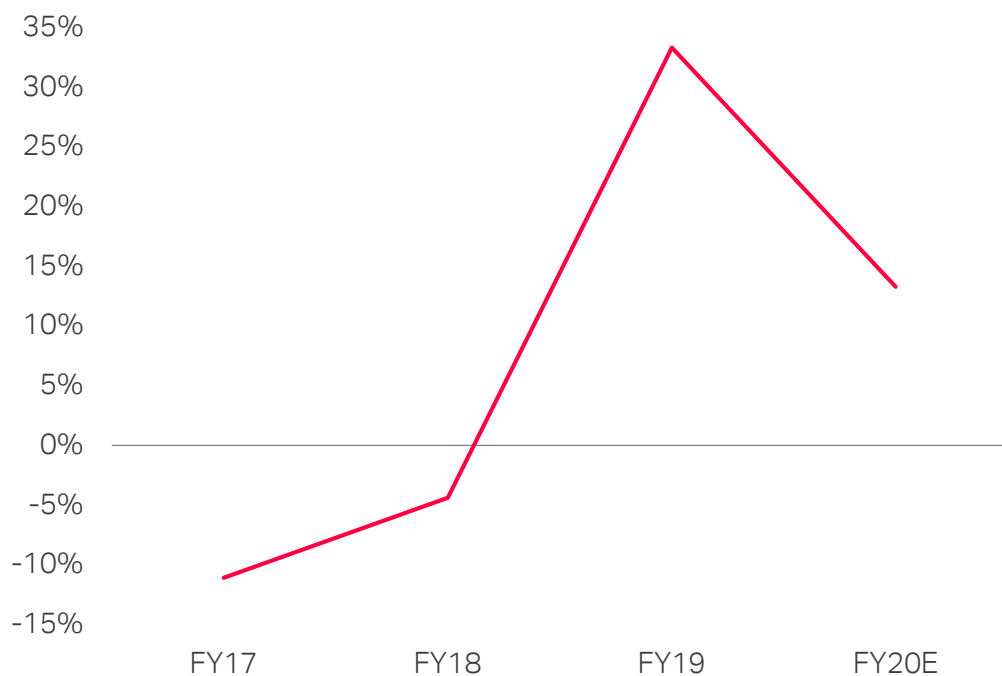


Sources: Budget documents, TS Lombard.

SUBSIDY BILL CONTINUES TO INCREASE

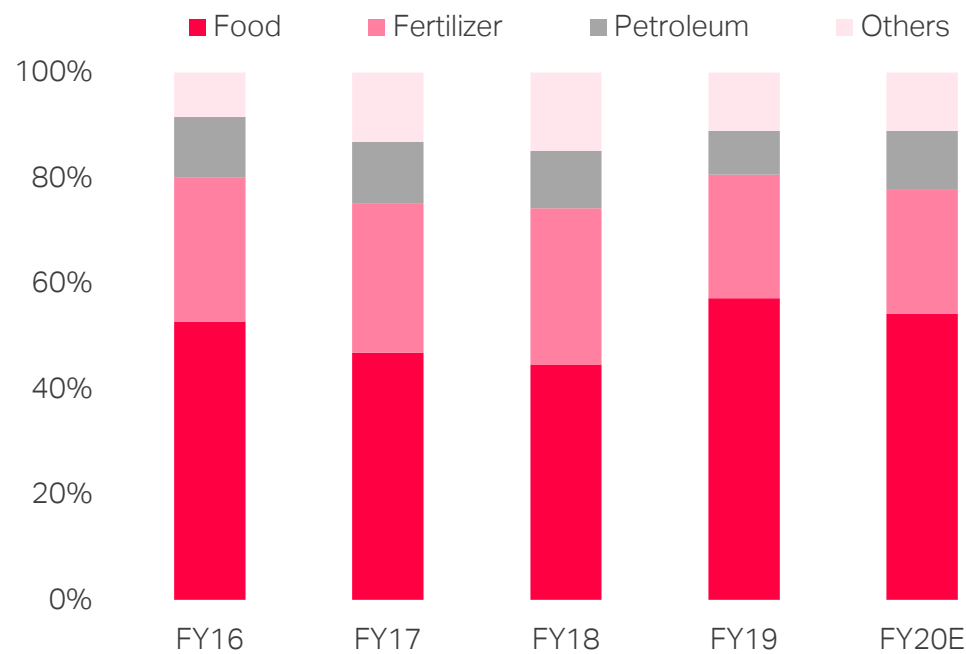
- Subsidies have increased by 13% yoy, although the magnitude of the rise is smaller than in FY19.
- The increase is mainly due to larger petroleum subsidies, even though the amount has been underestimated owing to a rollover of dues owed to state-run oil firms for selling LPG and kerosene below market prices.
- A drop in oil prices and/or rupee appreciation will help contain fuel subsidies, which are rising as the government increases LPG penetration to poor income households.

Growth in the subsidy bill (% yoy)



Sources: Budget documents, TS Lombard.

Distribution of the subsidy bill (%)

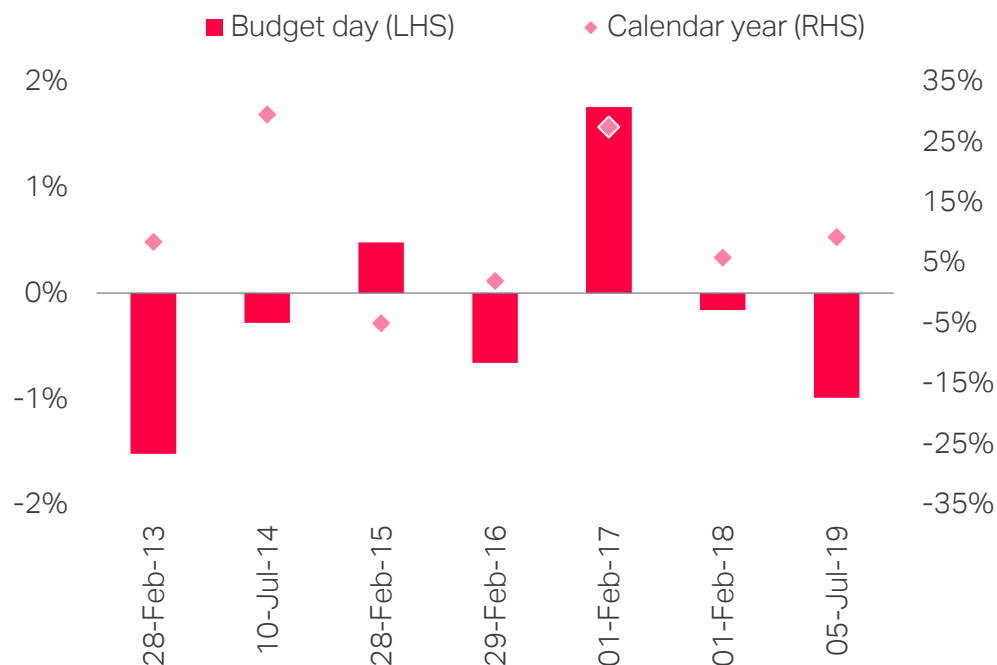


Sources: Budget documents, TS Lombard.

EQUITIES PLUMMET BUT BONDS RALLY

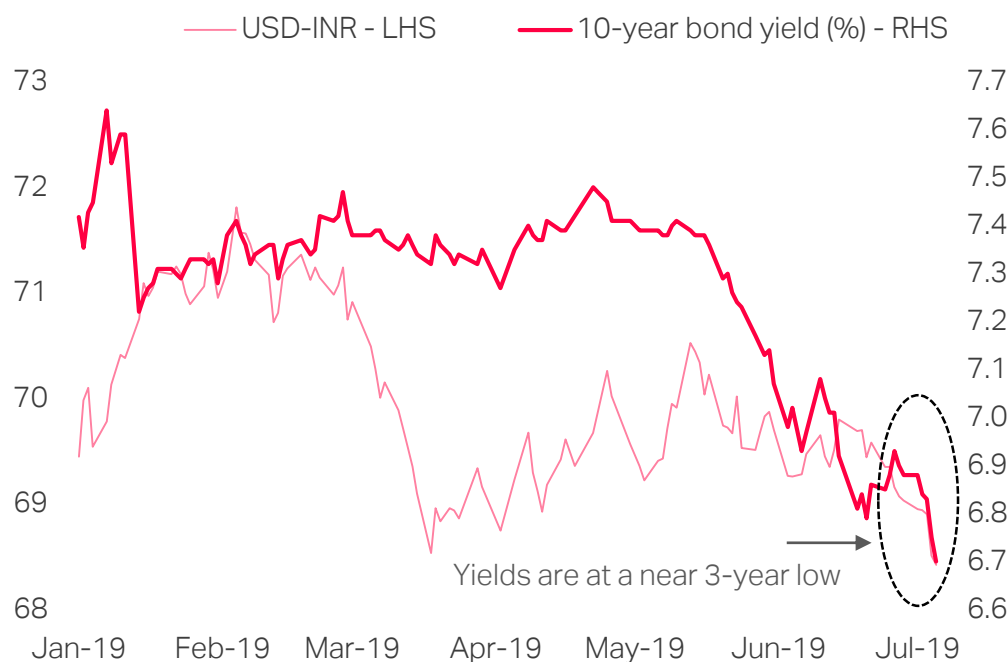
- This year the benchmark Sensex index recorded its biggest budget-day fall since 2013; a negative stock market reaction on budget day often coincides with limited returns during the calendar year.
- However, bonds rallied after the government had announced its intentions to tap the overseas markets for borrowings, thereby easing pressure on the local debt markets.
- Overseas bond issuance is likely to be 10-15% of total borrowing, or roughly US\$10bn.

Sensex change (%)*



Source: Bombay Stock Exchange. *Note: For 2019, the change is YTD.

Rupee vs benchmark government bond

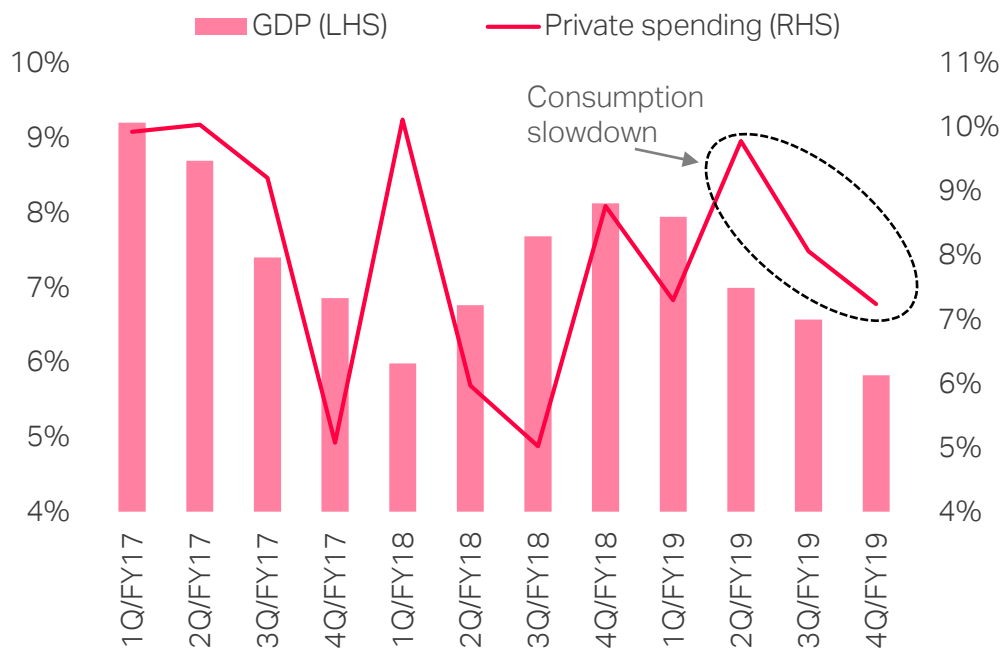


Source: Bloomberg.

FEW TRIGGERS FOR A DEMAND REVIVAL

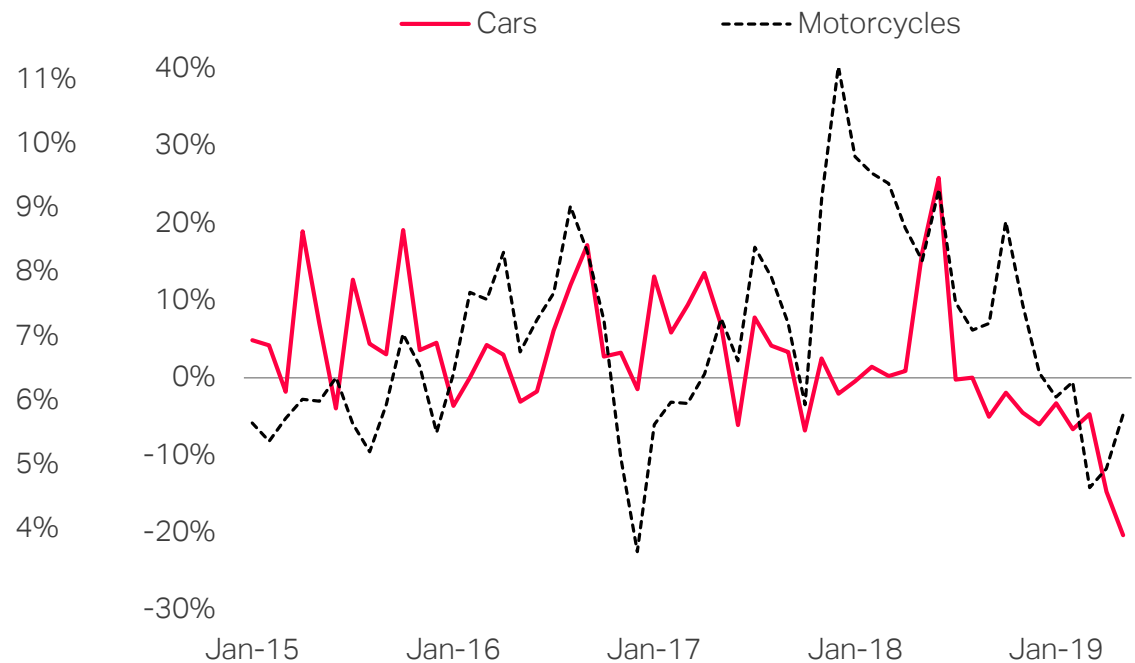
- Spending on rural schemes and disposable incomes will help the poor, but owing to the limited growth stimulus from the budget, the overall consumer demand recovery is likely to be gradual.
- Auto sales – a key indicator of demand in both rural and urban areas – continue to decline, partly owing to troubles in the shadow banking sector, which is a key lender to consumers.
- In June, Maruti Suzuki, India's largest car maker, cut vehicle output for the fifth consecutive month.

GDP vs consumption growth (% yoy)



Sources: CSO, TS Lombard.

Cars vs two-wheeler sales (% yoy)

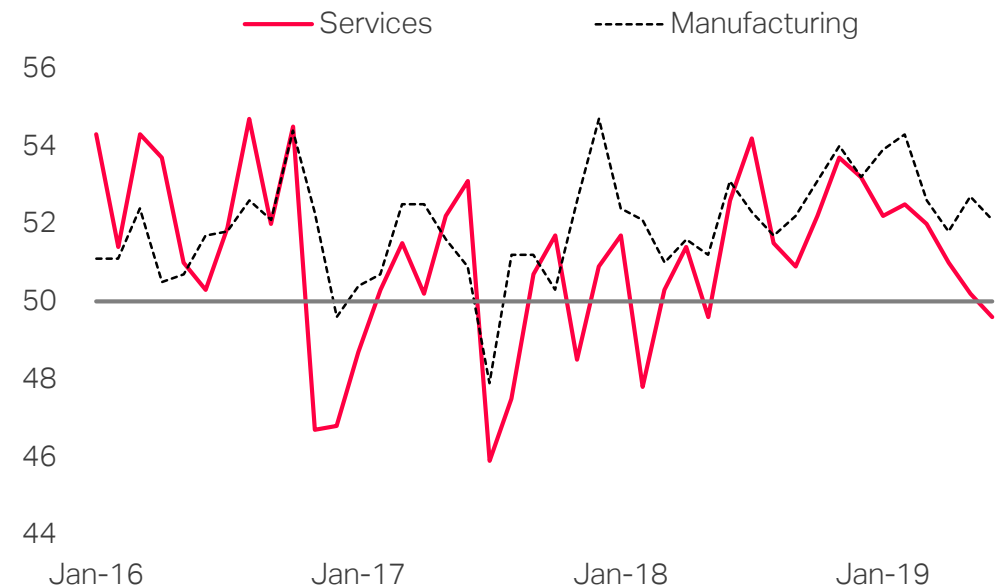
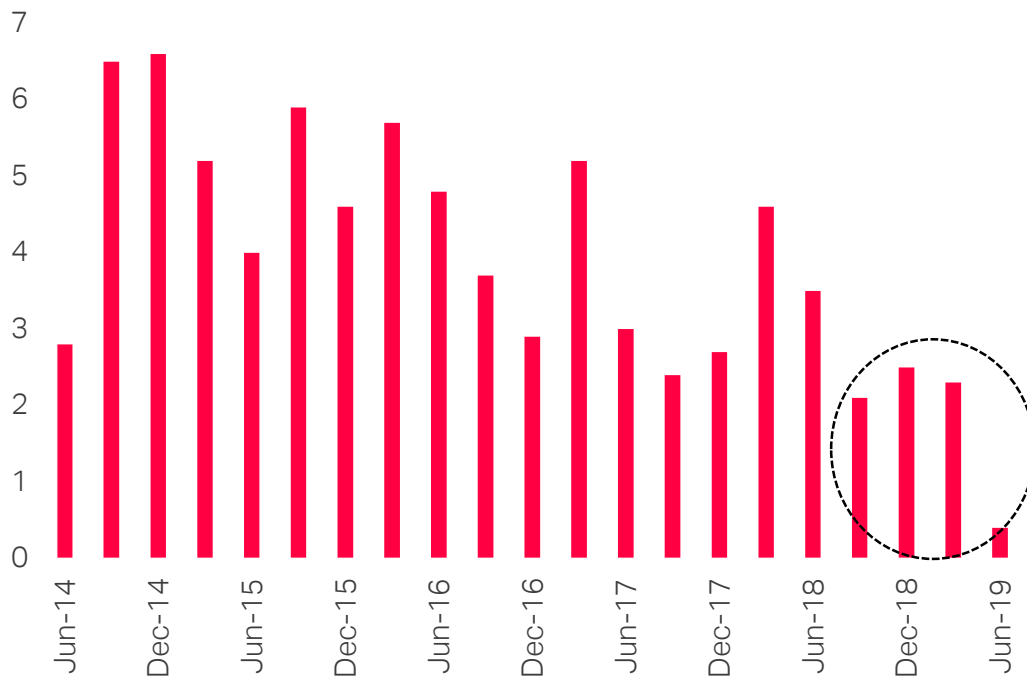


Source: Datastream.

INVESTMENT CONTINUES TO DECLINE

- The government is targeting a lofty Rs20 trillion annual spend on infrastructure but this depends heavily on private sector participation.
- New investment proposals have been slowing for the past four years, and reached new lows in 1Q/FY20. Investment proposals by the public sector were 20% of the past 4 quarters average, while those by the private sector were 15% of the average.
- The slowdown continues: high frequency PMI data for June showed a contraction in services output.

New investment announcements (Rs trillion) Services and manufacturing PMI*



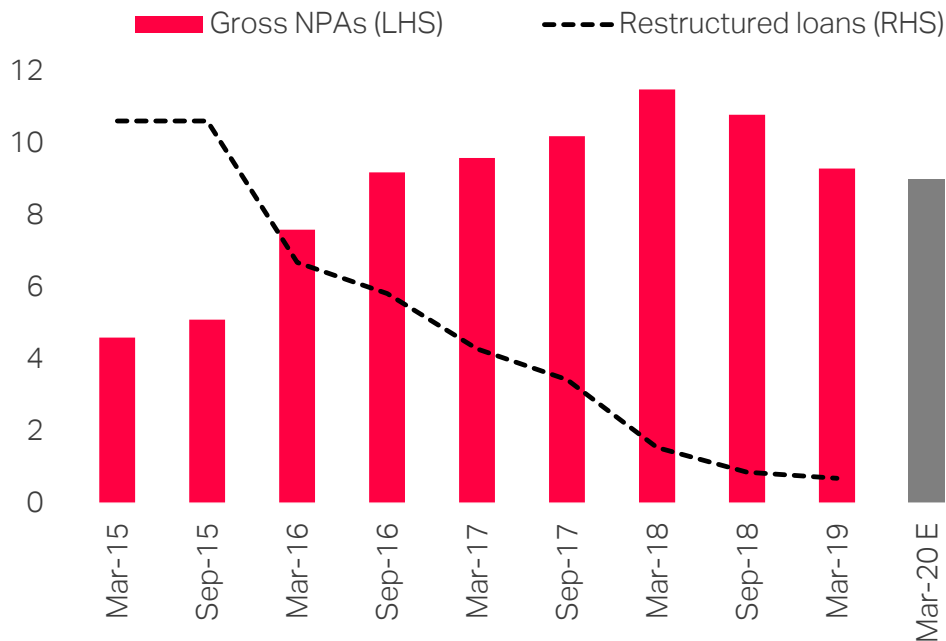
Source: Centre for Monitoring Indian Economy (CMIE).

Source: IHS Markit, Bloomberg. *Note: The 50-level demarcates expansion from contraction.

BANKS' NPAS IMPROVE BUT RISKS REMAIN

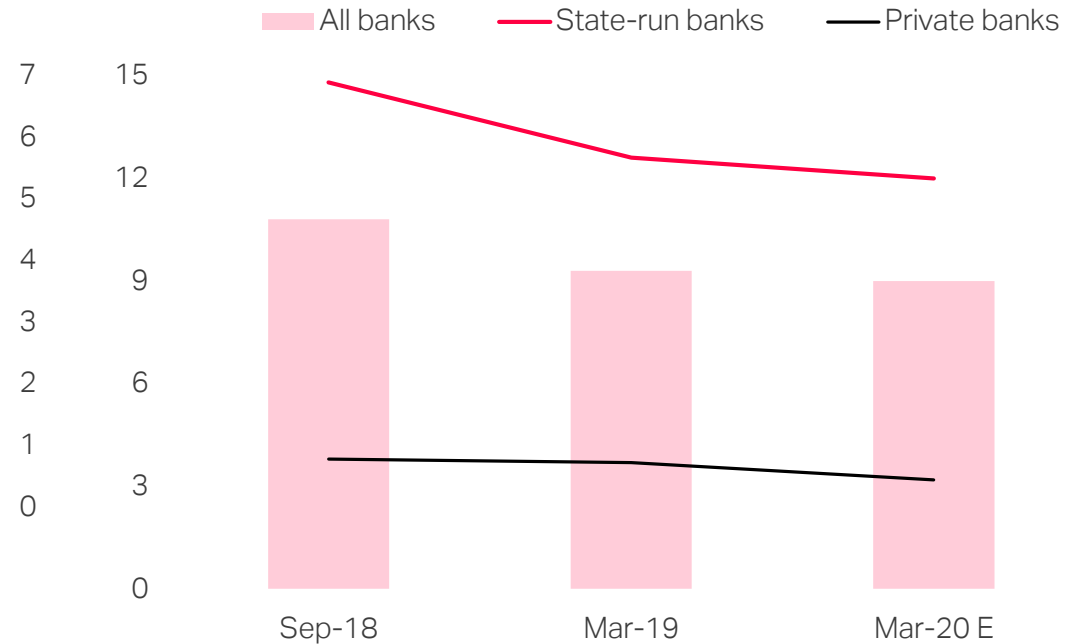
- The RBI expects bad loan ratios of banks to continue reducing gradually but the weekend declaration of another large fraud at state-run lender Punjab National Bank indicates that a lot of rot remains in the system. The Rs38 bn fraud follows a Rs130 bn fraud at the same bank in 2018.
- Recapitalization of state-run banks by the government is the main factor behind the “noticeable improvement” – as per the RBI’s assessment – in the health of the public-sector banks. Five state-run banks are still under the RBI’s Prompt Corrective Action framework, which limits their operations, but recapitalization has helped another six state banks leave that framework.

Gross NPA ratio vs restructured loans (%)



Sources: RBI Financial Stability Reports.

Gross NPA ratios by bank type (%)

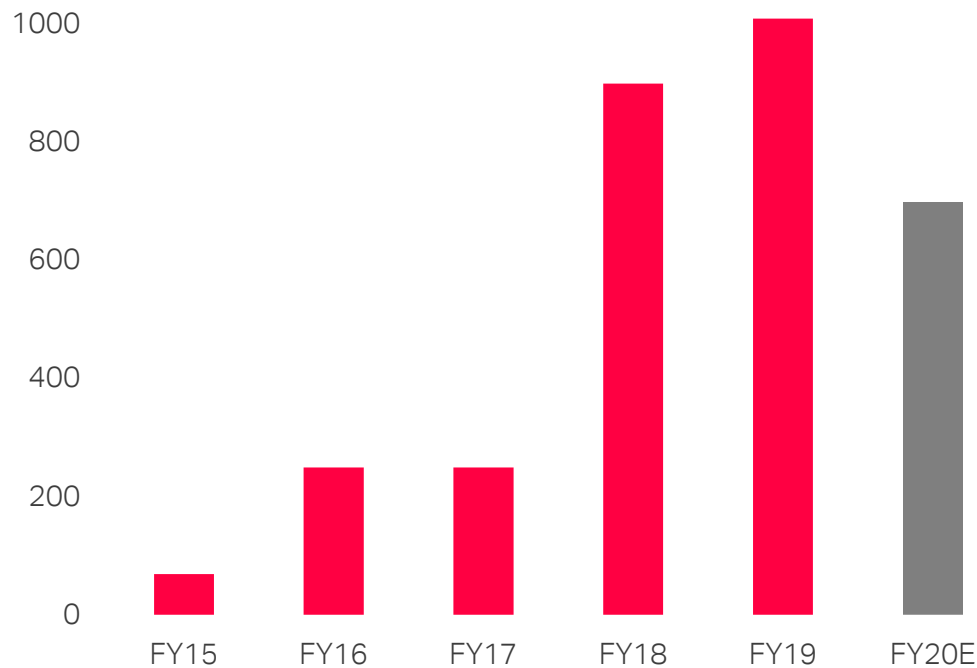


Sources: RBI Financial Stability Reports.

BANK RECAP AIMED AT REVIVING CREDIT

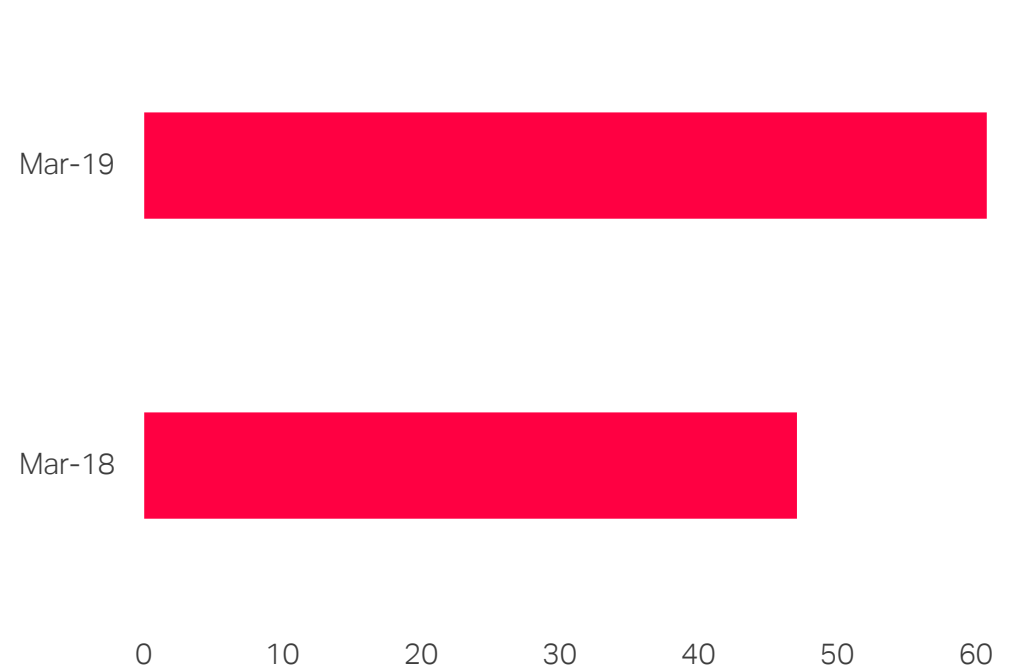
- **Sitharaman has announced a higher-than-expected Rs700bn bank recapitalization plan for FY20; it is the third such massive funding injection into the stressed state-run banks over the past three years.**
- **The hope is that pumping more money into these banks will help revive bank credit growth – state-run banks still own around two-thirds of India’s total bank assets.**
- **Most of the money has so far gone into provisioning.**

Bank recapitalization (Rs bn)



Sources: Budget documents, Bloomberg.

Provision coverage ratio of state banks (%)

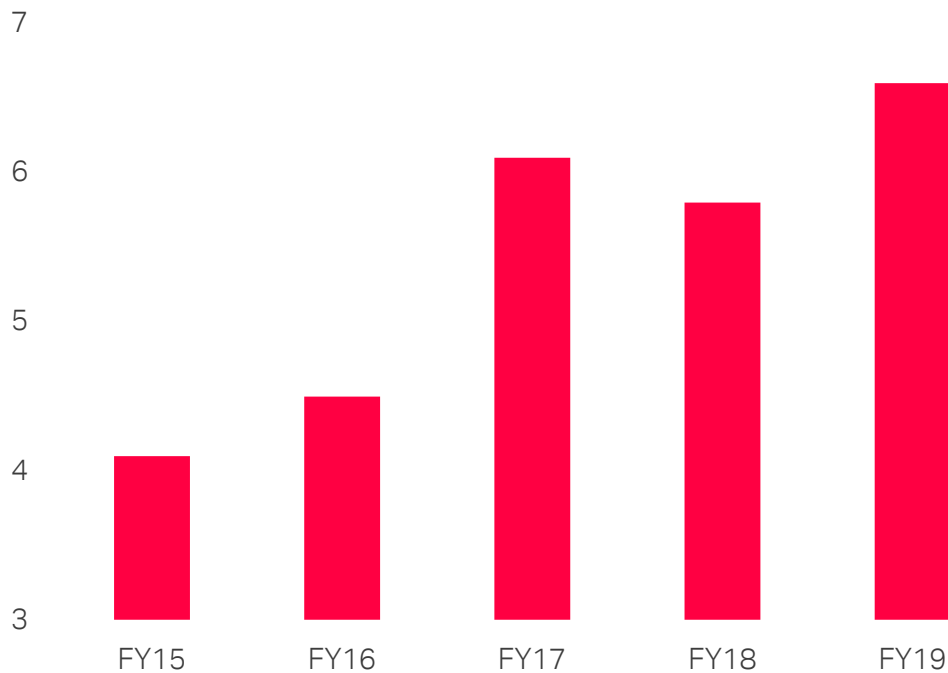


Sources: RBI Financial Stability Reports.

CONTAGION RISK FROM NBFCS IS A WORRY

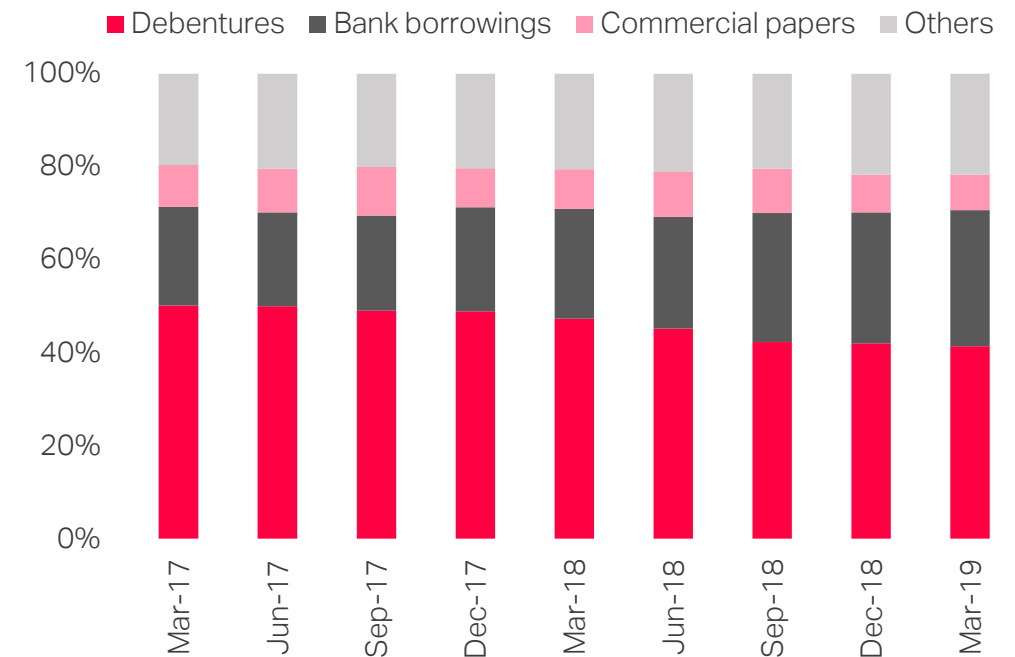
- The default by the large shadow bank IL&FS last September has led to liquidity stress among non-bank lenders amid the increase in funding costs and the difficulty in market access.
- Bad debt at NBFCS has been rising, while at the same time the share of bank borrowing as a proportion of the total borrowings of shadow banks has risen.
- The RBI has called for greater surveillance of the shadow banking sector, warning that a failure in the largest of such institutions could trigger a crisis similar to the collapse of a large bank.

Gross NPAs of NBFCS (%)



Source: RBI June 2019 Financial Stability Report.

Share of funding sources of NBFCS

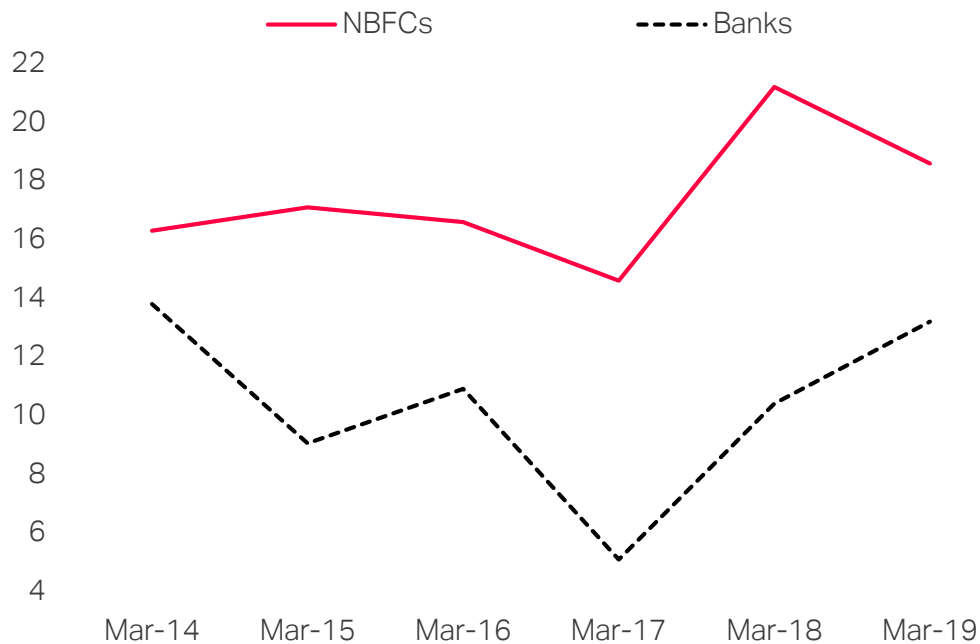


Sources: RBI Financial Stability Reports.

NON-BANKS SPARK CONSUMPTION SHOCK

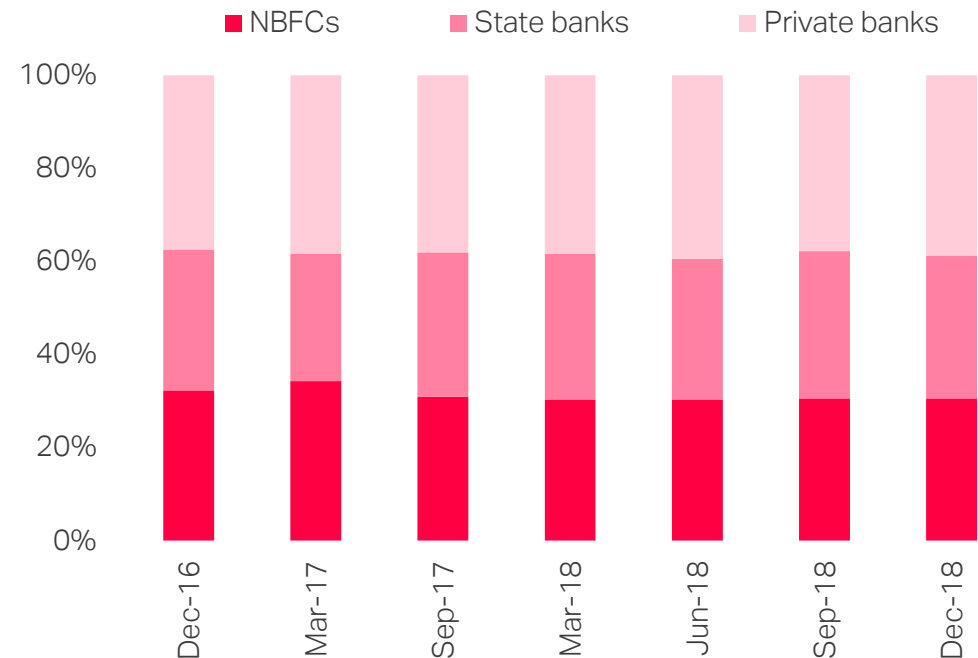
- **Sitharaman has offered an incentive to state banks to buy assets from NBFCs – a measure aimed at providing more liquidity to the shadow banks and thereby avert any potential crisis.**
- **NBFCs play a key role in funding consumer demand and capex by small and medium-sized firms; housing finance companies (HFCs) account for more than 40% of home loans.**
- **Bank credit growth has picked up but growth is not broad-based: credit demand is mainly from the retail, power and road sectors as well as from state-run firms.**

NBFCs vs bank credit growth (% yoy)



Sources: RBI Financial Stability Reports.

Relative share in auto loans (%)

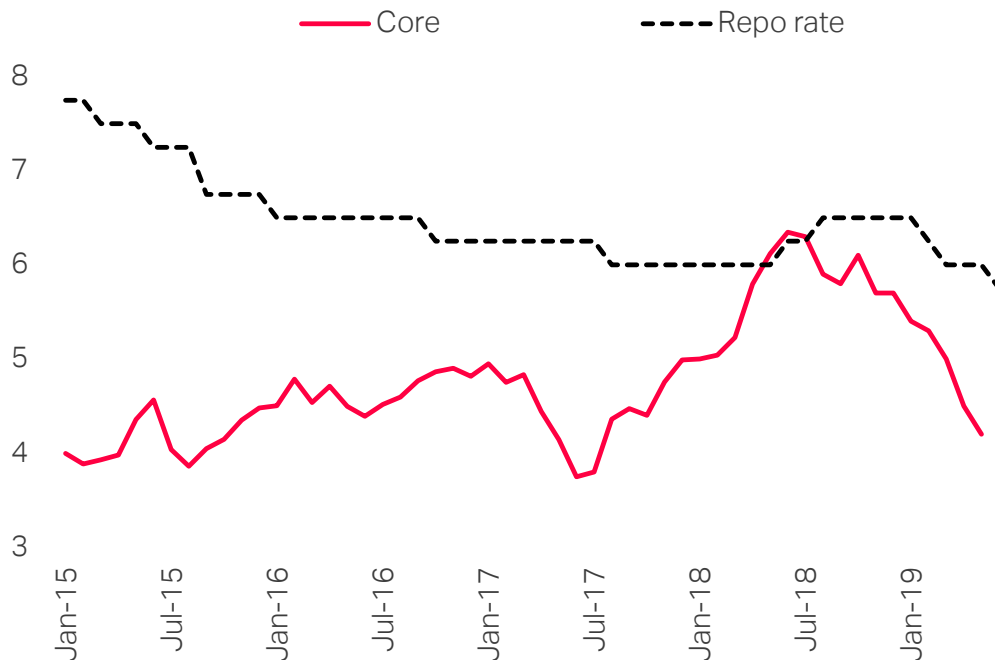


Source: TransUnion CIBIL in RBI Financial Stability Report, June 2019.

RBI POLICIES ARE LIKELY TO SOFTEN

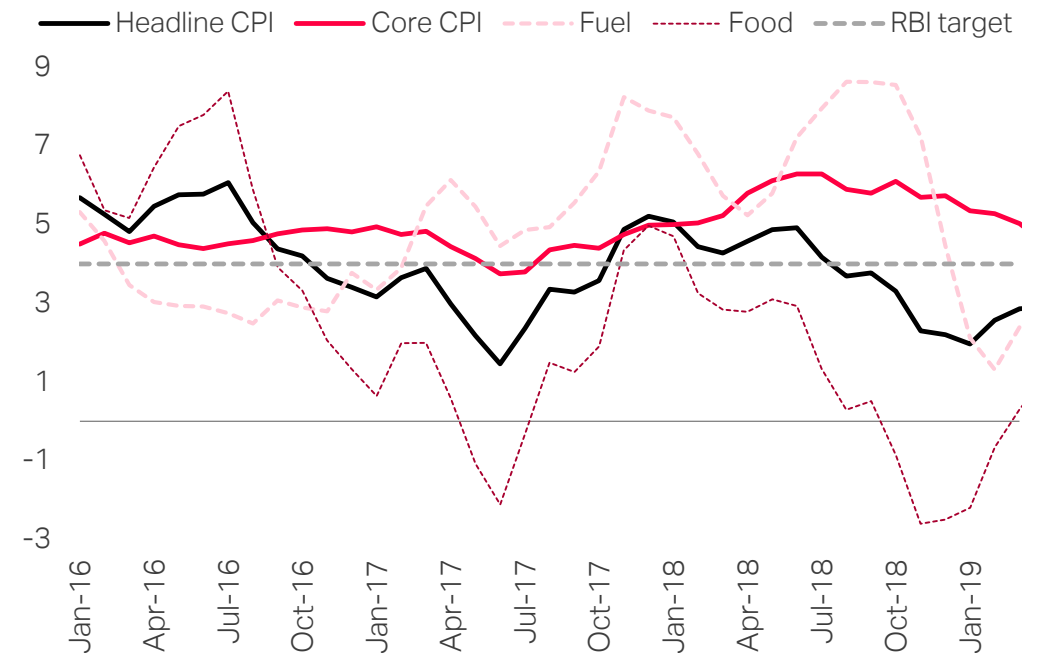
- Easing core inflation provides enough room for the RBI to cut rates again at its August policy review.
- The bank has cut rates by a cumulative 75 bps so far in 2019 as the headline CPI number remains well below the RBI's 4% target.
- However, food prices, which have been unusually low over the past year, are starting to rise, and there are potential spill-over effects on broader inflation; the progress of the monsoon – which has so far been weak – will be key to track in July.

Policy repo rate vs core inflation (% yoy)



Sources: CSO, RBI, TS Lombard.

CPI inflation vs RBI target (% yoy)



Sources: CSO, RBI, TS Lombard.

Global

Global Macro

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Global Political Drivers

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