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Economics / Politics / Markets

INDIA
BUDGET IN CHARTS

POPULISM WINS OVER FISCAL DISCIPLINE

Shumita Deveshwar

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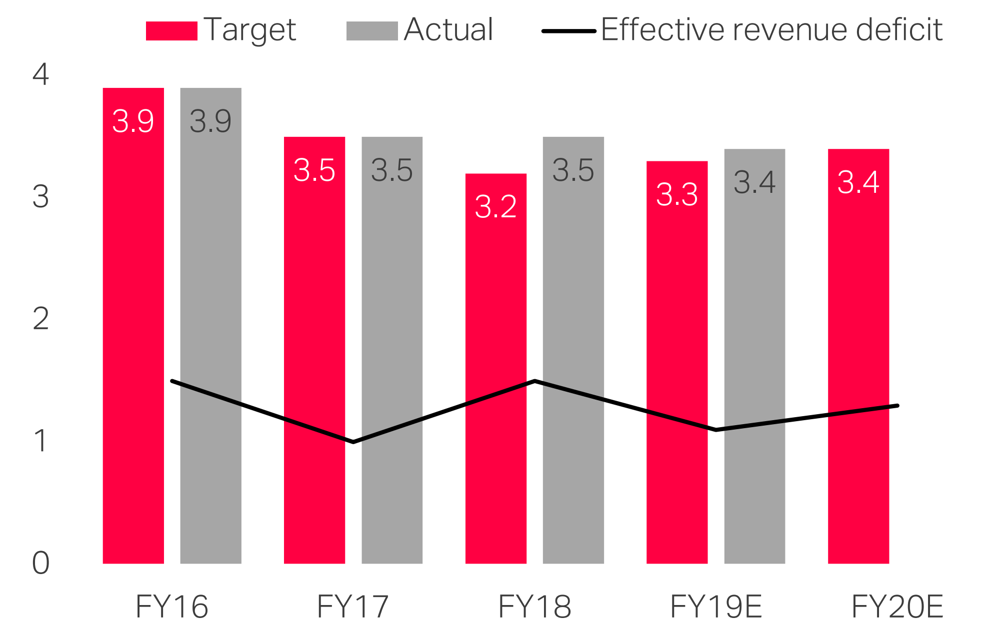
BUDGET MATH LIKELY TO GO AWRY

- Despite the authorities having narrowly missed the FY19 fiscal deficit target and then set a similar aim for FY20, higher spending and ambitious revenue projections will make achieving fiscal discipline a challenge.
- The projected budget gap of 3.4% of GDP is based on doubtful growth estimates and a fair bit of "creative accounting" that keeps some of the spending off the accounts. More important, the consolidated fiscal gap remains large – at more than 6%.
- The budget, which is clearly aimed at boosting consumption and wooing voters, may be too little, too late to guarantee Prime Minister Modi's re-election. The latest opinion polls show the vote gap between the ruling coalition and the opposition narrowing.
- Populist steps such as farm income support and tax relief for the middle class, announced in the "interim" budget, will lock the next government into these measures as it will be politically impossible to scale them back when it takes office in May.
- In fact, both of the national parties – the Bharatiya Janata Party and the main opposition Indian National Congress – are engaged in competitive populism.
- The onus on ensuring macroeconomic stability now rests with the new central bank governor: easier monetary policy amid loosening fiscal policy will create medium-term risks.

FISCAL CONSOLIDATION STALLS

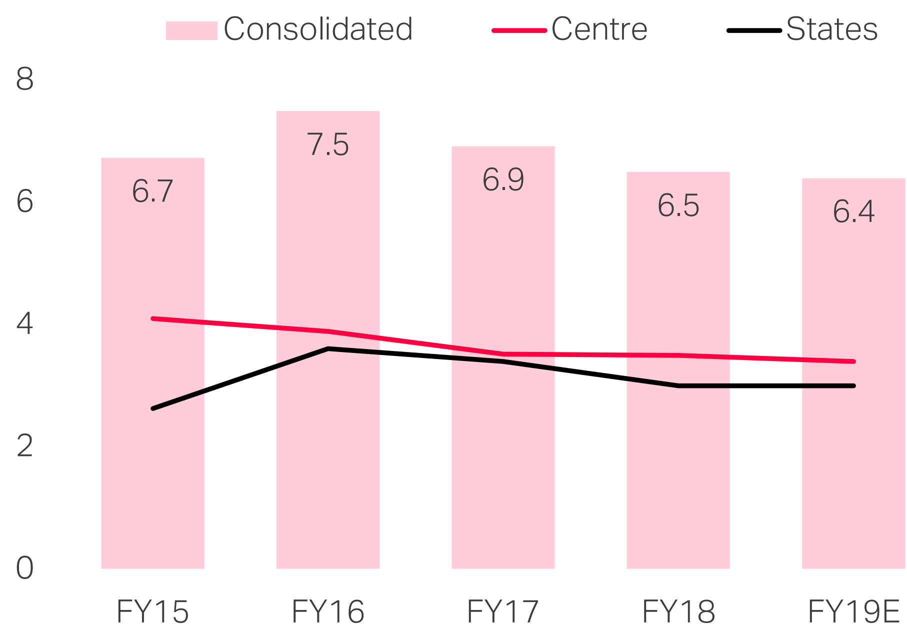
- **The central government has missed its budget target for the second year in a row and revised up the target for FY20 to 3.4% of GDP (from 3.1% earlier).**
- **Doubts overshadow the new targets as a new spending programme to support farmers' incomes has been introduced without new policies to increase revenues.**
- **The consolidated fiscal deficit of the central and state governments remains large and the spate of state-driven farm loan waivers could result in further fiscal slippage.**

Fiscal vs effective revenue deficit (% GDP)



Source: Budget documents.

Consolidated fiscal deficit (% of GDP)

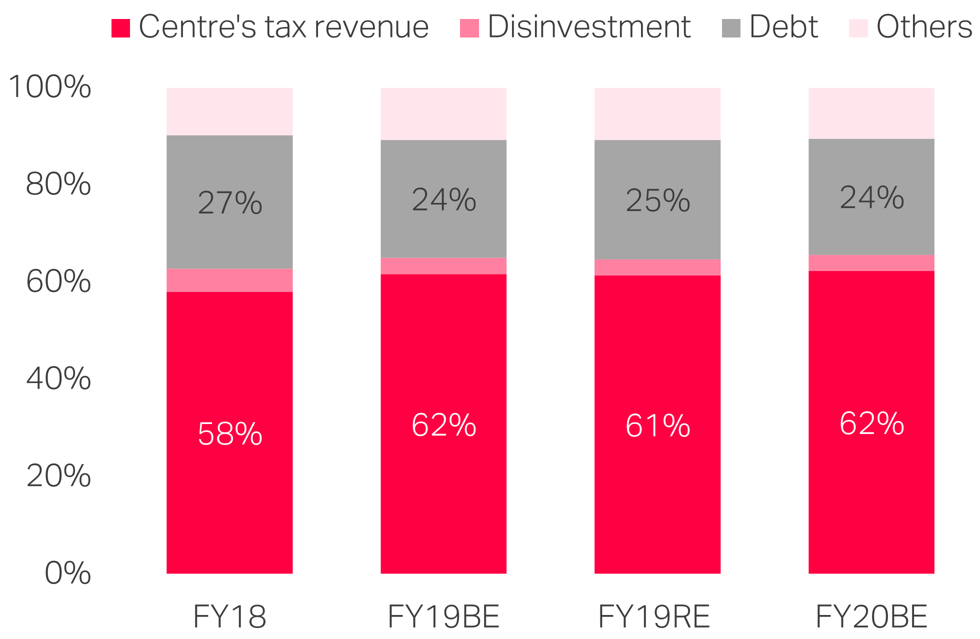


Sources: RBI, TS Lombard.

REVENUE TARGETS APPEAR AMBITIOUS

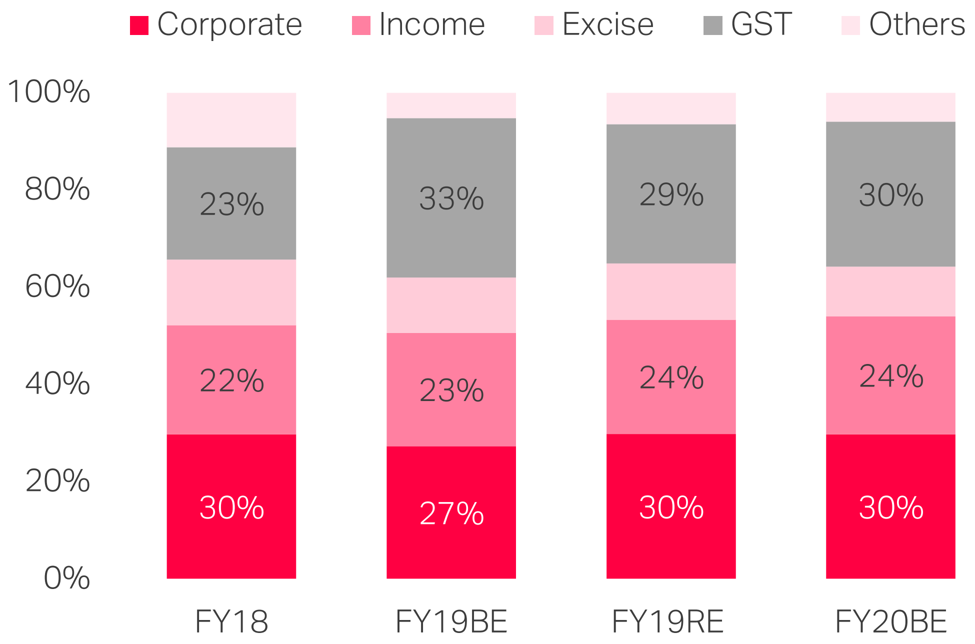
- **Corporate tax collections have been better than initially budgeted for FY19, helping the government offset part of the Rs1 trillion shortfall in GST revenues.**
- **Despite this large shortfall, the government's dependence on the new tax as a source of revenue is increasing.**
- **Even though the government has yet to raise more than half of its FY19 disinvestment target, it has left it at Rs800 billion for FY19 and raised it to Rs900 billion for FY20.**

Revenue break up % of total revenue)



Sources: Receipt budget, TS Lombard.

Tax categories (% of gross tax revenue)

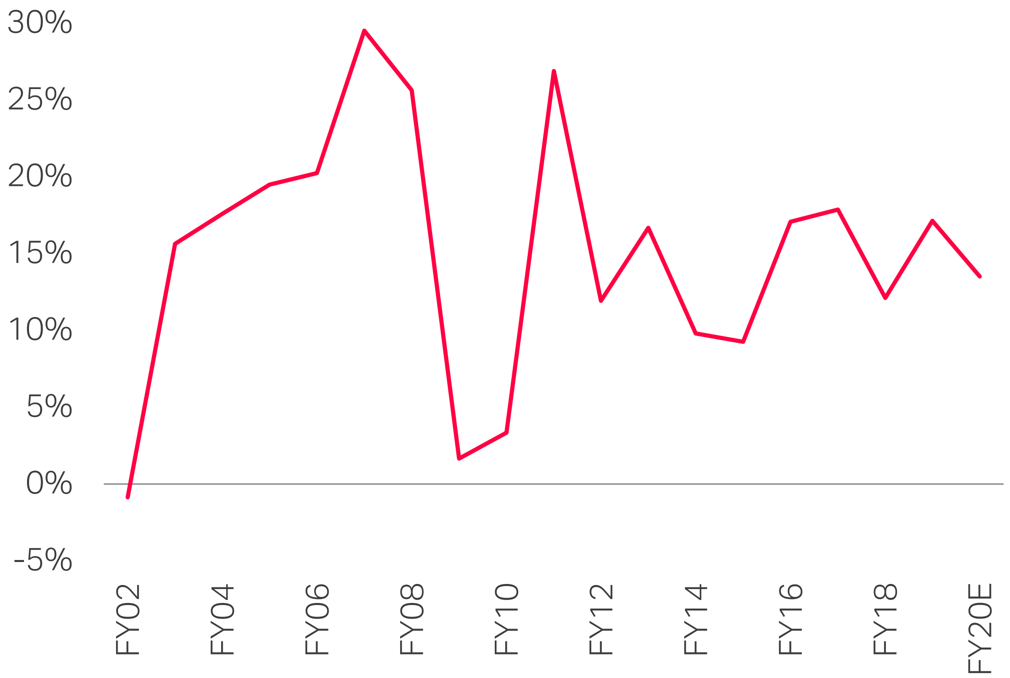


Sources: Receipt budget, TS Lombard.

THE STRUGGLE TO RAISE TAX REVENUES

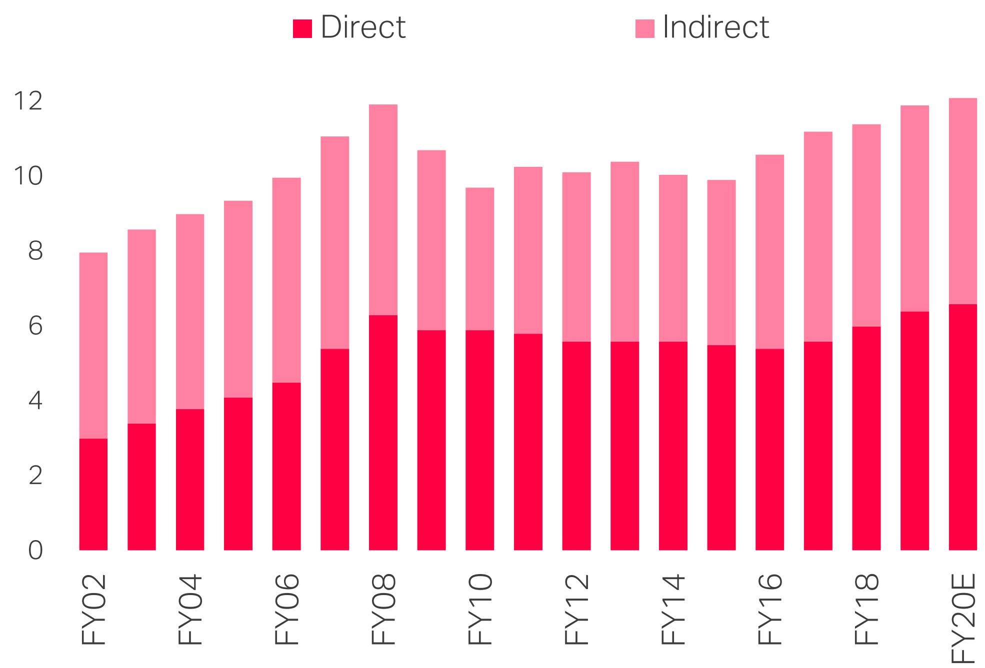
- **Despite tax-focused policies such as demonetization and GST, the government has found it difficult to sustainably increase growth in its total tax collections.**
- **Tax-revenue growth targets can be met only through a significant expansion of the tax base, increased compliance and measures to plug tax leakages. But the political will is fading and India's low income base is a structural constraint.**

Central govt tax revenue growth (% yoy)



Source: Income Tax Department.

Tax to GDP ratio (%)

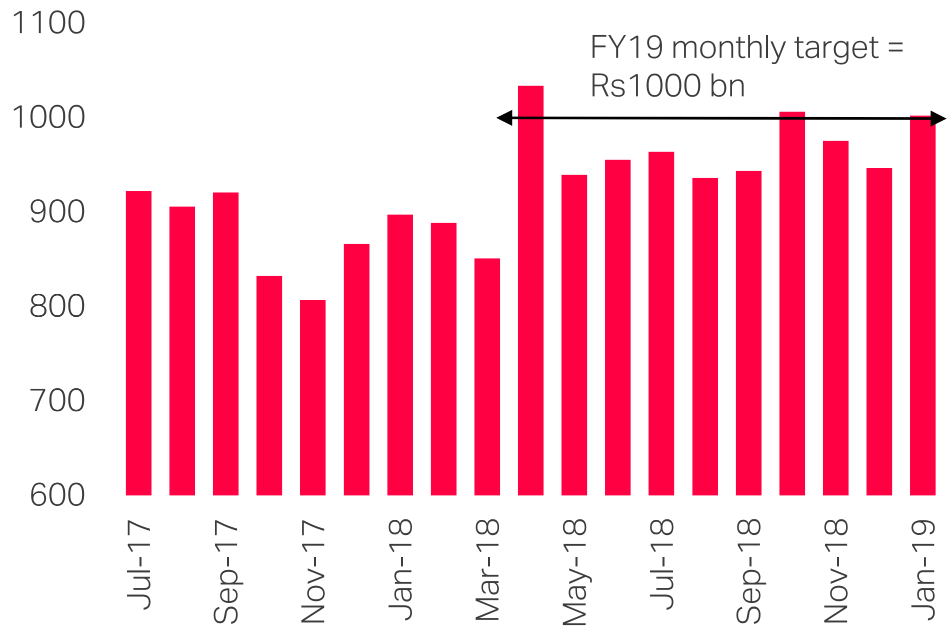


Sources: Income Tax Department, RBI.

GST REVENUES FALL SHORT OF TARGET

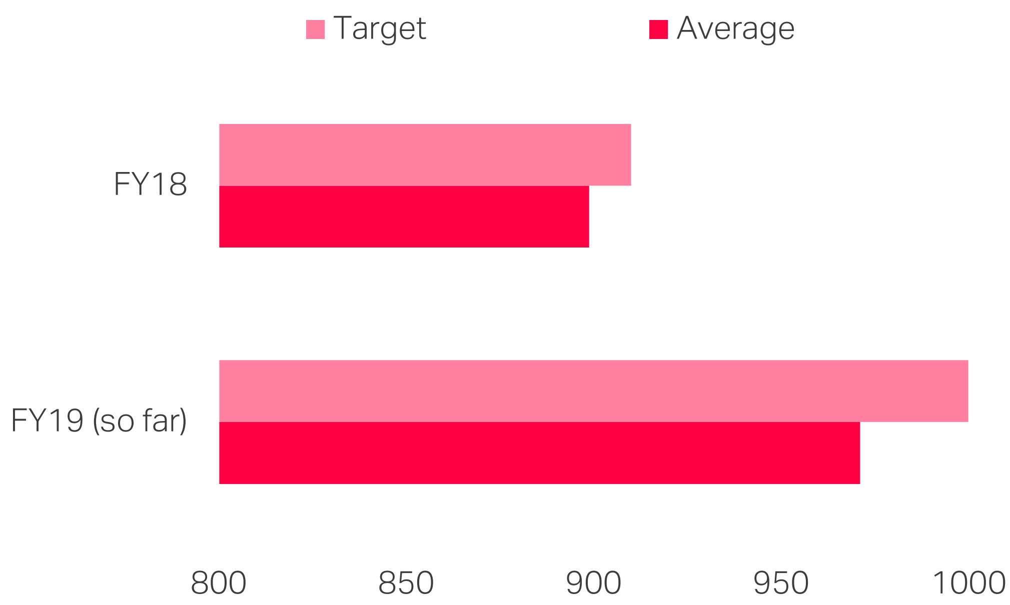
- **If the jump in the January GST collections is not sustained in February and March, revenues for the full FY19 may be even lower than the sharply revised down estimate.**
- **The government has kept the FY20 monthly target at the same level as initially budgeted for FY19; but collections will be limited by the many rate cuts, continuing teething issues and a lenient approach towards small businesses struggling with the new tax regime.**

GST receipts (Rs bn)



Sources: Ministry of Finance, Press Information Bureau.

GST monthly target vs achievement (Rs bn)

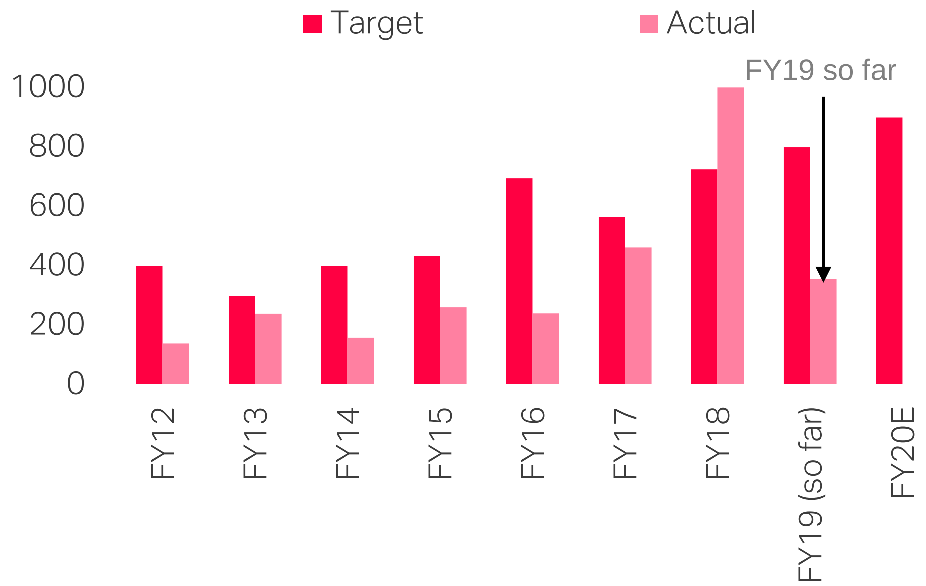


Source: GST Council.

DISINVESTMENT BUT NO PRIVATIZATION

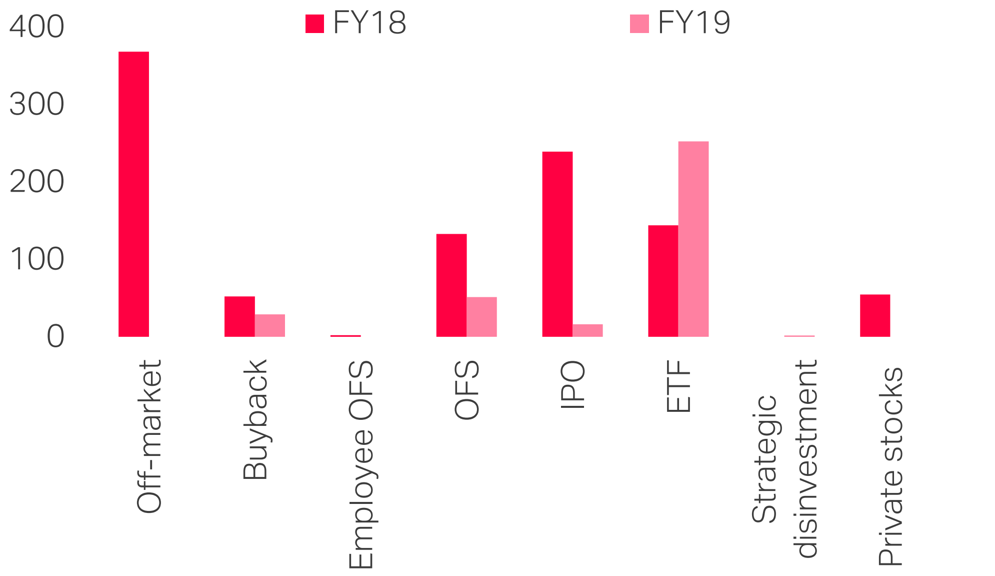
- The government has met (or overshot) its disinvestment target only once in the recent past: in FY18, when the sale of one state-run firm to another earned it one third of the projected revenues.
- Government ownership has hardly changed in recent years; efforts to privatize Air India in FY19 failed and the state-run Life Insurance Corp. remains a prominent buyer of stakes and a key participant in share sales.
- The government will try to sell Air India in FY20 and plans around 10 share listings.

Disinvestment target vs actual (Rs bn)



Source: Department of Investment and Public Asset Management (DIPAM).

Disinvestment aim vs achievement (Rs bn)

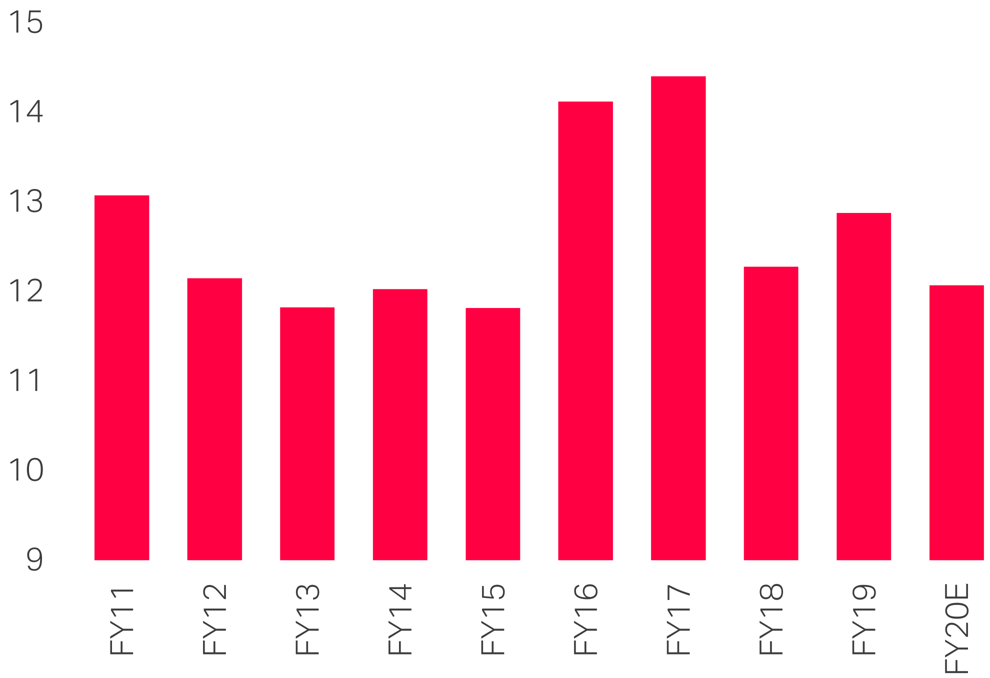


Sources: DIPAM, Budget documents, media reports

CAPEX HIT AS POPULISM RISES

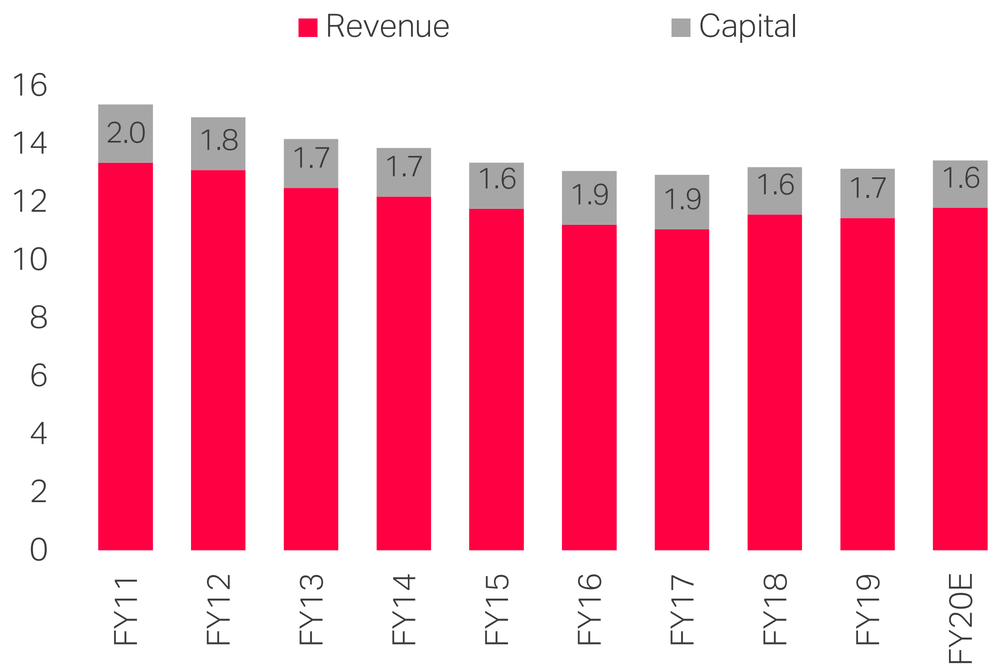
- Capital spending – both as a share of total expenditure and as a percentage of GDP – has taken a hit as revenue spending on non-productive purposes rises.
- Capex growth is budgeted at just 6% in FY20 vs an estimated 20% in FY19.
- Lower government capex spending will be negative for the overall capex recovery.

Capital spending (% of total)



Sources: Budget documents, RBI.

Revenue vs capital spending (% of GDP)

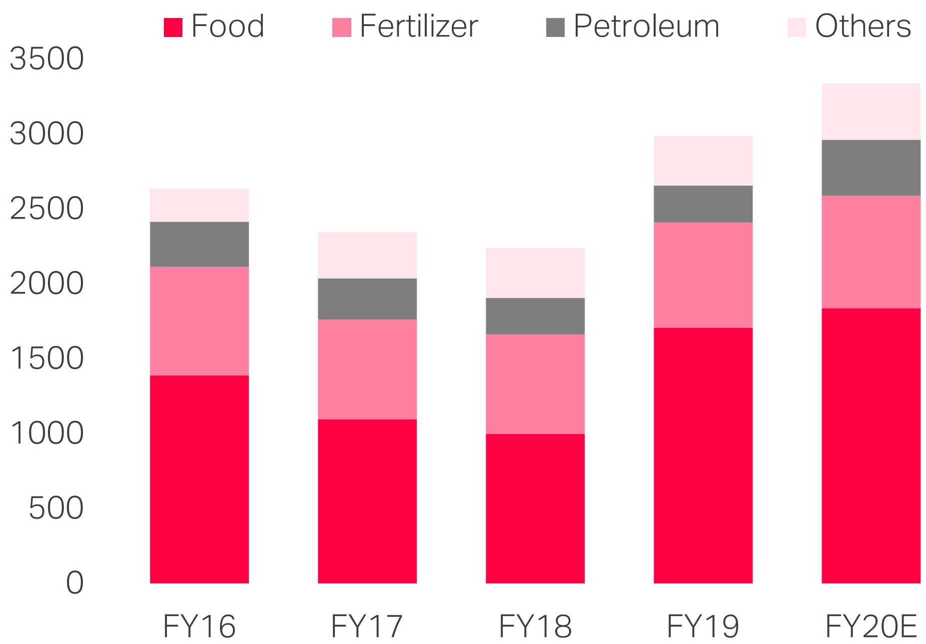


Sources: Budget documents, RBI.

SPENDING ON SUBSIDIES INCREASES

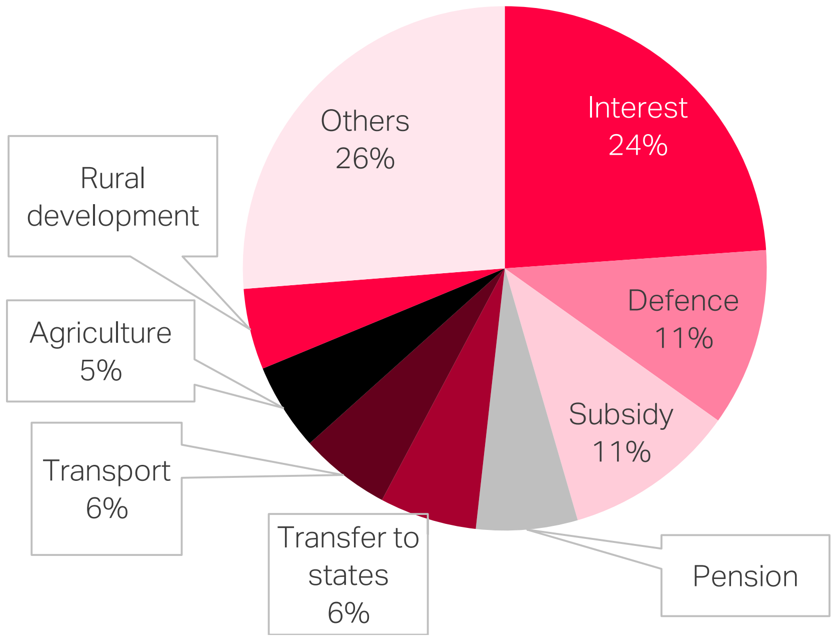
- **Subsidy spending on food jumped sharply in FY19 and the government is factoring in higher fuel subsidies in FY20 mainly owing to subsidies on cooking gas for poor households and a rollover of the FY19 subsidy bill.**
- **The top eight spending heads – including expenditure on interest payments, subsidies, pensions and defence – leaves just 26% of the total spending for the rest of the economy.**

Subsidies (Rs bn)



Source: Budget documents.

Major spending heads (% of total spend)

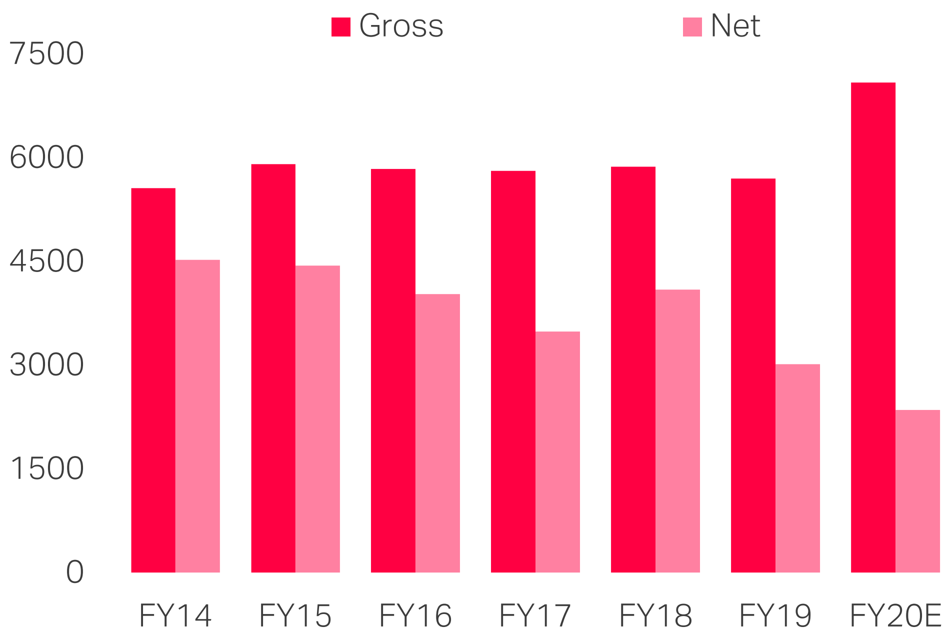


Source: Budget documents.

RECORD DEBT SALES BUDGETED

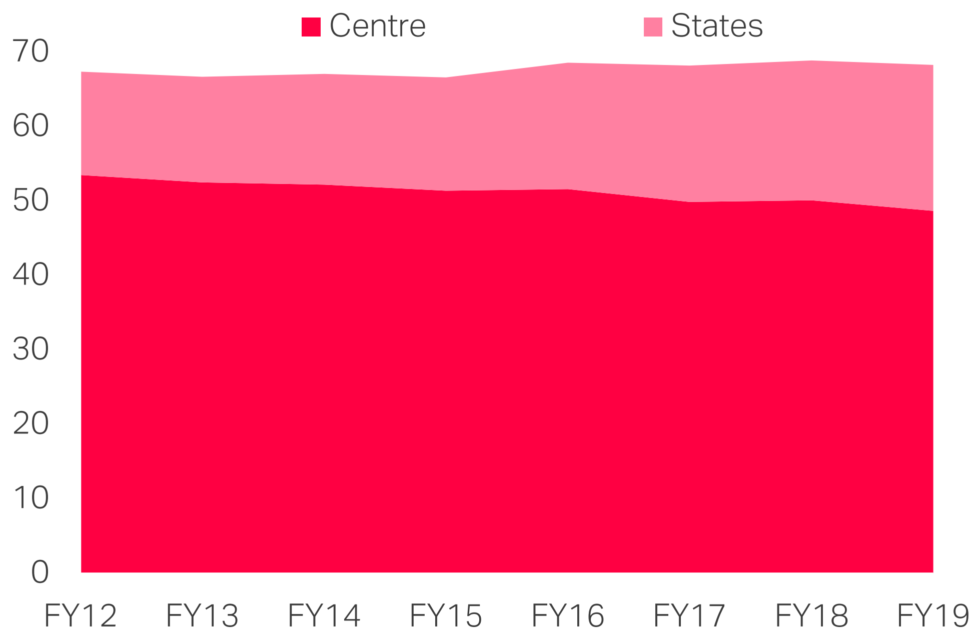
- **Record debt sales budgeted for FY20 will help finance the Rs750 billion cash handout to farmers and the Rs185 billion tax exemptions.**
- **Ratings agency Moody's says that India's high debt burden is the country's biggest credit challenge and is not expected to diminish rapidly.**
- **The government's stated commitment of a debt ceiling of 60% of GDP by 2025 will require significant fiscal consolidation in the coming years.**

Market borrowings (Rs bn)



Source: Budget documents.

General government debt (% of GDP)

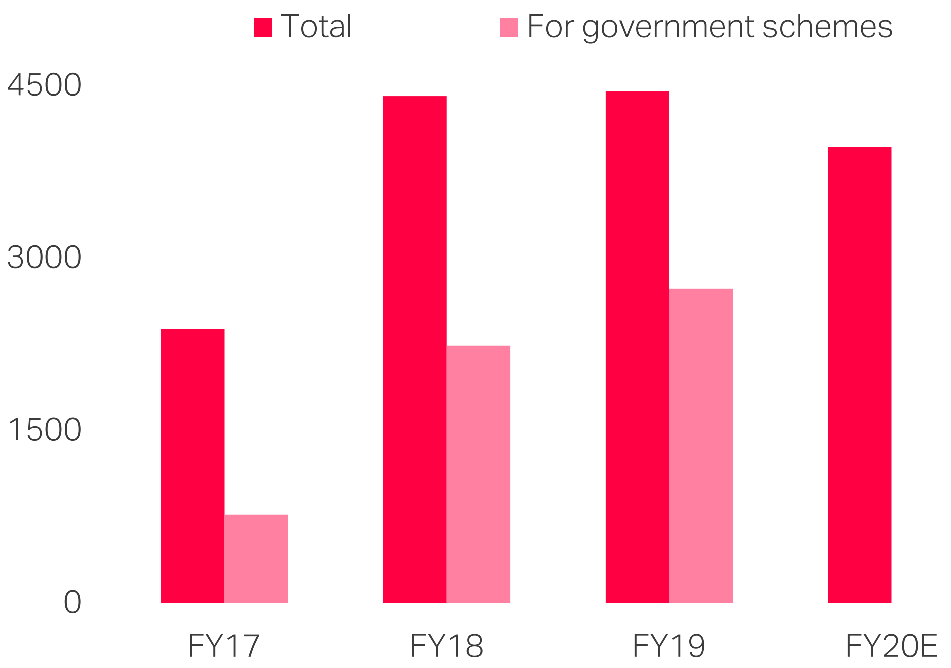


Source: RBI.

'CREATIVE ACCOUNTING' IS WIDESPREAD

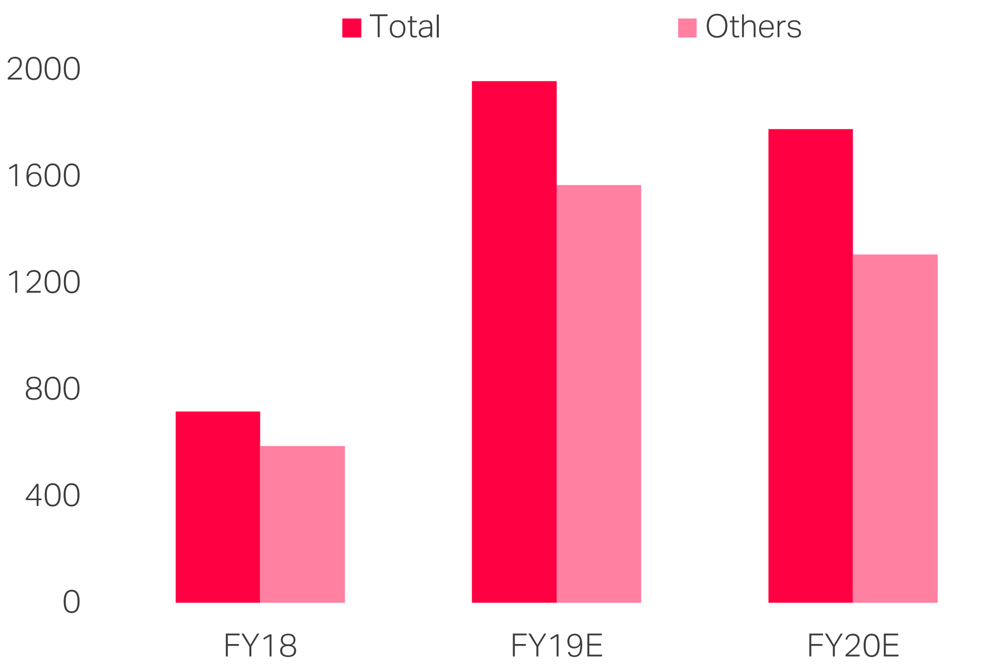
- **Off-budget financing has increased 3.5 times since FY17, with Food Corp. of India (FCI) and other state-run firms expected to raise funds for government programmes.**
- **Borrowings by the FCI exceed 1% of GDP but are not included in the budget; most FCI borrowing comes from "other" sources, such as the state-run Life Insurance Corp., the Employees' Provident Fund or the National Social Security Fund.**

Extra-budget funds by state firms (Rs bn)



Sources: Budget documents, media reports.

Resources raised by FCI (Rs bn)

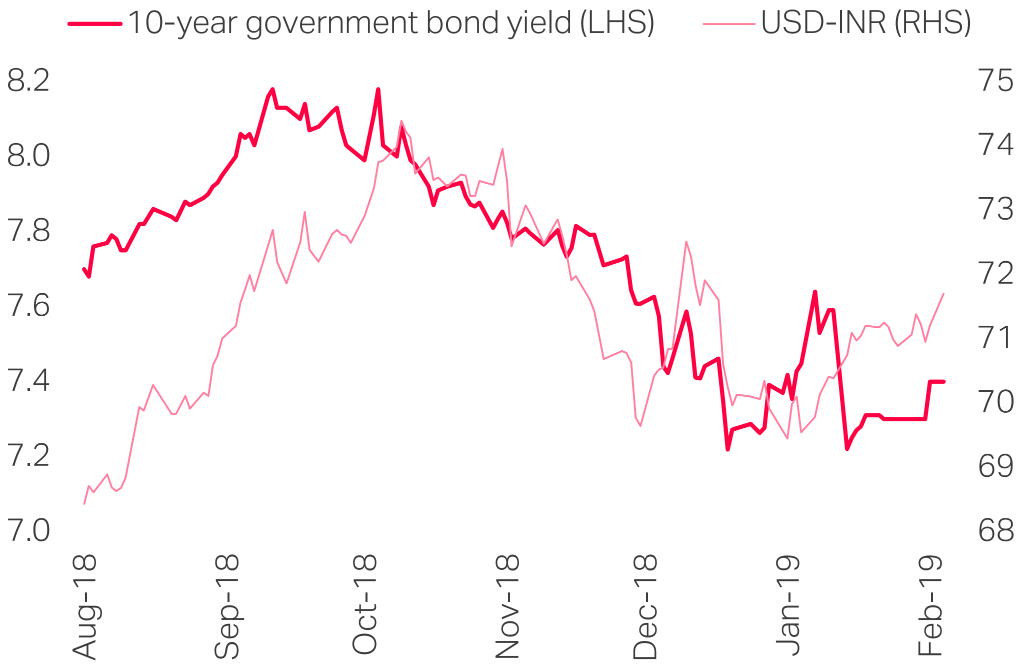


Sources: Budget documents, Bloomberg.

THE MIXED MARKET REACTION

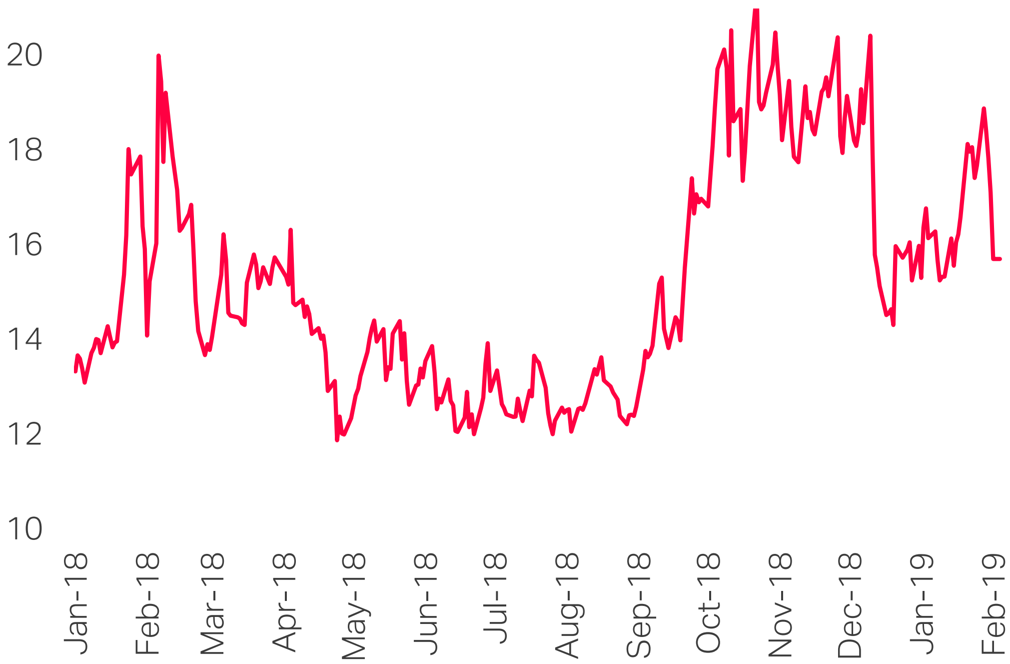
- Bonds and the rupee sold off following the budget as investors worried about the higher borrowing programme and fears of fiscal slippage.
- A government spending-led short-term consumption boost to the economy, however, has cheered equity investors, although we expect volatility to rise ahead of the April-May national elections.

Benchmark bond yield vs rupee



Source: Datastream.

Nifty VIX

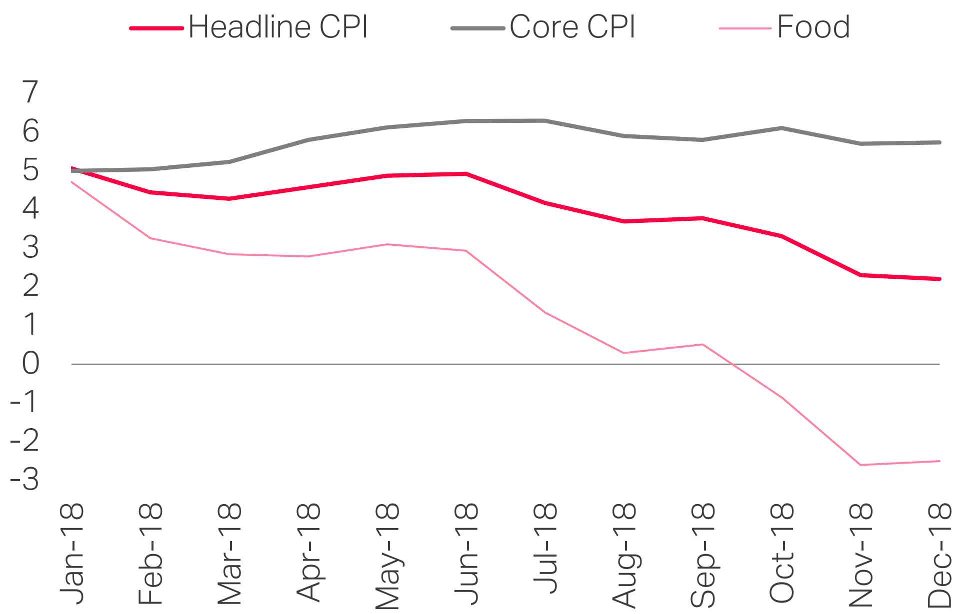


Source: National Stock Exchange.

A TRICKY TIME FOR MONETARY POLICY

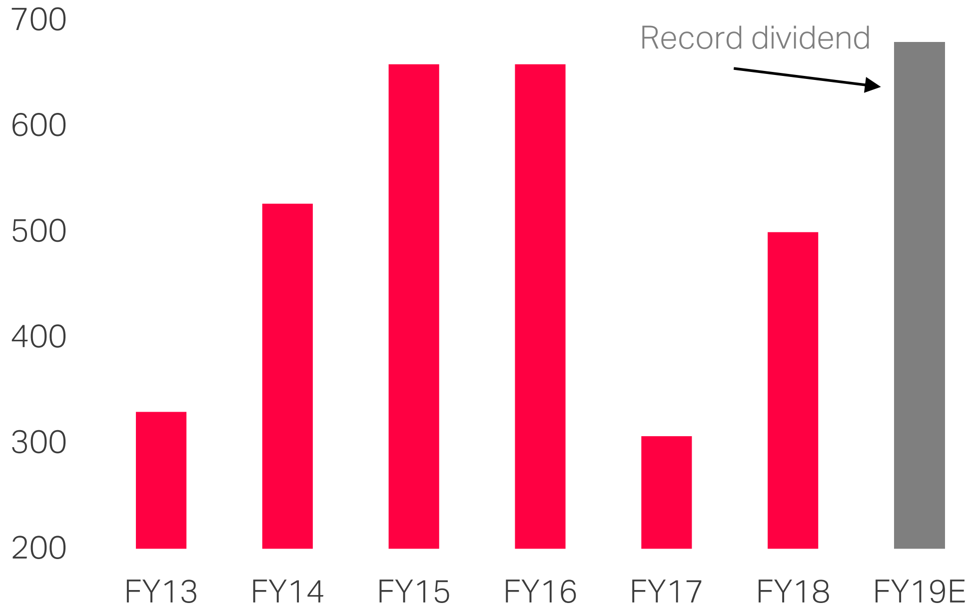
- Rural distress is evident from the sharp fall in food prices, which has kept headline CPI well below the RBI's 4% CPI target, even though core inflation is stubbornly high.
- The RBI has so far appeared to target core inflation, but the new RBI Governor is expected to be more lenient in his approach to monetary and banking policies.
- A record Rs680 billion RBI dividend is budgeted for FY19; the transfer of RBI reserves was a key point of conflict between the government and the RBI's previous leadership.

CPI inflation (% yoy)



Sources: Central Statistics Office, TS Lombard.

RBI dividend to the government (Rs bn)

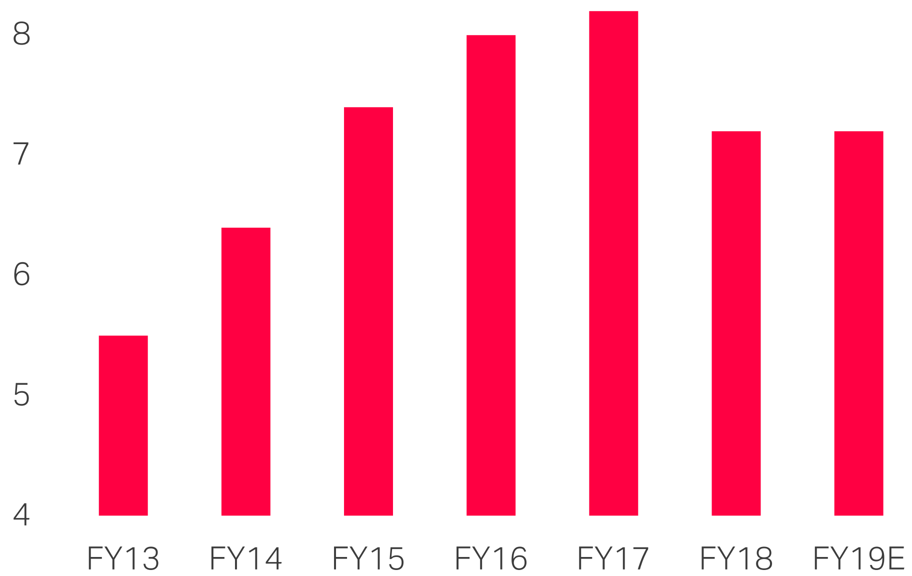


Source: RBI.

GROWTH RECOVERY DISAPPOINTS…

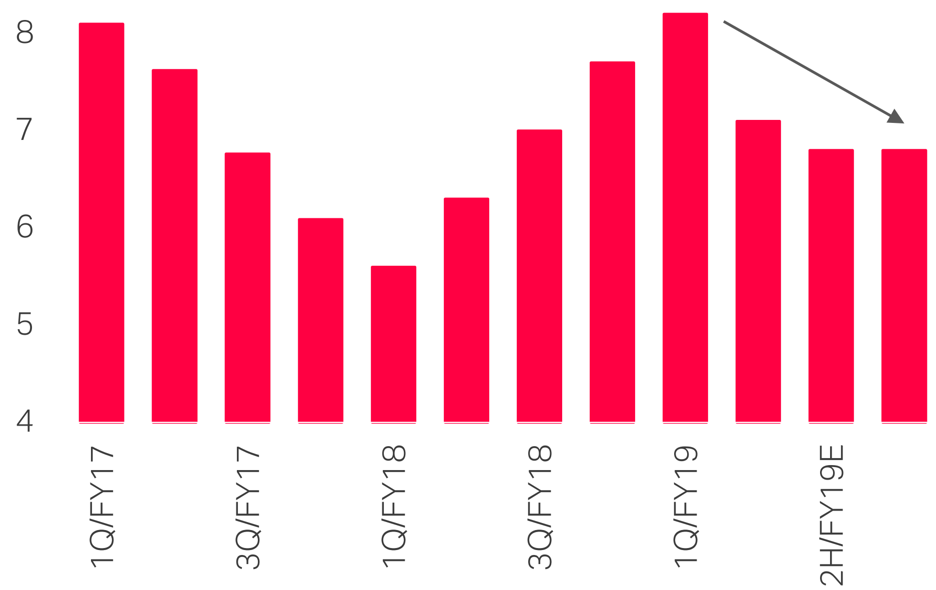
- **The government sharply revised up its GDP growth estimates for FY17 and FY18 just a day before the budget, which helps in its fiscal math.**
- **However, the earlier growth projection for FY19 shows a stalling of the growth recovery, with the pace of expansion expected to slow in H2/FY19.**
- **The budget's consumer spending focus shows that the government is worried about growth.**

Annual GDP growth (% yoy)



Source: CSO.

Quarterly GDP growth (% yoy)

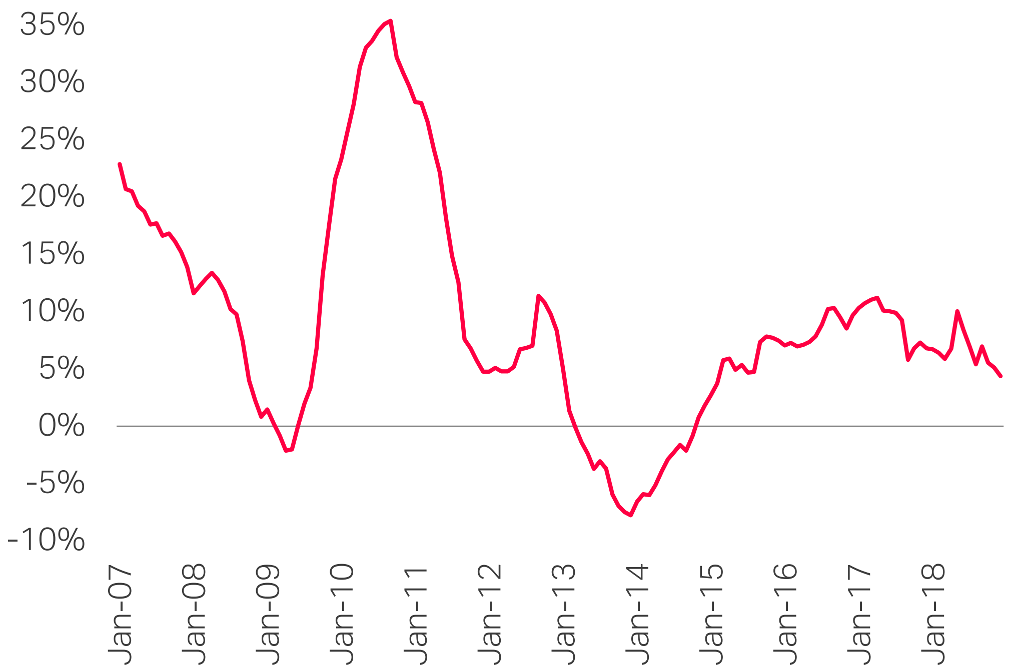


Source: CSO.

…AS IT ISN'T BEING FELT ON THE GROUND

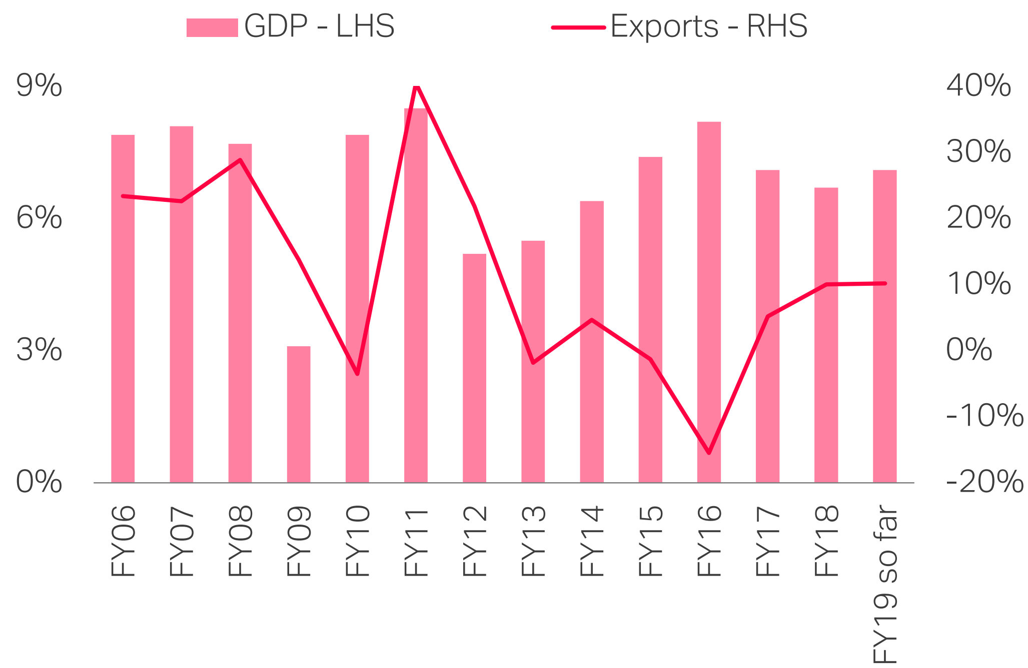
- **The past years' revision of GDP growth does not correspond with the reality on the ground: vehicle sales have slowed and the rural economy is in the doldrums.**
- **Apart from the domestic challenges, global headwinds are a concern: Indian growth is not decoupled from world growth.**

Passenger vehicle sales (%, 12m/12m)



Sources: Datastream, TS Lombard.

Growth in GDP vs exports (%)

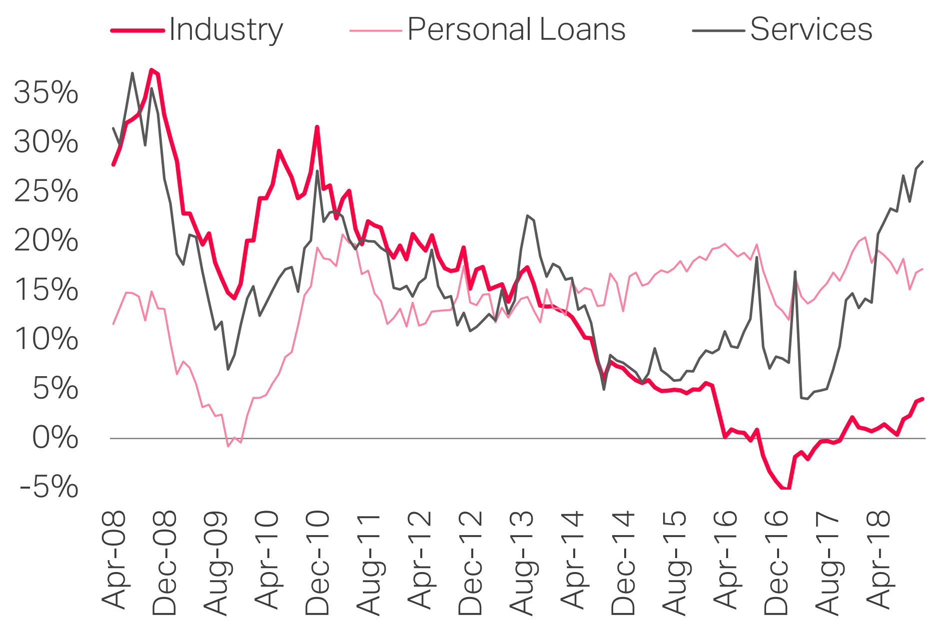


Sources: CSO, Ministry of Commerce, RBI.

BANKS' BAD DEBT EASING, ALBEIT SLOWLY

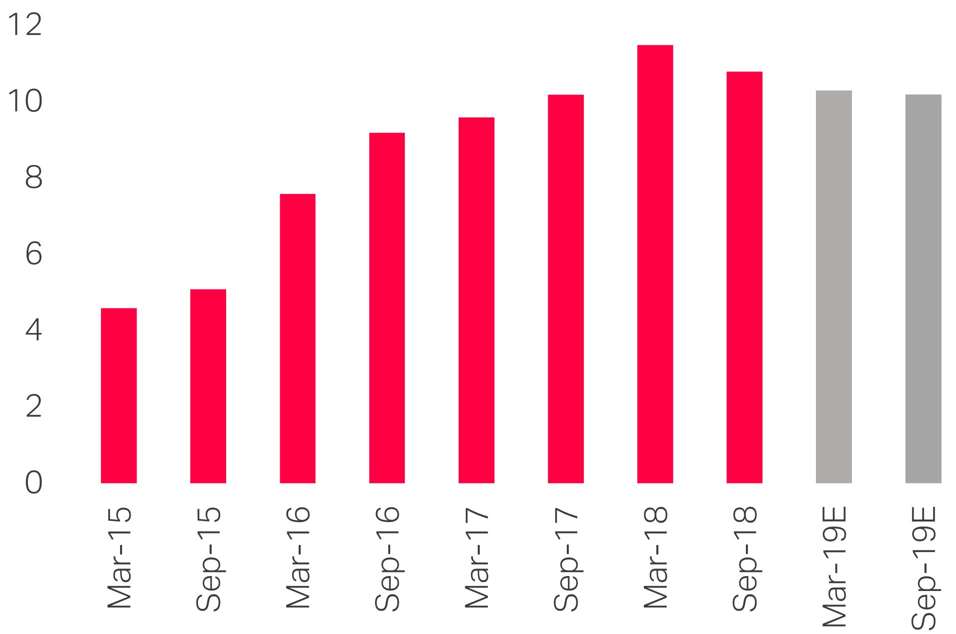
- Bank credit has picked up significantly over the past few months but the rise has been lopsided: retail- and services-sector loans have risen but industrial credit is muted.
- India's banking sector is starting to show signs of recovery only now – after three years – although the NPA ratio remains high.
- The RBI last week lifted lending curbs on three state-run banks and Finance Minister Piyush Goyal said in the budget that he hopes curbs on eight others will be lifted soon.

Sectoral growth of bank credit (% yoy)



Source: RBI.

Gross NPA ratio (%)

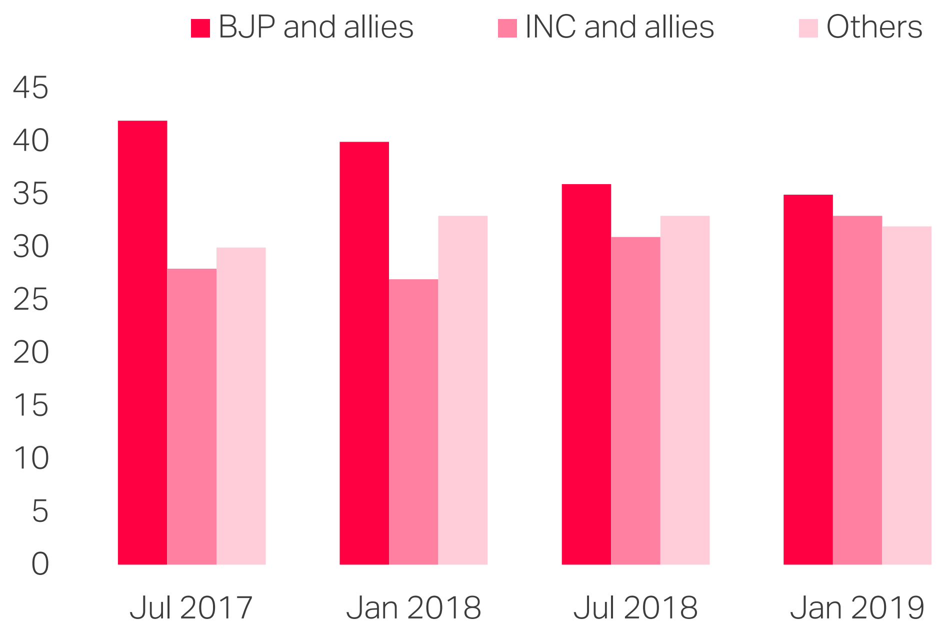


Source: RBI.

A BROADER RULING COALITION IS LIKELY

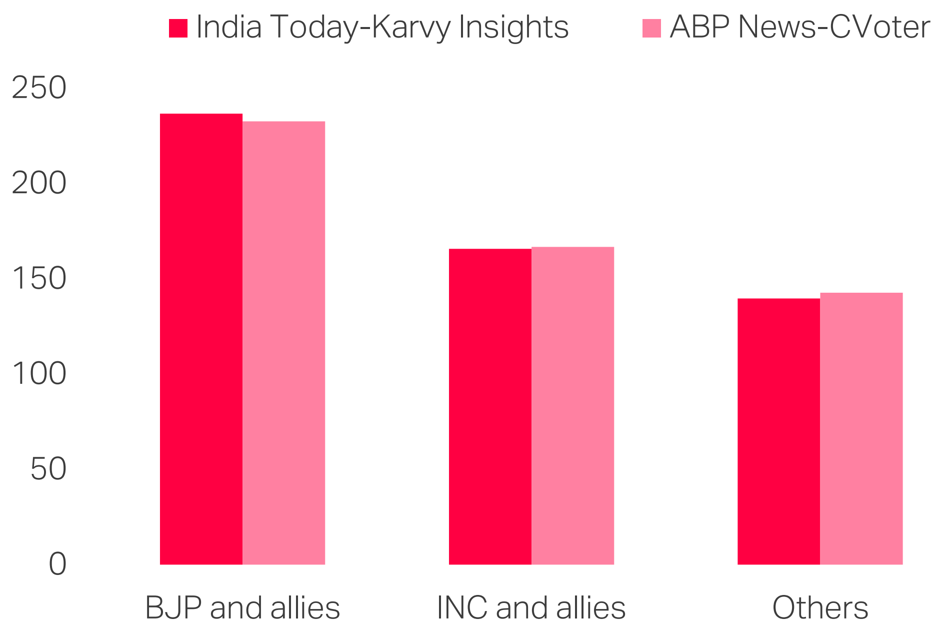
- **Opinion polls put the ruling BJP and the main opposition in a statistical dead heat as the vote gap between the two national coalitions appears to be narrowing.**
- **A regional party alliance in India's largest state will hit the BJP's national standing; a sweep of seats in Uttar Pradesh in 2014 resulted in the BJP winning a majority.**
- **The most likely outcome of the 2019 polls is a broad coalition led either by the BJP or by the INC.**

Projected party vote share (%)



Source: India Today-Karvy Insights Mood of the Nation polls.

Projected parliamentary seats



Sources: India Today-Karvy Insights, ABP News-Cvoter Desh ka Mood poll.

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United Kingdom & Europe
Pellipar House
9 Cloak Lane
London EC4R 2RU
Tel: +44 (0) 207 246 7800
london@tslombard.com

North America
183 Madison Avenue
Suite 419
New York 10016
Tel: +1 646 398 5903
newyork@tslombard.com

Asia Pacific
Unit 4, 16/F, Bonham Trade
Centre, 50 Bonham Strand
Sheung Wan, Hong Kong
Tel: +852 2521 0748
hongkong@tslombard.com

tslombard.com