The Great Indian Budget 'Tamasha' II

Tamasha, *noun (Indian English)*

1. a grand show, performance or celebration
2. sudden noisy activity; unnecessary excitement, worry or anger

   Source: Oxford Learners Dictionary

My note on the Budget last year used the second definition of *Tamasha* to describe what is often an annual excuse to fill column inches and screen time – all wrapped in a ceremony of "Breaking News" flashes and talking heads.

This is the more widely used definition, but this year's Tamasha has more of a celebratory lustre to it. The Indian Budget presented on 1st February turned out to be a "grand" step forward, more in keeping with the dictionary's first option. There has been a definitive policy switch to utilise macro stability built over recent years (combined with some fiscal firepower), as a springboard to re-ignite productive and sustainable growth.

Backdrop

The table in the annex provides a full picture but for some context, the fiscal deficit for the year ending 31 March 2021 is expected to be 9.5% of GDP (vs 4.6% in FY20). This spike is mainly due to the loss of tax revenues rather than stimulus spending. Unlike other economies, India chose not to stimulate, as the Economic Survey released on 29 January 2021 notes: "*There was no point in pushing the accelerator while the foot was firmly on the brake, as a demand stimulus at a time when supply was constrained would have not helped*". The IMF's January forecast corroborates this; real GDP growth, after falling 8% in FY21, is expected to bounce back to 11.5% in FY22 and 6.8% in FY23. The recovery underway is rather due to the economy's gradual re-opening in May'20 rather than to any fiscal pump priming. The decision not to stimulate last year has left the government with greater firepower to support this recovery. With this backdrop in mind our key takeaways are as follows.

Capex vs subsidies

An historic response may have centred on paying Indian citizens to dig holes and then re-fill them. Instead, Government capital expenditure is budgeted to increase by 26% in FY22 focusing on infrastructure and in particular roads and railways. This is on top of a 30% increase in FY21. The formation of a Development Finance Institution (DFI) has been announced which will finance infrastructure assets to the tune of US$70bn over the next 3 years. The Budget also proposes to launch a National Monetisation Pipeline (NMP) for monetising operating public infrastructure assets such as ports, airports, roads, railway infrastructure, and power transmission lines. This will be an important financing option for new infrastructure projects. Both the DFI and NMP will help in financing the US$1.3 trillion National Infrastructure Pipeline (NIP) announced prior to the budget.

Conservatism and transparency

Sceptics of India's official figures should take note. The government has brought off-balance-sheet funding of India's massive food subsidy programme onto its books for the first time. This in itself has increased the fiscal deficit by 1.5% in FY21 and 0.5% in FY22. The government's revenue estimates conservatively assume nominal GDP growth of 14.4% in FY22. Based on this, gross tax revenues are expected to rise by 16.7% in FY22. With a forecasted real GDP growth rate of 11.5% and an inflation range of 4-5%, nominal GDP growth can easily clock 15-16% and thus tax buoyancy may well surprise positively relative to budgeted numbers. Overall, the numbers look more real and believable.

Growth is the solution

The government estimates that the fiscal deficit for the coming financial year will be 6.8% of GDP, but as a consequence of targeted structural reforms of recent years, India entered this global pandemic in a more robust position. Indeed, the earlier fiscal deficit target of 3% by FY22 has now been replaced with 4.5% by FY26 without a visit from the Bond Vigilantes thus far. The medicine of austerity has not been prescribed and the anaemic reaction of bond yields (to date) shows market confidence in India's plan to invest its way back to sustainable growth. Perhaps this is also because the Government has not planned rampant stimulus but has been expansionary through targeted spending mentioned above. From a relative perspective, India's government debt–to-GDP looks likely to rise to ~90% from 72% in 2019 but this will still be one of the lowest in the world (see the chart in the annex).

How sustainable is this debt? India's *interest rate growth rate differential* is negative (government debt interest rate minus GDP growth) which gives us confidence that an expansionary mindset is appropriate.

Over to the private sector

Beyond capex spending the Government has sent a strong signal of intent:

- No wealth taxes or income tax rises
- FDI limits in the Insurance sector raised to 74% from 49%; allowing external control
- IPO of state-owned Life Insurance Corporation (LIC), India's largest life insurance company
- Full privatisation of two state-owned banks and one general insurance company this year
- An Asset Reconstruction Company for public sector banks' stressed loans

Not all will go to plan and no doubt there will be bumps along the road, but the focus on disruptive structural reforms is now displaced by a desire to revive animal spirits.

The portfolio

For the Gateway to India Fund, what changes incrementally is that we will now have <u>more</u> bottom-up stock selection opportunities to explore but the current portfolio's earnings growth for the coming financial year is set to be 41%. This is set to normalise to 25% for FY23 and the confidence in our expectations of a strong corporate earnings growth cycle going forward has been reinforced by this budget. Our main concern is the danger of underestimating profitability – a tendency that is prevalent when coming out of a weak economic environment.

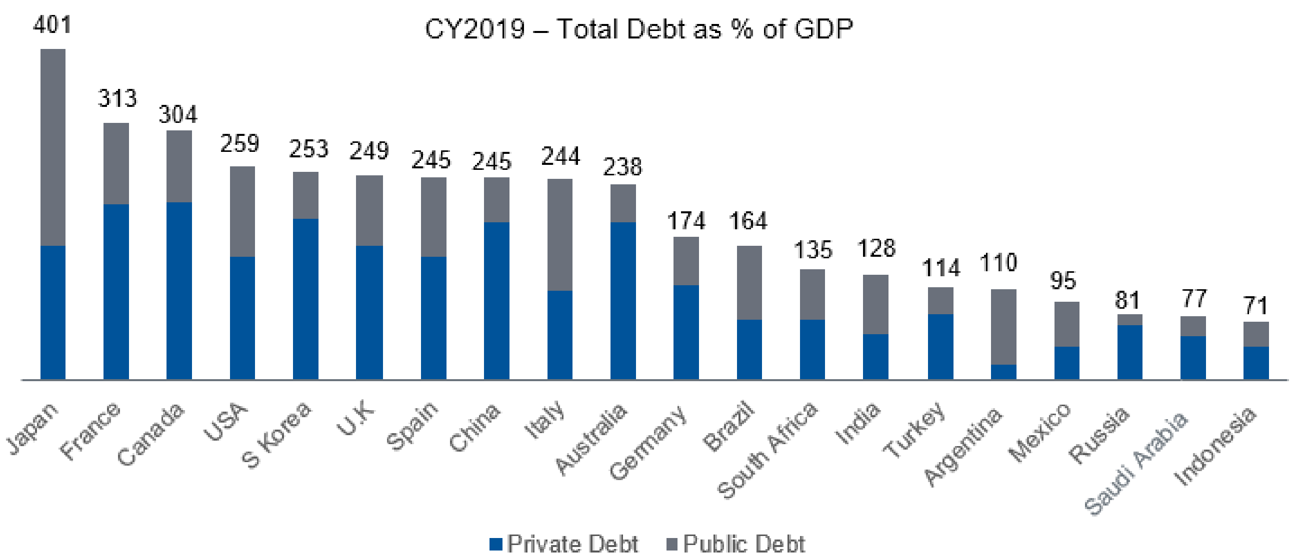
Tridib Pathak
Principal Advisor, Gateway to India Fund
3rd February 2021

	Budget 2021 at a glance (US$bn)	FY20 Actual	FY21 RE	% growth (F21 RE over FY20 Actual)	FY22 BE	% growth (F22 BE over FY21 RE)	% growth (FY22 BE over FY20 Actuals)
1	**Revenue receipts**	**230.6**	**213.0**	**-7.7%**	**244.9**	**15.0%**	**6.2%**
	Gross Tax Revenue	275.3	260.2	-5.5%	303.6	16.7%	10.3%
	Direct Tax	143.7	123.9	-13.8%	151.7	22.4%	5.6%
	Indirect Tax	131.5	136.3	3.6%	151.9	11.4%	15.5%
1.1	Net Tax Revenue (Centre)	185.7	184.1	-0.9%	211.6	14.9%	14.0%
1.2	Non-Tax Revenue	44.8	28.8	-35.6%	33.3	15.4%	-25.7%
2	**Capital Receipts (before borrowings)**	**9.4**	**6.4**	**-32.2%**	**25.7**	**304.3%**	**174.0%**
2.1	Recovery of Loans	2.5	2.0	-20.9%	1.8	-10.3%	-29.0%
2.2	Disinvestment Receipts	6.9	4.4	-36.4%	24.0	446.9%	247.9%
3	**Total Receipts**	**240.0**	**219.3**	**-8.6%**	**270.7**	**23.4%**	**12.8%**
4	**Total Expenditure**	**367.9**	**472.5**	**28.4%**	**477.0**	**1.0%**	**29.7%**
4.1	Revenue expenditure	321.9	412.4	28.1%	401.1	-2.7%	24.6%
4.2	Capital Expenditure	46.0	60.1	30.8%	75.9	26.2%	65.1%
5	**Fiscal Deficit (3-4)**	**-127.9**	**-253.2**	**98.0%**	**-206.4**	**-0.2%**	**61.4%**
	% GDP	***-4.6%***	***-9.5%***		***-6.8%***		
6	**Financed By**	**127.9**	**253.2**	**98.0%**	**206.4**	**-18.5%**	**61.4%**
6.1	Market Borrowing	85.5	174.4	104.1%	132.5	-24.0%	55.1%
6.2	Small Savings	32.9	65.8	100.2%	53.7	-18.4%	63.3%
6.3	External Debt	1.2	7.5	528.0%	0.2	-97.2%	-82.6%
6.4	Others	8.3	5.4	-34.7%	19.9	266.3%	139.3%
	Nominal GDP Estimate	**2,779.7**	**2,668.1**	**-4.0%**	**3,052.3**	**14.4%**	**9.8%**

Source: Government of India, Union Budget documents
INR to USD conversion rate as on 2nd Feb 2020

RE = Revised Estimate

BE = Budget Estimate



Source: IMF

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