Economics

DBS Flash

India fiscal: Treading a fine-line

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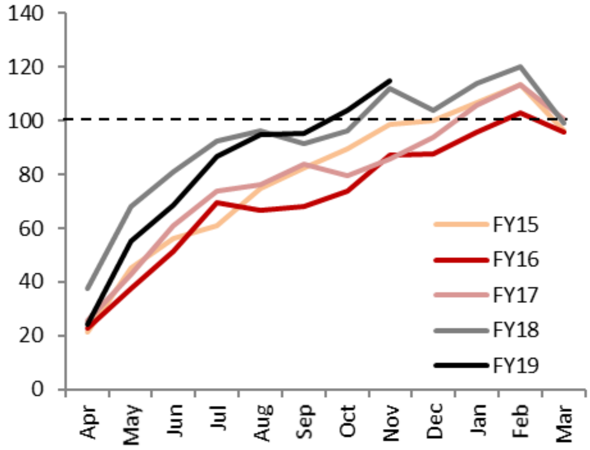
- *The run-rate of the FY19 fiscal math largely tracks trends in past years.*
- *Yet, slower revenue outruns, particularly indirect tax and divestment receipts, is worrisome. RBI's dividend, expected to be substantial, will likely help meet the deficit target, but that means the quality of fiscal adjustment will remain in doubt.*
- *The government will table an Interim budget on 1 February 2019, ahead of the April-May general elections.*
- *Around the budget, directed support measures for the farm sector and GST tweaks are likely.*

In the first eight months of FY19, the fiscal deficit target has been overshot by 15%, largely due to a revenue shortfall rather than front-loading of expenditure.

Lower than budgeted indirect tax revenues and weak divestment proceeds are a source of worry. Net direct tax collections have reached the half way mark, with four months left this FY. These revenues typically improve towards the end of the year due to end-fiscal flows. Markets are less optimistic of a similar boost in indirect collections. The current run-rate of the centre's GST revenues is tracking a shortfall of ~INR700-800bn vs the annual budget. An equally big concern are divestment efforts, with year-to-date collections still at a fifth of the target of INR800bn. To jumpstart the process, plans are to offload minority stake sales, conduct share buybacks and ETFs by end-year, alongside a possible merger of power sector financing firms. A late push for additional dividends from state-owned entities and the RBI is also likely, with speculation that the central bank might transfer INR300-400bn (~0.2% of GDP) to the state's coffers, which will be in addition to the INR400bn assured in August 2018.

FY19 fiscal deficit run-rate vs past trends
% of Budgeted deficit target for the respective year



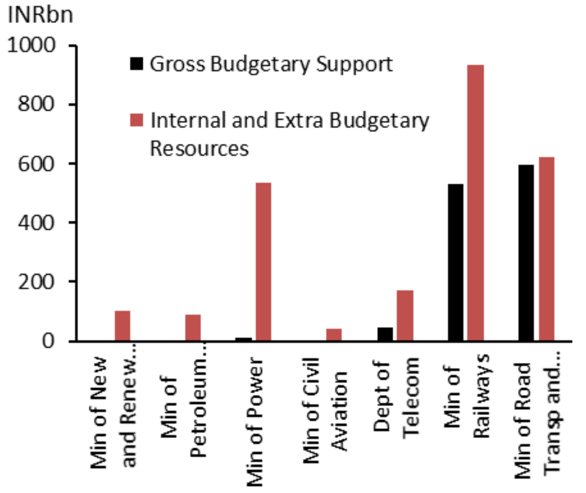
Source: CEIC, government statistics, DBS Group Research

Despite the downbeat year-to-date math, we think that a sizeable slippage in the fiscal deficit target is unlikely. As the accompanying chart highlights, ongoing deterioration is not completely out of sync with past trends. We also observe, in the chart above, that in recent years, the government has been proactive in jumpstarting expenditure earlier in the year, even if revenues catch-up at a much slower pace. To facilitate this process, the Budget presentation was also forward by a month to February. This has led the fiscal run-rate to worsen progressively for three-fourths of the year and then moderate in the final quarter as expenditure is curtailed and seasonal revenue flows kick-in.

Back to the FY19 math, spending data in November already points to a decline in revenue and capital sub-heads. Further expenditure compression is on the cards, helped also by the freeze that routinely takes effect in the final quarter of the year.

While a large miss on the quantitative target is unlikely, quality of the consolidation efforts will be questionable. Part of the fiscal adjustment in the final quarter might also entail help from one-off revenue sources, revisions to the budgeted economic indicators (higher nominal GDP makes deficits seem smaller), off-budget financing (see chart below), postponement of spending items (e.g. subsidies), and prevailing accounting methodology of cash vs accrual basis.

FY19-Off- budget resources take up part of the load



Source: Budget documents, DBS Group Research

Interim budget will be tabled in early February

The government has prioritised fiscal consolidation in recent years, but markets eye risks to the outlook. Routinely a vote-on-account is tabled in an election year, which is then followed by a regular budget presentation by the incoming administration. **Departing from this practise, the government might table an interim budget for FY20** [1]. Along with revised estimates for FY19, the Budget might lay out projections for FY20 and signal policy continuity, if voted back into power. An overview of the past five years' achievements and blueprint for the upcoming year is also expected to be a part of the announcement. The Economic Survey will reportedly be presented along with the full-term Budget in June/ July, post-elections. By convention, changes to the direct tax structure or amendments to the respective Acts are unlikely. **Around/at the budget, support measures for the farm sector and GST tweaks are likely.**

Immediate priorities will be to address rural distress and lower the economic pain from GST adherence. On the latter, the GST Council moved 23 items from the highest tax slab to 18% last month, along with plans to provide relief to micro and small medium enterprises (MSMEs) – via hike in exemption threshold, free accounting software and extension of composition scheme to service providers.

For the rural and farm sector, there might be directed support via one/ a combination of these measures: a) income payout and/ cash handout to bridge the gap between actual crop vs assured support prices (taking a leaf off Andhra Pradesh's Rythu Bandhu scheme); b) crop insurance scheme; c) interest-free crop loans. Press reports peg the annual costs of such benefits at INR2.3trn (1.2% of GDP), which will require the centre to share the cost burden with the respective states. Apart from these, bank recapitalisation funds, crop support prices etc. will also need more headroom.

If confirmed, the impact of these measures will be more apparent in the FY20 fiscal math. This will require the authorities to either set the fiscal target higher than the FRBM's suggested -3.1% of GDP or factor in 12.5-13% nominal GDP growth estimate vs FY19's budgeted 11.5%. We see the possibility of the FY20 deficit being pegged at -3.2-3.3% of GDP. On revenues, greater traction in GST revenues due to a wider tax base and improved compliance, and steady commodity prices will be factored in.

At a broader level, the government might reinforce that fiscal rationalisation will remain a priority if they return to power. Promises to follow-through with social spending plans and rural employment schemes will also accompany. Just as the central government deficit stabilises around -3.5% of GDP, India's consolidated deficit remains elevated. State fiscal deficits have been higher than the 3% FRBM threshold for the past three years and is likely to extend into FY19. This in turn will keep India's general government deficit levels elevated at 6.5% of GDP in FY19 and 6.2% in FY20.

Notes:

[1] Local press reports: Mint, Financial Express and others

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).