Economics

DBS Flash

India budget: pro-consumption bias

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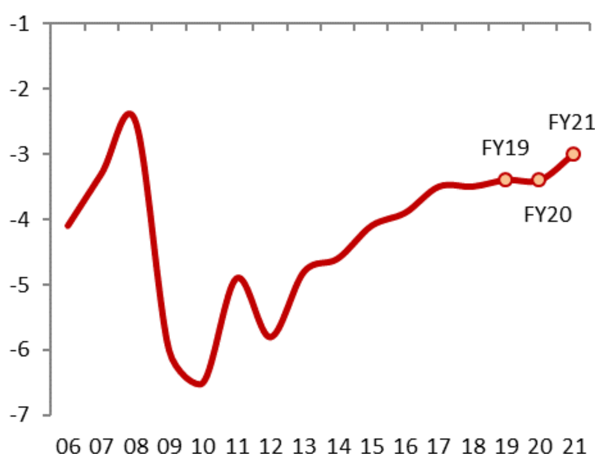
- *Ahead of general elections, India's interim Budget for FY20 carried a strong consumption focus, concentrated on the rural/agricultural sector, sops for the middle class and workers, along with a broader social push.*
- *A recurring direct income support (~0.4% of GDP) was outlined for the small and marginal farmers.*
- *There was a marginal slippage in the FY19 and FY20 fiscal deficit targets, resulting in a higher borrowing quantum.*
- *The underlying math points to aggressive revenue assumptions, including for indirect collections.*
- *We also note that this Interim Budget holds till July 2019, when a full-year budget is likely to be tabled.*
- *The consumption-push and growth stimulus will be positive for growth, but limits scope for a monetary easing cycle.*
- *Regardless of the outcome of the forthcoming elections, India's political-economy is attaining modern welfare dimensions—direct cash transfer, universal basic income, and jobs provisions.*
- *As was the case with the 2014 elections, when despite a change in government, impetus for GST, financial inclusion, and fuel subsidy reduction did not waver, we expect some of the new welfare measures to take shape independent of the election outcome.*

Ahead of the general elections due in April-May this year, India's interim Budget for FY20 carried a strong focus on the rural/agricultural sector, sops for the middle class and workers, along with a broader social push. There was a marginal slippage in the FY19 and FY20 fiscal deficit targets, resulting in a sharp increase in the borrowing quantum.

On balance, Friday's announcements suggest that the economic priorities have taken precedence over near-term fiscal consolidation as the 3% of GDP fiscal target stands delayed. The consumption-push and growth stimulus will be positive for growth, but limits scope for an aggressive monetary easing cycle. We also note that this Interim Budget holds till July 2019, when a full-year budget is likely to be tabled, after the general elections.

The underlying fiscal math

The outgoing year and FY20 marked a modest fiscal slippage. The government revised up the FY19 fiscal deficit at -3.4% of GDP vs -3.3% in the budgeted estimate. This was broadly in line with our expectations where -3.5% was seen a red line for any deterioration in the math. The slippage is more notable for FY20, to -3.4% vs -3.1% laid out in the roadmap, built on a 11.5% nominal GDP growth projection.



Source: CEIC, DBS Group Research

Refer to important disclosures at the end of this report.

Highlights of the fiscal math

INR bn	FY1819 RE	FY1920 BE	FY1819 % of GDP	FY1920 % of GDP
Revenue receipts	17297	19777	9.2	9.4
Gross Tax revenues	22482	25521	11.9	12.1
Less - State's share and contingency firms	7638	8471	4.1	4.0
Net Revenue receipts	14844	17050	7.9	8.1
Non-tax revenues	2453	2726	1.3	1.3
Capital Receipts	7276	8065	3.9	3.8
Recovery of loans	132	125	0.1	0.1
Misc capital receipts (includes divestment)	800	900	0.4	0.4
Debt receipts	6344	7040	3.4	3.4
Total receipts	**24572**	**27842**	13.0	13.3
Revenue expenditure	21406	24479	11.4	11.7
Compensation to employees				
Interest payments	5876	6651	3.1	3.2
Subsidies	2987	3338	1.6	1.6
Capital expenditure	3166	3363	1.7	1.6
Total expenditure	**24572**	**27842**	13.0	13.3
Fiscal balance	**-6343**	**-7041**	-3.4	-3.4
Revenue Balance	**-4109**	**-4702**	-2.2	-2.2
Primary balance	**-467**	**-390**	-0.2	-0.2
Primary balance (excl one-of	**-1267**	**-1290**	-0.7	-0.6

* RE - revised estimate; BE - Budgeted estimate

Source: Budget documents, DBS Group Research

The breakdown reveals that the government has built in aggressive revenue assumptions in FY20, but nominal growth assumption is realistic at 11.5%. As a percentage of GDP, gross tax revenues are forecasted to improve by 0.2% of GDP, with the bulk of the lift seen coming from higher income tax collections as well as GST revenues. Firstly, the centre's GST revenues fell short by INR1trn in FY19 compared to budgeted estimates, despite which an INR1.1trn increase in built into the FY20 receipts (from INR5.03trn to INR6.1trn). Recent reduction in GST rates, higher thresholds and wider umbrella of tax payers under the composition scheme are also likely to slow collections further in FY20. Secondly, income tax revenues are also projected to improve, factoring in a wider tax base and improved compliance. Under other revenue heads, excise duty collections are expected to moderate as oil prices ease and past tax cuts bite. Notwithstanding the year-to-date disappointment over divestment proceeds, FY20 budgets a target of INR900bn vs INR800bn in FY19 (with actual collections at a third). Dividends and profit transfers from the RBI and other public sector entities, is projected to increase marginally from INR1.2trn to INR1.4trn.

With lack of fresh revenue generating measures in the interim budget, much of the funding is likely to arise from higher markets-based borrowings (see table in the final section of the note).

Higher revenue projections are meant to plug an increase in spending requirements**, as the government adopted a pro-consumption focus in the Interim Budget**. Sops were announced for the rural/ agricultural sector, tax benefits for the middle class/ workers and retaining a broader social push.

Amongst the highlights was a strong attempt to address rural distress through a direct income transfer, under the aegis of Pradhan Mantri Kisan Samman Nidhi (PM KISAN). This will target marginal and small landholding farmer families, having cultivable land of up to 2 hectares (implying tenant farmers will be excluded). Pegged at INR6000/annual support is likely to be transferred directly into the beneficiary's bank accounts, in equal three instalments, and intended to reach 120mn recipients. At a cost of INR750bn/ annual, it accrues to 0.36% of GDP in FY20 terms, with the ball set rolling by an INR200bn (0.1% of GDP) allocation in FY19. Prima facie, the support program is more measured than earlier feared, particularly setting aside concerns over a nationwide farm loan waiver, which ran the risk of impacting credit behaviour and distorting markets. This income support scheme is seen as a boost to lift rural consumption, however, might pose implementation challenges, about targeting beneficiaries and receiving updated land ownership records.

Other support measures are highlighted in the next sub-section. The overall expenditure is slated to increase by 0.3% of GDP, primarily on account of higher revenue expenditure, whilst capital spending is expected to decline by 0.1% of GDP.

The primary deficit (excluding one-off revenues) is budgeted to narrow by a modest 0.1% of GDP in FY20, suggesting a mildly contractionary budget, which will be a challenge in an election year.

Highlights of key measures

(the complete list can be found here)

Rural, farm and allied sectors: Apart from the previously announced Minimum Support Prices (MSPs) increases and efforts for effective procurement, the PM Kisan package (explained above) was unveiled. Separately, INR190bn has been set aside for the rural roads scheme. Interest subvention of 2-5% for farmers hit by natural calamities. Additional 2% interest subvention is likely to be provided to farmers pursuing the activities of animal husbandry and fisheries, who avail loan through Kisan Credit Card. Timely repayment makes up eligible for an additional 3% interest subvention.

Labour markets/ unorganised sectors: In a bid to provide better social sector benefits to the unorganised sector employees, in addition to the health coverage provided (under Ayushman Bharat), life & disability coverage (under Pradhan Mantri Jeevan Jyoti Bima Yojana), a mega pension was unveiled, named as the Pradhan Mantri Shram-Yogi Maandhan. A measured allocation of INR5bn has been made towards this scheme.

Taxation/real estate: Personal income tax slabs were left unchanged but individual taxpayers with taxable annual income up to INR500k will be given get full tax rebate. Subsequent official remarks suggest that tax paid this year with be set-off against the tax payable in FY20. In addition, standard deduction thresholds have been raised. On the real estate end, exempt levy of income tax on notional rent on a second self-occupied house has been exempted. The period of exemption from levy of tax on notional rent, on unsold inventories, stands extended to two years, from the end of the year in which the project is completed.

Financial sector/ banks: Three banks have been taken out of the Prompt Corrective Action framework (PCA). The Budget speech did not contain an outright allocation for the banks' recapitalisation funds.

Defence spending: The budget has been increased notably to INR3trn in FY20, from INR2.95trn and INR2.7trn in FY18. This also includes an increase in outlays towards the One Rank One Pension (OROP) scheme.

An ambitious **10-year roadmap** to improve the ease of living was also unveiled, which including social infrastructure, digitalisation, pollution control, achieving self-sufficiency in food, amongst others.

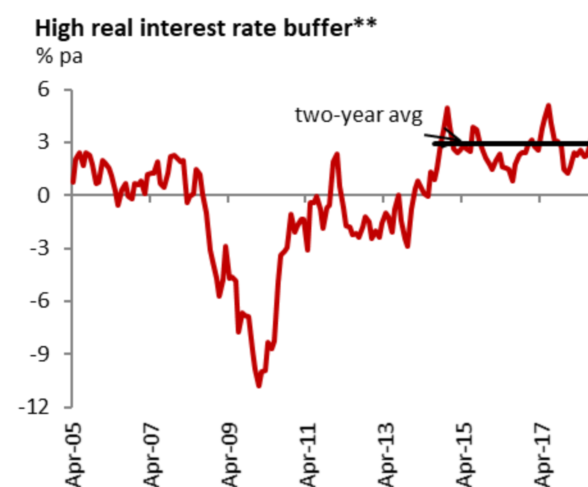
Policy implications

Domestic bond markets were watching the borrowing program with trepidation and a sharp increase in the gross borrowing program saw the long-term yields jump in response on Friday. Gross market borrowings are slated to rise to INR7.1trn (excluding switching) from a revised INR5.7trn in FY19.

INR bn	FY1718 Actuals	FY1819 BE	FY1819 RE	FY1920 BE
Market loans (net)	4507	4621	4227	4731
Repayments	1373	1435	1483	2369
Buyback	415	719	-	500
Switching	592	281	281	500
Gross market loans	6296	6775	5710	7600

Source: Budget documents, DBS Group Research

On policy, the Reserve Bank of India is likely to factor in today's modest fiscal slippage at its 7 February review. **Nonetheless, with the broader fiscal targets not deviating sharply from the consolidation path, we expect the RBI to priortise its price stability mandate.** Inflation has been downbeat this year; CPI inflation fell from 4.9% YoY in April-May 2018 to 2.2% in December, mainly due to disinflation in the food segment. The trend is likely to be benign at 2.0-3.0% in the coming months, opening the door for the RBI to shift from 'calibrated tightening' to a 'neutral' stance at next RBI review next week.



We expect rates to be on pause in rest of 2019, albiet we acknowledge rising odds of rate cuts. The wide cushion on real rates vs the region also provides the RBI with sufficient justification. That said, the pro-consumption bias in the FY20 budget might be seen as a lagged risk to the core inflation outlook and thereby limiting the scope of a rate easing cycle. We will watch the central bank's commentary closely gauge their assessment of domestic and external risks, which will reveal whether they see the need to shift to a dovish bias or stay cautious given the likelihood that headline inflation will move back towards 4% by end-year.

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

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