



## *2019 Interim Budget: Walking the fiscal tightrope*

*HDFC Bank  
January 2019*



With the outcome of the recent assembly elections, rural distress has emerged as a key pressure point. With six states going into polls along with the Lok Sabha elections in 2019, fiscal priorities could, see some rejig in the FY20 budget.

Announcement of populist measures without the adequate fiscal space may create stress on both Centre's as well as states' finances, going forward.

As per the current available data (till Nov'18), India's fiscal deficit has already breached the budgeted target and touched 114.8% of BE. At the same time last year, the deficit was 112% of the full-year target.

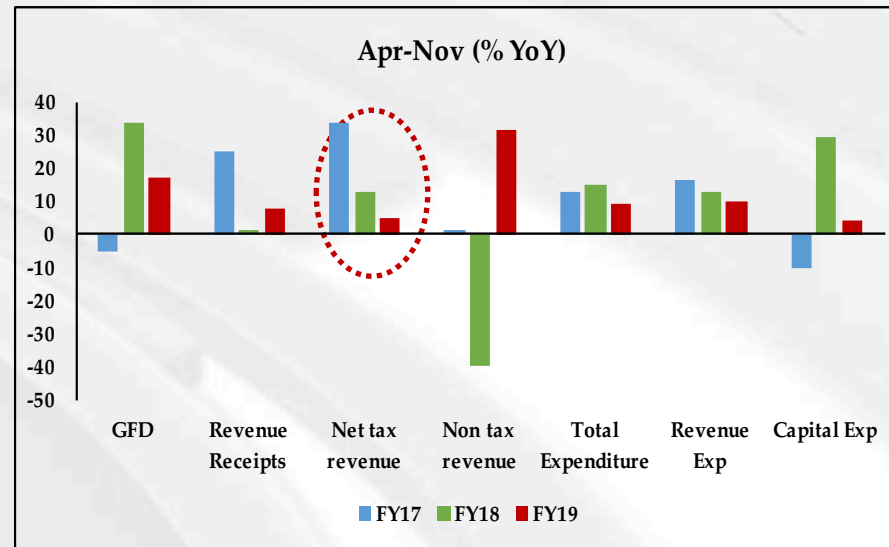
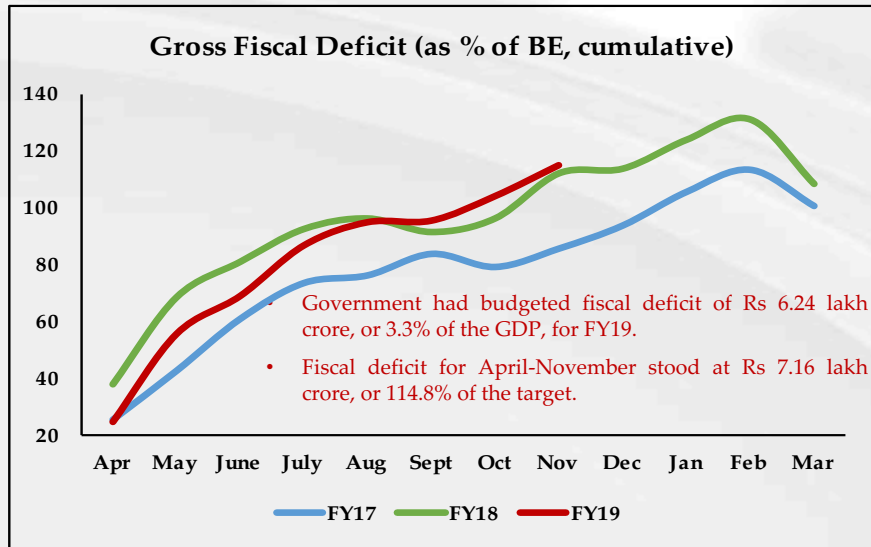
While there will likely be a slippage on the indirect tax side, improved buoyancy in direct tax collection, possibility of interim dividend payout by the RBI and higher than budgeted disinvestment proceeds could come as a buffer. The expenditure side seems largely on course as of now but the quality of expenditure could take a hit.

**While central government's finances remain tight, state governments' finances are relatively in a better position with their GFD-GDP ratio being 1.8% in H1 2018-19 vis-à-vis the budgeted target of 2.6%. Moreover, given that states generally undertake capital expenditure in the second half of fiscal, an increase in the capital expenditure might also be witnessed in H2 of 2018-19 on the states' side.**

**Net - net the government is expected to meet its deficit target of 3.3% of GDP in FY19. While, uncertainty looms with regard to FY20 deficit target, we expect it to be broadly the same as that of FY19's – at 3.25% of GDP. While gross market borrowings are expected to go up by 10% in FY20, net impact on the market is unlikely to be significant given large redemptions.**



- The fiscal deficit touched 114.8% of the full-year estimates at the end of November, marking a deterioration relative to 112% recorded in the same period last fiscal.
- While the expenditure largely remained on course (at 66.1% of BE), subdued tax receipts (on indirect tax side) largely contributed toward bloating the deficit (net tax receipts were only 49.4% of estimates compared with 57% last year. ).
- Disinvestment proceeds have also been a bit off the mark but are likely to catch up to meet the FY19 BE in the remaining four months
- Non tax revenue, on the other hand, have been buoyant and are likely to provide an offset

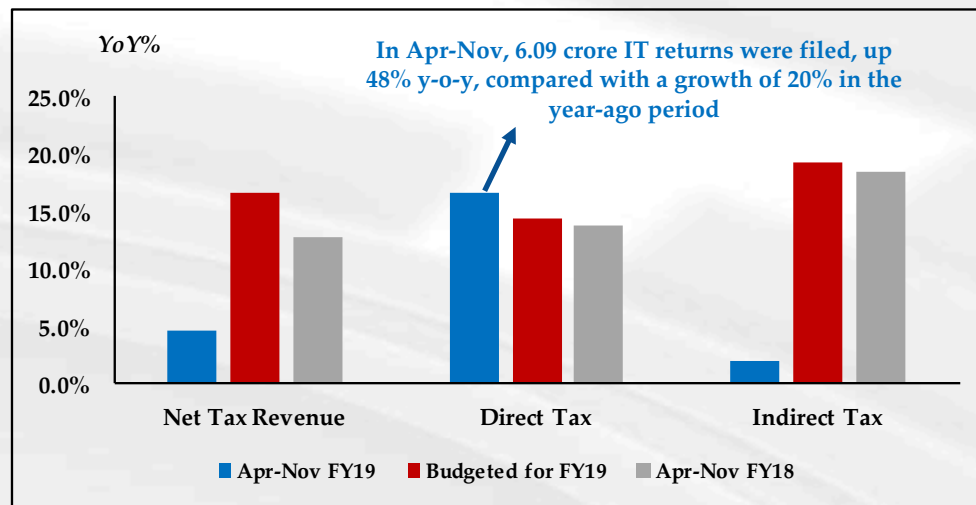


As % of BE		
Apr-Nov	FY19	FY18
Revenue Receipts	50.4	53.1
Tax Revenue	49.4	57.0
Non Tax Revenue	56.6	36.5
Non debt capital Receipts	28.5	73.3
Total Receipts	49.3	54.2
Total Expenditure	66.1	68.9
Revenue	66.4	70.5
Capital	63.8	59.5
Fiscal Deficit	114.8	112.0

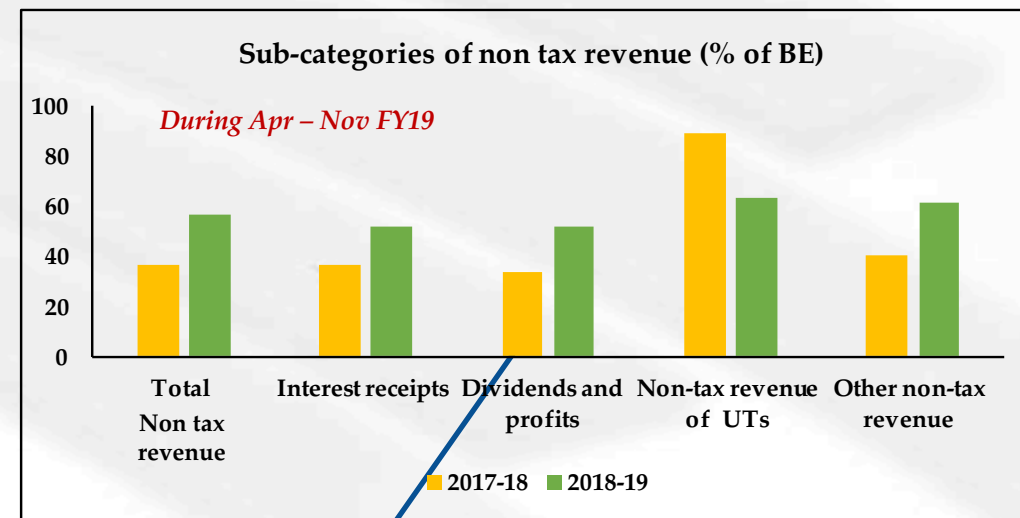
# Shortfall mainly in tax revenues.....non tax revenues to provide an offset

During Apr-Nov 2018, net central tax receipts are at INR 7.32 tn, just 4.6% higher than last year, and well below the 16.6% growth budgeted. At this pace, the center is looking at a revenue shortfall of INR 1.8 tn or 0.96% of GDP, assuming other things equal.

## Higher than budgeted direct tax collections could come as a buffer



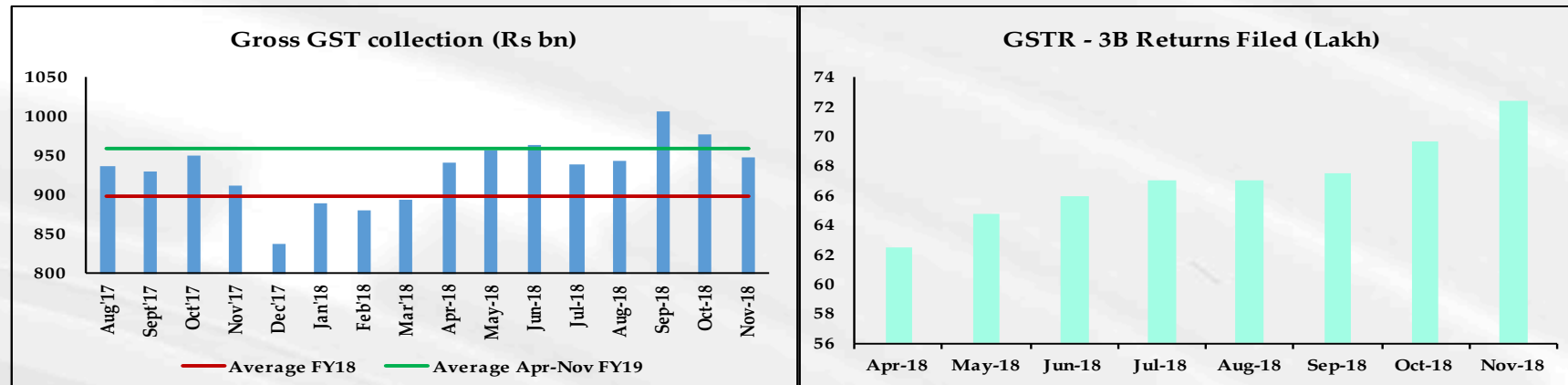
- Within the direct taxes, corporate tax collections have been more buoyant - 16.6% YoY increase during Apr-Nov FY19 as compared to 12.4% last year.
- Income tax collections are coming in slightly higher than last year - 16.4% YoY in eight months of FY19 compared to 15.3% last year.
- Estimated buffer on account of direct tax receipts - Rs 300 bn



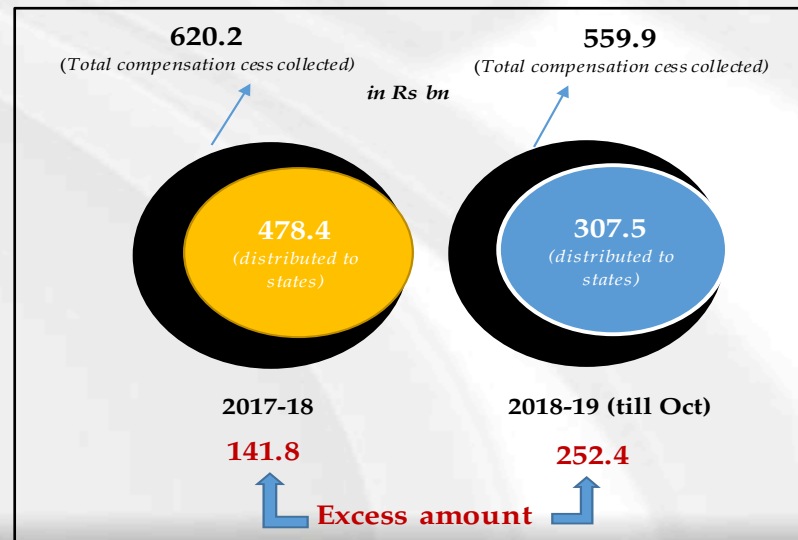
- Receipts on the non-tax revenue side could come as a buffer- the RBI has already transferred a surplus amount of Rs 50,000 cr as against Rs 30,659 cr in FY18.
- As per media reports, the government may seek to get interim dividend of Rs 300-400 bn from the RBI. The exact buffer on this category, however, remains uncertain at this stage.

# Despite a pick up in FY19, GST collections are likely to fall short of the target

- There could be Rs 700 bn – Rs 1 tn shortfall in the overall GST collections (states' + centre) compared to the projections of over Rs 12 tn for FY19. Out of this, the Centre's exchequer could face Rs 300-400 bn of shortfall.
- Further, GST collections could come under some pressure due to cuts in the rates of 22 items in December.
- However, improved compliance, as well as some buffer coming from the compensation cess, may partly come to the rescue



The Centre is expected to get roughly Rs 200 bn from the excess amount of the compensation cess collected



Due to an improvement in compliance, the overall GST revenue deficit for states has come down to 10% in April-November 2018 from 20% in the August 2017-March 2018 period (to be viewed against the 14% y-o-y growth target set under the GST compensation law).

Revenue position for consuming states is gradually improving

GST Revenue Shortfall (%)		
State/UT	Aug'17 to Mar'18	Apr'18 - Nov'18
<b>Shortfall dropping/surplus</b>		
Andhra Pradesh	7	-2
Uttar Pradesh	12	7
West Bengal	13	9
Madhya Pradesh	26	17
Bihar	38	20
Karnataka	22	21
<b>Shortfall rising</b>		
Goa	23	25
Delhi	6	21
Tamil Nadu	4	6
Maharashtra	3	5
Punjab	37	37
Kerala	16	16
Gujarat	14	14

Producing states

### State-wise performance

- 6 states have already achieved the target – e.g. Mizoram, Arunachal Pradesh, Manipur, Telangana and Andhra Pradesh.
- 7 are within a striking distance of achieving it (deficit is in the range of 1-6%) – Maharashtra, Sikkim, UP, West Bengal, Tamil Nadu, Nagaland, Assam.
- 18 are still more than 10% away from achieving it (deficit more than 10%) - worst performing states are Punjab, Uttarakhand, Himachal Pradesh and Puducherry where the deficit is over 25%

### Reasons for such a varied performance....

- Differentiated taxation capacity
- End in tax arbitrage that used to benefit certain states (valid for UTs such as Puducherry) earlier.
- Subdued collections from services (valid for Bihar & HP)
- Low compliance in states like Uttarakhand

As per media reports, the government may consider extending the compensation period for the states against their revenue losses by another three years. Earlier, the states were supposed to receive compensation for first five years since the implementation of GST in 2017, that is, till 2022. This could now be extended to 2025.





**While some of the below changes have helped to stabilize the GST regime in FY19, these remain “work in progress”**

## **Rate structure simplified**

List of items under the 28% GST rate has been pruned.

Moving from 5 slabs to possibly 3 over the next couple of years

Positive effect - reduction in disputes over classification

## **Improved compliance mechanism**

A higher threshold of Rs 1.5 cr per annum for SMEs, without input credit entitlement and consequent paperwork.

A new simplified compliance process is being worked out – pilot expected to start from April 2019

## **Some of the operational challenges addressed**

Doing away with the requirement of paying tax under reverse charge mechanism upon purchases from unregistered suppliers.

Levy of GST on advance payments has been withdrawn

## **Important legislative changes proposed**

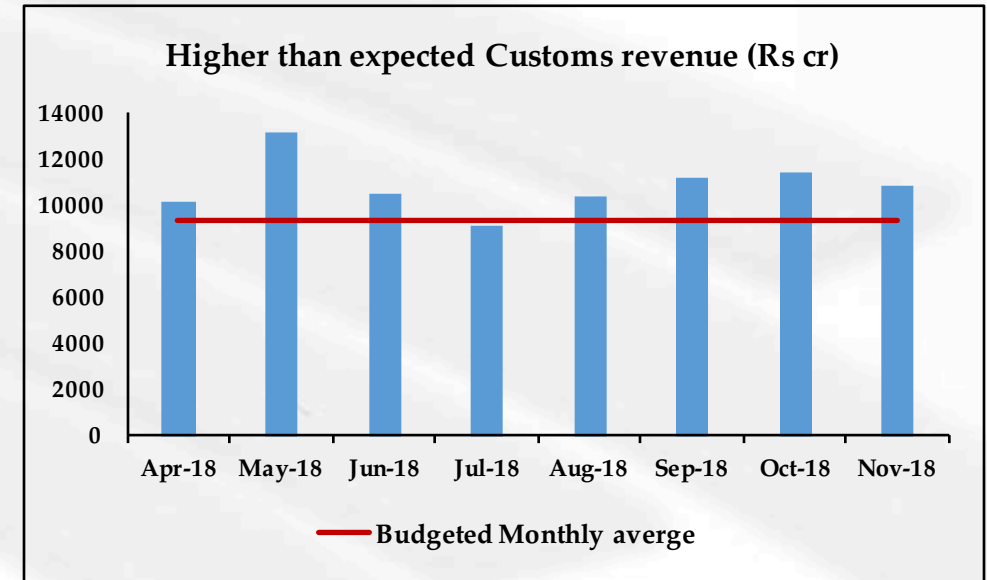
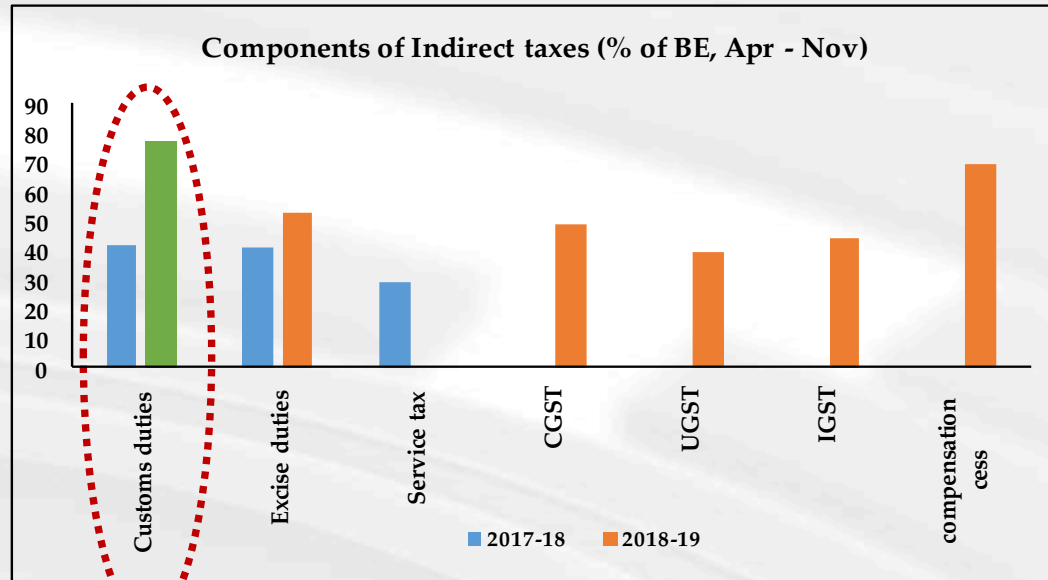
Doing away with the requirement of input credit reversal in case of high seas and in-bond sales.

Removing the ambiguity on taxation w.r.t. billing from an Indian office to overseas office of a same entity.

Widening of the ambit of input tax credit provisions.

## **Managing a federal structure with a centralized approach**

The GST council decided recently to create a centralised body to address a situation where different states take contrary views on same issue.

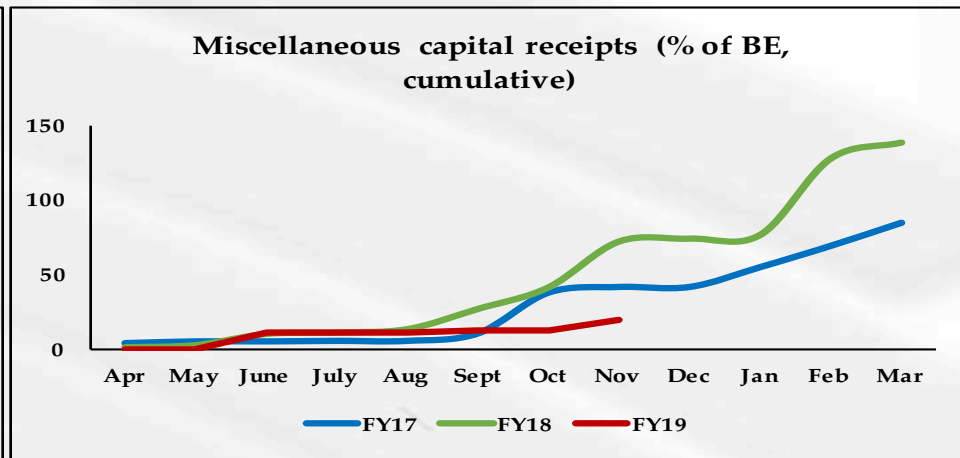
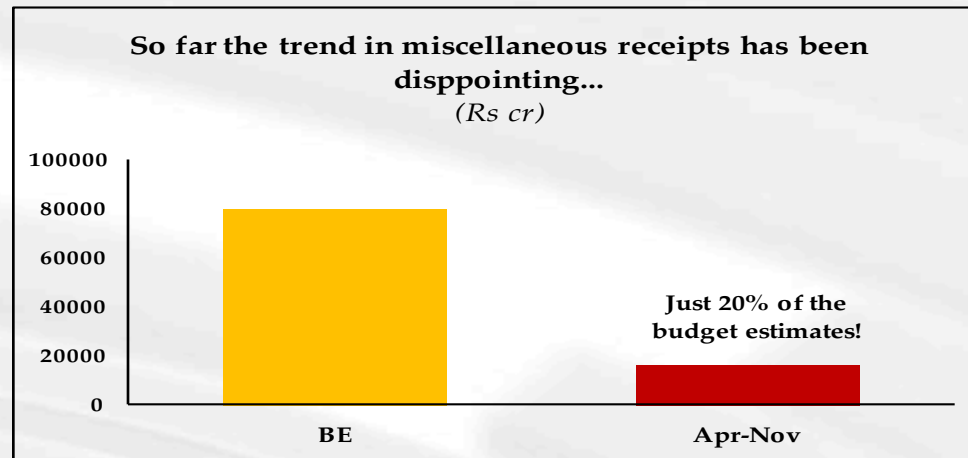


- Against a budgeted monthly expectations of about Rs 94 bn from Customs revenue, actual realization has remained healthily above Rs 100 billion for each month during Apr-Nov FY19, barring July.
- More importantly, H2 of the financial year could see even better revenue from Customs, given the rupee has stabilized at a level higher than the average level in the first half and that higher custom duty rates (rates were hiked in Aug & Oct) would be fully applicable as opposed to gradual rise in rates of different commodities in H1.
- Overall, given the current run rate and expectations for the remaining four months, custom duty collections could exceed the target by Rs.100-150 billion.



# Disinvestment challenge: Government to exceed the target?

While the current trend in disinvestment receipts is disappointing, collections could go up if they follow previous years' trend

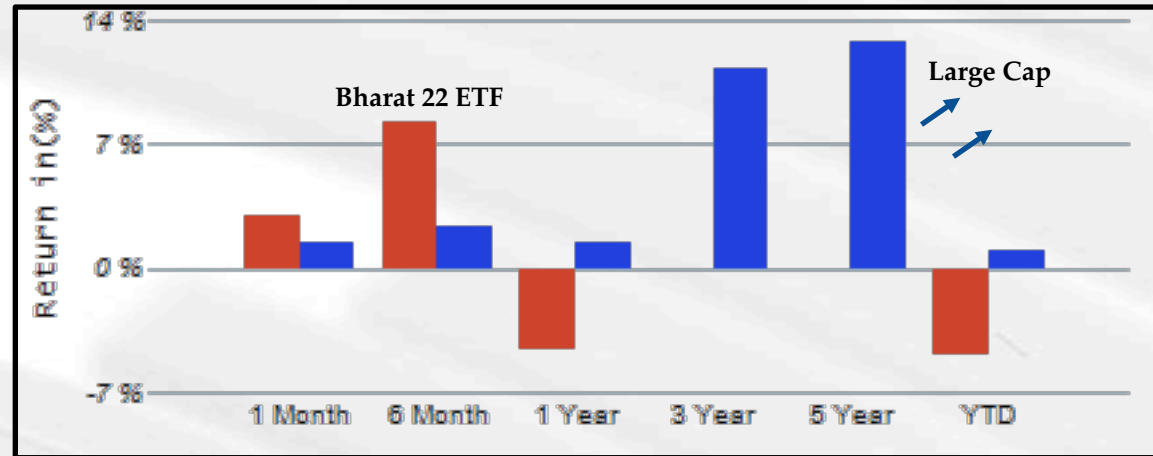


## A plan in place!



- PFC-REC deal to fetch around Rs 140-150 bn
- Another offering of Bharat-22 ETF could get about Rs 100 bn
- NTPC acquisition of the Centre's 63.7% stake in SJVN Ltd
- Strategic sales of Dredging Corp, Scooters India, Pawan Hans, AIATSL (Air India's ground handling subsidiary), and Central Electronics this year
- IPOs of Mazagon Docks, MSTC, rail companies RVNL and IRFC (in which 10% each will likely be divested)
- State-owned companies buying back shares - Rs 120 - 150 bn.

Over one year, the performance of the Bharat 22 ETF at -6.6% as against up to 7% from BSE Sensex and its competitors for the same period doesn't inspire confidence

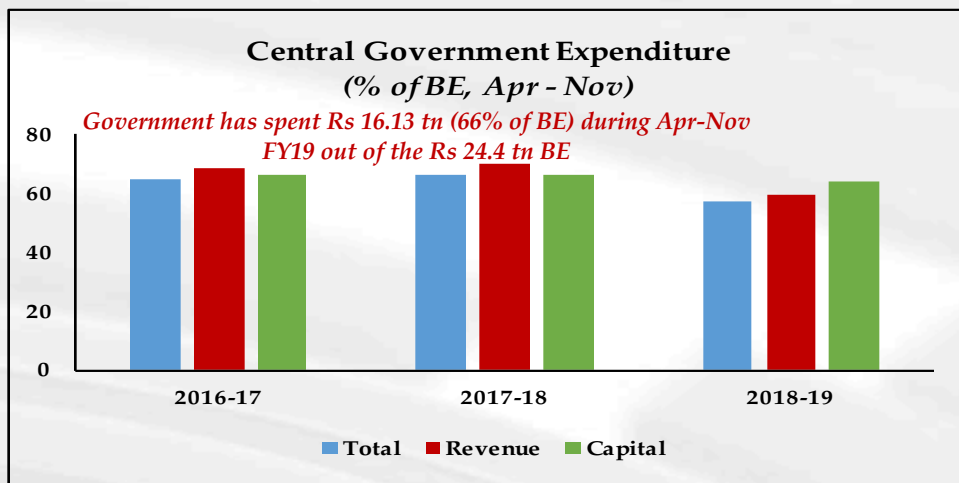


- Bharat 22 ETF was launched in November 2017 and was a modest debut on the bourses with around 4% gain on exchanges.
- Bids of nearly Rs 32,000 crore came in, with foreign portfolio investors bidding for one-third of the money.
- An allotment of Rs 14,500 crore was made to investors against an initial issue size of Rs 8,000 crore
- However, within six month, the fund's assets under management came down to Rs 5,500 crore, which suggests that its initial popularity waned with some investors redeeming within months of its launch. The fund currently has assets under management of Rs 5,191 crore (9 Jan 2019).

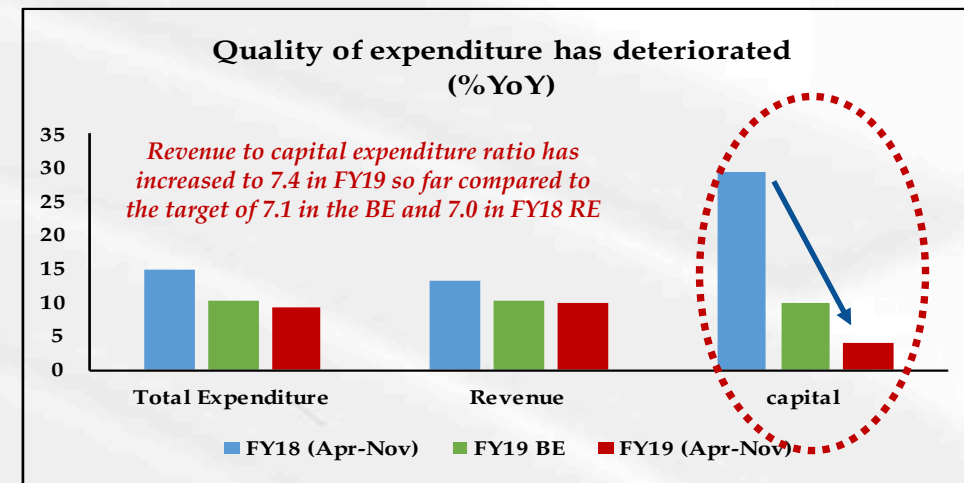
However, performance of the ETF may not have a material impact on the next round of its subscription

# Meanwhile, government's expenditure largely remain on course....but with a dent on quality

For now, the expenditure side looks comfortable and broadly in line with the BE



But the quality of expenditure has been impacted...



The second half looks more tricky....

- ❖ **Past trends remain inconclusive:** In our analysis of expenditure patterns of the last couple of years, no definitive trend has been observed with regard to expenditure over H1 and H2. For instance, capital expenditure picked up sharply in Q3 FY18 but fell sharply in Q4 – leading to an overall fall in total expenditure over H2 FY18 compared to H1. Exactly opposite was observed in FY17.
- ❖ **Fiscal profligacy on account of political compulsions unlikely:** Historical evidence has again been inconclusive on this hypothesis as well (expenditure went up during NDA-1 & UPA-I period but declined during UPA-II). Moreover, given that serious fiscal constraints looms, the government, in our opinion, is unlikely to go the fiscal profligacy path.
- ❖ **Overall a cut in productive expenditure?:** If we assume the current run rate of capital expenditure to continue for the remaining 4 month of FY19 (assuming ceteris paribus), we could a shortfall of about Rs 260 bn in capital expenditure from the BE. **Our base case** – Even if the capital expenditure picks up during Dec-Mar FY19, it is unlikely to meet its budgeted target, leading to some compression in the productive spend.

## Ultimately boils down to slippages and offsets within ministries



As part of government's expenditure management, ministries can not spend more than 33% of expenditure in the last quarter and 15% in the last month of the financial year.

As % to BE (Apr-Nov)		
	2017-18	2018-19
Some ministries which are under spending compared to last year		
Ministry of coal	61.5	59.9
Ministry of communications	83.0	76.4
Ministry of consumer affairs, food and public distribution	92.3	83.0
Ministry of corporate affairs	75.3	60.8
Ministry of development of north eastern region	56.9	38.1
Ministry of finance, of which	61.5	56.9
Ministry of food processing industries	48.5	31.1
Ministry of human resource development	63.9	46.5
Ministry of mines	70.7	58.4
Ministry of parliamentary affairs	65.0	58.4
Ministry of women and child development	63.7	57.6
Ministry of youth affairs & sports	50.5	39.3
Some of the ministries which are over spending compared to last year		
Ministry of agriculture	67.9	70.2
Ministry of chemicals and fertilisers	70.7	76.2
Ministry of civil aviation	78.6	83.5
Ministry of electronics and IT	66.5	72.9
Ministry of external affairs	57.9	68.4
Ministry of health and family welfare	67.1	70.7
Ministry of home affairs	71.5	74.9
Ministry of power	51.9	74.3
Ministry of shipping	58.0	76.9
Ministry of steel	58.9	72.7
Ministry of road transport and highways	71.8	75.5
Ministry of railways	58.1	60.0



## Managing the optical deficit

### Slippages



Rs 300-400 bn shortfall in Centre's GST collections

Around Rs 400 - 500 bn additional expenditure (oil subsidy, higher MSPs, Ayushman Bharat, overspending in some ministries) over and above the budgeted amount

Rs 200 bn from **GST compensation cess** corpus

Rs 300 bn **overshoot** in direct tax collections

Rs 50 bn excess in **disinvestment proceeds**

An expected Rs 300-400 bn in **interim dividend by the RBI**

**Savings from ministries**, which have underspent (e.g. Ministry of Women & child development)

Usual **accounting tweaks** (deferring payments)

### Offsets



- Overall, at the moment, we are not building in a scenario of a fiscal slippage on government GFD target of 3.3%.
- While prima facie, this may seem like a “no risk” scenario for the markets, incoming news flow on the possible accounting tweaks could keep investors on the sidelines.
- Credibility of fiscal statistics will be as important as adherence to the budgeted fiscal targets.

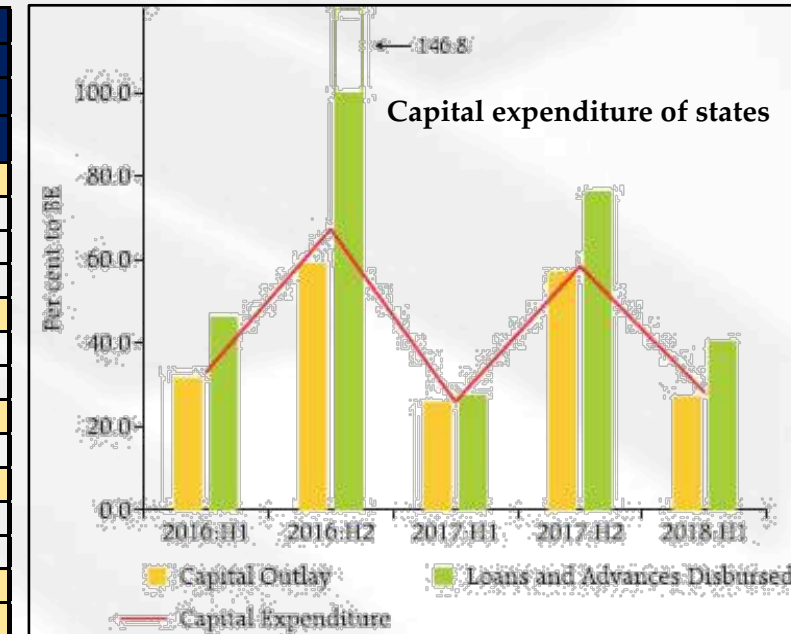


# Growth impulse through higher expenditure in H2 likely to come from states as Centre's finances remain stressed

Combined revenue expenditure (of 24 states) is still less than 50% of BE in H1, and scope exists for higher expenditure in H2 with their GFD-GDP ratio being 1.8% in H1 2018-19 vis-à-vis the budgeted target of 2.6%.

Moreover, it has been observed that states generally undertake capital expenditure more in the second half of fiscal. Given this, an increase in the capital expenditure might also be witnessed in H2 of 2018-19 on the states' side.

Budgetary Position of States during April-September, 2018								
	₹ billion				(Per cent)			
	Actuals		Budget Estimates		Per cent to BE		Growth Rate	
	Apr.-Sept, 2018	Apr.-Sept, 2017	2018-19 BE	2017-18 BE	Apr.-Sept, 2018	Apr.-Sept, 2017	Apr.-Sept, 2018	Apr.-Sept, 2017
<b>REVENUE RECEIPTS</b>	10160.6	8949	26064.9	23332.9	39	38.4	13.5	13.6
a) Tax Revenue	7682.2	6905.7	18837.7	16750.6	40.8	41.2	11.2	14.4
b) Non-Tax Revenue	725.8	585.5	2153.2	1862.8	33.7	31.4	24	14.1
c) Grant in aid and Contributions	1752.6	1458.2	5074.1	4719.5	34.5	30.9	20.2	9.8
<b>CAPITAL RECEIPTS</b>	79.7	21.2	591.2	490.9	13.5	4.3	276.4	-35.8
a) Recovery of Loans and Advances	71.9	20.6	579.3	489.1	12.4	4.2	248.9	-32.9
b) Other Receipts	7.8	0.6	11.9	1.8	65.4	30.9	1272.6	-75
<b>Revenue Expenditure</b>	10341.5	9248.4	25933.2	23324.9	39.9	39.7	11.8	13.2
Of which: interest payments	1048.7	995.6	2809.4	2578.1	37.3	38.6	5.3	17.2
<b>Capital Expenditure</b>	1493.3	1236.6	5290.6	4757.6	28.2	26	20.8	-19.1
(a) Capital Outlay	1346	1151	4928.1	4446.2	27.3	25.9	16.9	-13.3
(b) Loans and Advances disbursed	147.3	85.7	362.5	311.4	40.6	27.5	71.9	-57.1
<b>Revenue Deficit</b>	180.9	299.4	-131.7	-8.1	-137.4	-3712.2	-39.6	3.3
<b>Fiscal Deficit</b>	1594.6	1514.8	4567.7	4258.6	34.9	35.6	5.3	-15.1





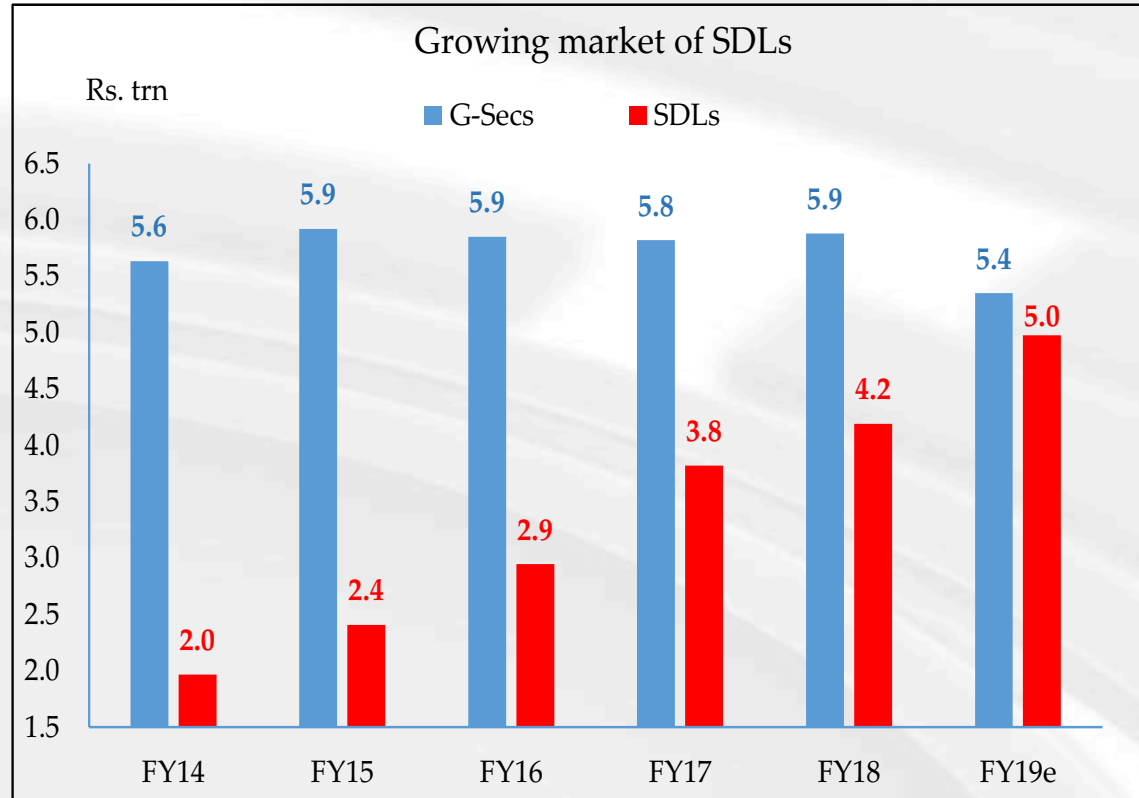


## Financing of Fiscal Deficit

	Rs crore		as % of GFD	
	2017-18	2018-19	2017-18	2018-19
	Apr - Nov			
<b>GFD</b>	6,12,105.0	7,16,625.0		
<b>External Financing</b>	7,949.0	-3,453.3	1.3	-0.5
<b>Domestic Financing</b>	6,04,156.4	7,20,078.8	98.7	100.5
<b>(a) Market Borrowings</b>	4,21,048.9	4,29,398.0	68.8	59.9
<b>(b) Securities against Small Savings</b>	49,835.4	45,396.6	8.1	6.3
<b>(c) State Provident Funds</b>	5,430.9	5,051.4	0.9	0.7
<b>(d) Special Deposits</b>	-176.7	-414.8	0.0	-0.1
<b>(e) National Small Saving Fund</b>	54,112.4	85,189.5	8.8	11.9
- i- Savings Deposit and Certificates	54,828.6	85,272.5	9.0	11.9
- ii- Public Provident Funds	18,893.9	17,389.3	3.1	2.4
- iii- Investment In Securities	-34,688.0	-37,712.8	-5.7	-5.3
- iv- Income/Expenditure of NSSF	15,077.9	20,240.5	2.5	2.8
<b>(f) Others</b>	-14,411.6	-8,041.0	-2.4	-1.1
<b>(g) Cash Balance {Decrease(+)/Increase(-)}</b>	4,123.0	944.1	0.7	0.1
<b>(h) Investment (-) / Disinvestment(+) of Surplus Cash</b>	84,194.0	1,62,555.0	13.8	22.7
<b>(i) Ways &amp; Means Advances</b>	0.0	0.0	0.0	0.0

## Market borrowings in Q4 to be driven by States

While central government has completed 78% of the planned borrowings so far, state governments have completed only 58% of the planned borrowings



Government Borrowings (Rs. Trn)		
	Centre	State
H1-FY19	2.9	1.6
H2-FY19	2.5	3.4
Oct-Dec	1.3	1.3
Jan-Mar e	1.2	2.2

**SDL:** State Development Loans (SDLs) are dated securities issued by states for meeting their market borrowings requirements. They are similar to G-Secs issued by the central government.

## Greater risks for next year's fisc?



- The 2019-20 interim Budget may not commit fully to future fiscal targets as 15th Finance Commission report expected in October 2019. The recommendations will kick in from fiscal 2020-21 – most important to watch out for will be tax devolution to the states.
- Fiscal deficit target for 2019-20 is 3.1% of GDP, according to the existing medium-term framework
- Government under pressure to push populist schemes aimed at the rural economy - Possibility of a universal or quasi-universal basic income transfer, first full year of Ayushman Bharat's implementation, possible dole out of more farm Loan waivers by other states
- Overall, we expect a similar fiscal deficit target for FY20 as for FY19 ~ 3.2 -3.3% of GDP

# Universal basic income: is it fiscally feasible?



- Under this welfare architecture, all existing subsidies are replaced by a single unconditional cash transfer
- Tentative estimates suggest that the exchequer could take a hit of Rs 600-700 bn a year with possible shareability with states.
- An estimated 90-110 million extremely small and marginal farmers (who own land) could be targeted in the pilot phase – *Telangana's "Rythu Bandhu"* costs around Rs 120 billion to support 5.9 million farmers.

## Does the government have the necessary fiscal space?

**Important considerations** – Coverage of population and the appropriate amount to be transferred

Economists' proposals on UBI			
	Amount/person (Rs)	Coverage	Cost to government (% of GDP)
Vijay Joshi	3500	Entire population	3.5
Pronab Bardhan	10,000	Entire population	10.0
Arvind Subramanian	7620	75% of population	4.9

## Can the government cut down existing subsidies to provide for a UBI?

- By eliminating all non-merit subsidies (5% of GDP), the government could support the type of cash transfer suggested by Subramanian (4.9% of GDP).
- However, out of the 5%, only 1.3% is accounted by the centre, rest is on account of states.
- Given political compulsions, unwinding of existing schemes may prove to be a herculean task both for states and the centre.

# Recently announced relief measures for the rural economy likely to keep the revenue expenditure high

## Recent loan waiver/relief measures announced by the state governments

States	Measures announced	Estimated cost
Assam	<b>Debt relief scheme</b> - writing off 25% of the loan availed by a farmer (max limit Rs. 25,000) through Kisan Credit Card and PSBs.	Rs. 6.0 bn
	<b>Interest relief scheme</b> - farmers to avail crop loans at zero interest rate from FY2020.	NA
Chhattisgarh	<b>Crop loan waiver</b>	Rs. 61.0 bn
	<b>Increase in MSP of paddy</b> from Rs. 1,700 per quintal to Rs. 2,500 per quintal	NA
Rajasthan	<b>Short term crop loan waiver</b> from cooperative banks and of loans of up to Rs. 0.2 mn from nationalized and other banks	Rs. 180.0 bn
Madhya Pradesh	<b>Waiver of short-term crop loans</b> from nationalized and cooperative banks of eligible farmers as on March 31, 2018	Rs. 350 -380.0 bn
Gujarat	<b>Electricity bill waiver</b> for people in rural areas	Rs. 6.5 bn
Maharashtra	<b>Relief package to onion farmers</b>	Rs. 1.5 bn
Jharkhand	<b>Mukhya Mantri Krishi Yojana</b> - transfer of Rs. 5,000 per acre to 2.3 million farmers from FY2020	Rs. 22.5 bn

- **Seven states have recently announced pro-poor/farmer relief measures** - going by past trends, spending might be staggered over next couple of years.
- However, **this may lead to further stress on revenue expenditure** (already pressured by staggered implementation of the pay revision and funding of previous loan waivers by some states).
- **Risk of continued pre-election dole outs** - elections to be held in six states (Andhra Pradesh, Maharashtra, Odisha, Haryana, Sikkim and Arunachal Pradesh) in 2019, in addition to the Lok Sabha elections.
- **May lead to a cut in productive expenditure or an increase in borrowings.**





## Government's allocation on major health schemes

Rs crore	Actual 2016-17	RE 2017-18	BE 2018-19
Pardhan Mantri Swasthya Suraksha Yojana	1953.2	3175.0	3825.0
National Health Mission	22454.4	30801.6	30129.6
Rashtriya Swasthya Bima Yojna	465.6	470.5	2000.0

- For FY19, the health ministry has estimated a total expenditure of Rs 60 bn for the scheme, compared to Rs 20 bn allocated in the BE. Out of this, 60% will come from the Centre and 40% from the states.
- For FY20, the scheme's total annual requirement (states +centre) is projected at Rs 120 bn
- Education and health cess alone may not be able to sustain the scheme
- For the Budgetary support, the plan is to merge similar existing schemes (for instance, RSBY) into the Ayushman Bharat.
- So far, 5.29 lakh hospitalization claims have been filed under the scheme worth about Rs 684.6 cr with an average hospitalization cost working out to be Rs12,932 per patient, higher than Niti Aayog's estimate of about Rs 10,000.
- This cost may come down as the scheme matures. However, operational costs on account of frauds, excessive diagnostics, overcharging, etc. that may come with fuller implementation, may have a bigger draw down on government's funds than as is currently anticipated.



## FY20 market borrowing expectations



- Assuming the fiscal deficit at 3.25% of GDP in FY20, gross borrowings could be in the range of Rs. 6.0 – 6.2 trn, that is around 10% higher than the gross borrowings in FY19
- However, given the large number of redemptions in FY20, the net impact on the market is unlikely to be significant. Net borrowing could remain broadly unchanged at around Rs. 3.6 trn

Our Assumptions		FY20 Redemptions (G-Secs, Rs. Bn)	
Rs crores	FY20		
Nominal GDP	2,10,63,937.3	Jun-19	640
Fiscal Deficit	6,84,578.0	Jul-19	428
FD as % of GDP	3.25	Aug-19	60
		Jan-20	1350
		<b>Total</b>	<b>2478</b>

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