Angel Broking

UNION BUDGET

2019-20 PREVIEW

Slowdown post IL&FS crisis warrants further stimulus

Given recent slowdown in the economy there are expectations from the final budget would contain further stimulus measures to boost the economy. With the RBI finally realizing that inflation is subdued they have cuts rates by 75bps so far in 2019. However transmission of policy rate cuts has been an issue and so far there has been negligible transmission given tight liquidity conditions.

Tight fiscal and monetary policy over the past few years coupled with major structural changes have taken a toll on growth which was further exacerbated post the IL&FS crisis and its fallout. This is reflected in high frequency numbers like IIP and auto sales numbers as well as the GDP numbers which slowed down to 5.8% in Q4FY19 from 8.0% in Q1FY19.

Government sticks to fiscal deficit target in FY19 through sharp cutback in expenditure

Gross tax revenues for FY19 fell way short of expectations at ₹ 20.78 lakh cr. as compared of revised target of ₹ 22.48 lakh cr. As a result net tax revenue came in short at ₹ 13.17 lakh cr. as compared to revised estimates of ₹ 14.84 lakh cr. There was shortfall in both direct and indirect tax collections which was a fallout of the slowdown in the economy

Shortfall in direct tax collection was largely on account of personal income tax collection which fell well short of the revised estimates (₹ 5.29 lakh cr.) at ₹ 4.62 lakh cr. Corporate tax collections though were mostly in line with the revised estimates. GST collections too fell well short of revised estimates (₹ 6.44 lakh cr.) at ₹ 5.84 lakh cr.

Non tax revenues came in marginally ahead of revised estimates at ₹ 2.46 lakh cr. Non Debt Capital Receipts were also marginally ahead of revised estimates with Recovery of Loans at ₹ 17,840 cr. while Disinvestment proceeds stood at ₹ 85,045 cr.

Shortfall in revenues was balanced by a cut in Expenditure to ₹ 23.11 lakh cr. (94.1% of revised estimates). While capital expenditure was cut by 4.3% to ₹ 3.03 Lakh cr. revenue expenditure was cut sharply by 6.2% to ₹ 20.1 lakh cr. Expenditure on major subsidies stood at ₹ 1.97 lakh cr. as compared to revised estimates of ₹ 2.66 lakh cr. which indicates that the Government may have resorted to off balance sheet funding of subsidies.

FY20 Fiscal deficit and borrowing numbers worrying markets given shortfall in tax collection numbers

While the Government has managed to meet fiscal deficit targets for FY19, bond markets remained worried about issuances in FY2020. Fiscal deficit estimate at 3.4% of GDP was well ahead of glide path of 3.1% for FY2020. While net borrowing figures are manageable at ₹4.73 lakh cr, gross market borrowings are already significant at ₹7.61 lakh cr in FY2020 against ₹5.71 lakh cr in FY2019.

Given a shortfall in revenues in FY19 and slowdown in the economy revenue targets set for FY20 in the interim budget may not be achievable. Nominal GDP growth to may need to be scaled down from earlier estimates of 11.8% yoy as both the real GDP growth and inflation are likely to be subdued in the first half of FY20.

Fiscal Slippage a necessity to boost growth

Given that there is going to be revenue shortfall FY20, it would be a challenge for the government to meet the fiscal deficit target of 3.4% for FY20. The government could try and make up for the shortfall in tax revenues by the following steps:

1) Transfer of surplus RBI reserves to the Government

2) Rollover of some FY20 expenditure to FY21

3) Cut back in plan expenditure

4) Increase in off balance sheet expenditure with portion of subsidies being transferred to state owned enterprise balance sheet

Revenue expenditure is budgeted to grow to ₹ 24.5 lakh cr in FY20 driven by interest payments and social outlays including the "Pradhan Mantri Kisan Samman Nidhi (PM-KISAN)".The scope of the PM-KISAN too was recently expanded to cover all farmers which would lead to an increase in outlay from the earlier budgeted ₹ 75,000 cr. to ₹ 89,000 cr.

In the past whenever there has been any pullback in government expenditure it has largely been on the capital expenditure side which is not desirable given the current slowdown in the economy. Given the increased social outlay in FY20 and thrust on rural economy it would not be possible for the Government to cut back significantly on revenue expenditure. It may also not be feasible to keep funding subsidies using state owned enterprises balance sheet which have started to get stretched.

The Government has shown it's intent to stimulate the rural economy by addressing the agri distress in the interim budget. We now expect that the Government will try and address the slum in consumer spending by providing tax breaks to the middle class which could be either by the way of restructuring the tax slabs or by increasing the tax exemption limit on housing loan interest from current levels of ₹ 2 lakh.

A 10-20bps increase in fiscal deficit will not worry the markets much and some amount of fiscal slippage has already been factored in by the bond markets with the 10 year G-Sec trading at ~110bps above the repo rate as compared to normal spread of ~75bps.

Given the severity of the NBFC crisis we feel that expansionary fiscal and monetary policy is the need of the hour to revive the economy moving before the slowdown becomes deep rooted and well entrenched given that Inflation is not really a concern at this point of time. The RBI if required could infuse liquidity into the system through OMO's to ensure that higher government borrowing does not lead to crowding out of private investments and to ensure transmission of rate cuts.

Markets are still waiting for the final report being prepared by the Bimal Jalan Committee which will give it's recommendation on transfer of surplus RBI reserves to the Government. One time large transfer to the Government could be used for recapitalizing PSU banks along with reducing fiscal deficit. Staggered transfer over the next few years might not allow the Government to recapitalize PSU banks but will definitely address the fiscal deficit which will also be positive for the markets.

Budget 2019-20 at a glance

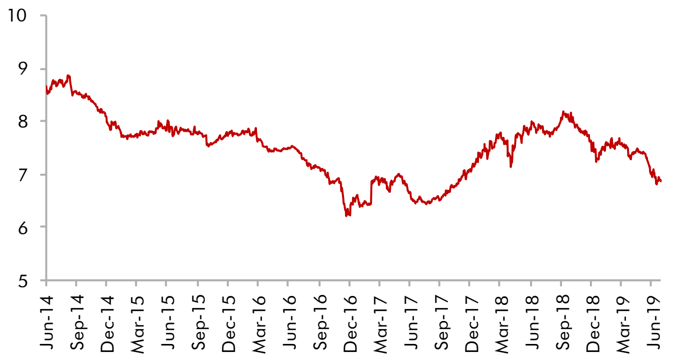
Particular (₹ in Cr)	FY18A	FY19RE	FY19A	FY20BE	FY19A	FY20BE
	(₹ in Cr)				YOY (%)	
(A) Revenue Receipts (1+2)	14,35,233	17,29,882	15,63,170	19,77,693	9	27
Gross Tax Revenue (a+b)	19,19,009	22,48,175	20,78,405	25,52,131	8	23
Devolution to States/Trf to NCCD	6,73,006.0	7,61,454.0	7,61,454	8,44,605.0	13	11
%	35.1%	33.9%	36.6%	33.1%		
1) Tax Revenue (Net to Centre)	12,42,488	14,84,406	13,16,951	17,05,046	6	29
a) Direct Taxes	10,01,974	12,00,000	11,25,220	13,80,000	12	23
Income Tax	4,30,772	5,29,000	4,61,650	6,20,000	7	34
Corporate Tax	5,71,202.0	6,71,000	6,63,570	7,60,000	16	15
b) Indirect taxes	9,16,972	10,48,175	9,53,185	11,72,131	4	23
Custom Duties	1,29,030	1,30,038	1,17,930	1,45,388	-9	23
Excise Duties	2,59,431	2,59,612	2,30,900	2,59,600	-11	12
Service Tax	81,228	9,283	6,880	0	-92	-100
GST	4,42,562	6,43,900	5,83,970	7,61,200	32	30
Others	4,721	5,342	13,505	5,943	186	-56
2) Non Tax Revenue	1,92,745	2,45,476	2,46,219	2,72,647	28	11
(B) Capital Receipts (3+4+5)	7,02,649	6,86,352	7,48,250	7,55,210	6	1
3) Recovery of Loans	15,633	13,155	17,840	12,508	14	-30
4) Disinvestment	1,00,045	80,000	85,045	90,000	-15	6
5) Borrowings and Other Liabilities	5,86,971	5,93,197	6,45,365	6,52,702	10	1
Total Receipt(A+B)	21,37,882	24,16,234	23,11,420	27,32,903	8	20
(C)Revenue expenditure	18,78,835	21,40,611	20,08,460	24,47,908	7	22
6) Of which interest payments	5,28,951	5,87,570.0	5,87,570	6,65,061	11	13
(D) Capital expenditure	2,63,140	3,16,624	3,02,960	3,36,292	15	11
Total Expenditure (C+D)	21,41,975	24,57,235	23,11,420	27,84,200	8	20
(E) Fiscal Deficit (C+D-A-3-4)	5,91,064	6,34,198	6,45,370	7,03,999	9	9
(F) Revenue Deficit (C-A)	4,43,602	4,10,729	4,45,290	4,70,215	0	6
(G) Primary Deficit (E -6)	5,91,064	46,628	57,800	38,938	-7	-33
GDP	1,68,87,543	1,86,52,882	1,90,10,200	2,07,05,853	13	9
Fiscal Deficit (% of GDP)	3.5%	3.4%	3.4%	3.4%		

Exhibit 1: Key Financial Indicators (% of GDP)

% of GDP	FY18A	FY19RE	FY19A	FY120BE
Gross Tax Revenue	11.4%	12.0%	10.9%	12.3%
Devolution to States	4.0%	4.1%	4.0%	4.1%
Net Tax to Centre	7.4%	8.0%	6.9%	8.2%
Direct Taxes	5.9%	6.4%	5.9%	6.7%
Indirect taxes	5.4%	5.6%	5.0%	5.7%
Capital Receipt (ex borrowing)	0.7%	0.5%	0.5%	0.5%
Revenue Expenditure	11.1%	11.5%	10.6%	11.8%
Subsidies	1.3%	1.6%	1.6%	1.6%
Total Capital Expenditure	1.6%	1.7%	1.6%	1.6%
Total Expenditure	12.7%	13.2%	12.2%	13.4%
Revenue Deficit	2.6%	2.2%	2.3%	2.3%
Fiscal Deficit	3.5%	3.4%	3.4%	3.4%
Primary Deficit	0.4%	0.3%	0.3%	0.2%

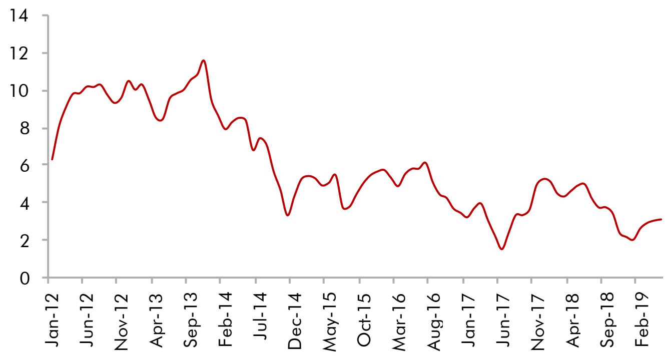
Budget document, angel Research

Exhibit 2: Bond Yields have started falling



Source: RBI

Exhibit 3: CPI inflation has remained low in recent times



Source: Bloomberg

Likely focus areas in Union Budget

- **Agriculture** - Government will reiterate it's focus on the rural sector. While the Government has already launched the "Pradhan Mantri Kisan Samman Nidhi (PM-KISAN)" and in fact increased it's scope to cover all farmers we expect some further measures like tweaking of the MSP programme. There are talks that the Government can could model the MSP program in similar lines to the Madhya Pradesh Government's Bhavantar Program wherein the farmer can sell is produce at market rates and the Government makes good the difference between the selling price and the MSP to the farmers. Therefore the Government will have the option of physical procurement as well as provision of deficiency price payments.

- **Infrastructure** – Given that Infrastructure is one of the key focus area of the Government we don't think that there is going to be any cut back in capital expenditure for FY20 despite shortfall in tax revenues. While infrastructure financing has mostly moved out of the Budget and it is nodal agencies like NHAI and DFCCIL which funds and executes infrastructure projects, we believe that the Government would use the Union Budget to highlight their plans over the next five years. The Government is expected to reiterate its thrust on building world class infrastructure projects including roads, ports, MRTS and railways

- **Housing** - The Government could also try and stimulate the economy by increasing the tax breaks available for interest paid on housing loans which would lower taxable income in the hands of the salaried class. It would serve the dual purpose of boosting consumption demand as well as stimulating the housing sector which has been going through a slump

- **Make in India** – The Government could tweak it's policies which would encourage domestic manufacturing especially in the defence sector with a view to reduce dependence on imports and at the same time boost domestic manufacturing

Impact on sectors

- Positive for all Agri input related companies, as farmer income will go up marginally.
- This will be positive for the FMCG sector, as it will increase the disposable income in the hands of rural households. Positive for FMCG companies like HUL, Dabur, Marico, etc.
- This is likely to create a positive sentiment among first time buyers for entry-level small cars, two wheelers and tractors.
- Positive for consumer discretionary companies like Bata India, Safari Industries, TTK prestige and VIP Industries.

- Positive for L&T and other Infrastructure (Road) companies.
- Potive for cement companies such as Ultractech, ACC, Shree Cement, Star cement, etc.
- Positive for railways allied companies like Titagarh Wagons, Texmaco & Alstom India.

- Positive for Real estate companies like Sobha Developers & Godrej Properties.
- Positive for housing allied sectors like paints, plywood tiles and cement.

- Positive for companies engaged in defence sector like BEL, L&T, and Bharat Forge

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