EcoScope
The Economy Observer

India's reported fiscal deficit could top 12% of GDP in FY21

RBI purchases may amount to 2.5–3% of GDP

- **After Japan declared an economic stimulus package worth ~20% of its GDP to combat the impact of the COVID-19 crisis, the US Federal Reserve announced last week that it would pump an additional US$2.3t to support its economy. With every such piece of news, pressure on the Indian government to jump on the wagon increases sharply. Thus far, the Reserve Bank of India (RBI) has done the heavy lifting, but the fiscal support extended has amounted to just ~0.9% of GDP, among the least compared with the support pledged by the world's other major economies.**
- **Our estimates suggest that even if the government does not announce any additional stimulus package, India's reported fiscal deficit target would slip by almost 2 percentage points of GDP this year (to ~5.6% of GDP from the target of 3.5%) on account of lower taxes, lower denominator (GDP), and the welfare package, partly offset by windfall gains from lower crude oil prices (and an expected hike in excise duty).**
- **However, as discussed in an earlier report, we strongly believe the government could introduce an economic fiscal stimulus package to support vulnerable working classes, MSMEs, and the worst-affected industries. We estimate a package amounting to ~2% of GDP, which would have to be funded by the RBI by subscribing to one-off non-renewable COVID-19 support bonds.**
- **The center's fiscal deficit could therefore stand at ~7.6% of GDP, the widest since liberalization. Moreover, while states have budgeted for a fiscal deficit of 2.7% for FY21, the figure is likely to be ~4.4% of GDP. This implies the combined fiscal deficit could be ~12% of GDP (INR25t) in FY21, the highest in at least the past five decades, since the time that this data has been available, and higher than the previous peak of 9.6% of GDP in FY02. A sensitivity analysis of fiscal receipts vis-à-vis GDP growth confirms a combined fiscal deficit of 11–14% of GDP in FY21.**
- **This suggests that if the authorities wish to keep bond yields under check, the RBI's purchase of government securities would have to be much higher. Considering that foreign capital inflows remain weak, in our view, the RBI may eventually resort to buying gilts worth INR5–6t (or 2.5–3% of GDP) this year.**

India has declared a welfare package and announced compliance-related relaxations for businesses worth INR1.85t.

India's fiscal support package too small against packages of several global nations: In light of the disruption caused by the COVID-19 lockdown, many of the world's major economies have announced large fiscal support for their countries. Early this week, Japan announced a fiscal stimulus package worth ~20% of its GDP *(refer to Exhibit 1 on the following page and Appendix I at the end of the report)*. With every such piece of news, pressure on the Indian government to jump on the wagon increases sharply. Thus far, India has declared a welfare package and announced compliance-related relaxations for businesses worth INR1.85t (or 0.9% of GDP), among the least compared with the support pledged by the world's other major economies.

Monetary easing in line with that of global counterparts: Nevertheless, the RBI's measures to support borrowers and lenders during this difficult phase have been in line with those of its global counterparts *(refer to Appendix II for details on the monetary easing announced by select nations)*. The RBI has provided a three-month moratorium to all borrowers, effectively cut policy rates by 115 bps (reverse repo rate has been reduced to 4% from 5.15%), extended the marginal standing facility, and reduced the cash reserve ratio, among many other measures. The only major difference vis-à-vis the most active central banks is the absence of outright purchase of government securities or non-gilt papers.

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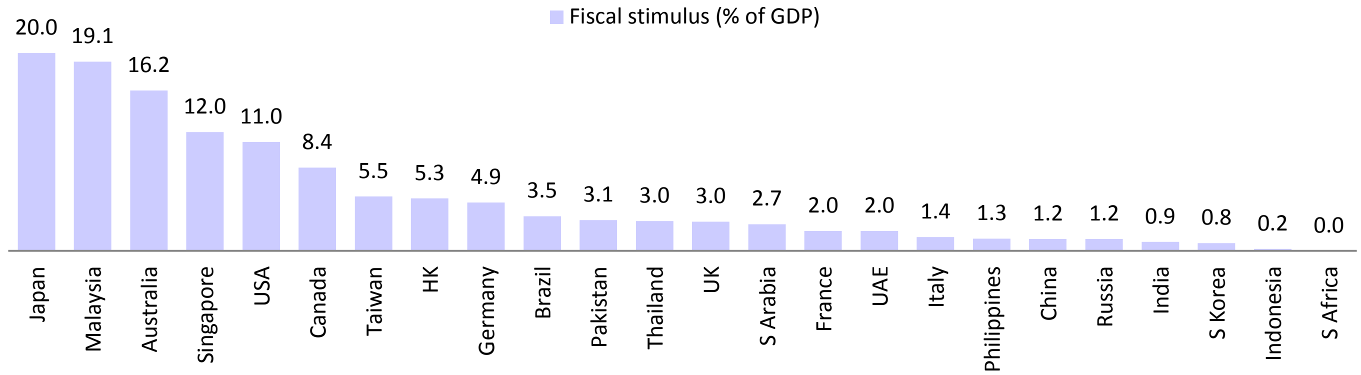
Exhibit 1: Size of fiscal stimulus packages announced by world's major economies (% of GDP)



Appendix I gives details on country-wise fiscal stimulus

Updated as of April 14, 2020

Source: International Monetary Fund (IMF), MOFSL

One way to ascertain governments' ability to stimulate the economy is to understand the likely fiscal slippage in the absence of any additional fiscal stimulus.

Center's fiscal deficit could slip by 2 percentage points of GDP in FY21: With the economy stagnating, the question now is not about the slowdown, but the intensity of recession. There is no doubt that almost all major economies would decline in CY20; therefore, the fiscal stimulus seems like a no-brainer. Nevertheless, the difficult question for the Indian economy is to mull over the extent of fiscal stimulus. With India's combined fiscal deficit (at ~6% of GDP) already among the highest compared with major economies, there is limited scope for a large fiscal stimulus. One way to ascertain the ability of governments to stimulate the economy is to understand the likely fiscal slippage in the absence of any additional fiscal stimulus.

Four forces in particular would be at play in FY21, which would help determine the likely extent of fiscal slippage: a) the adverse impact on direct taxes (due to a high level of unemployment and lower corporate profit (or outright loss), b) the adverse impact on indirect taxes (due to very weak economic activity), c) additional spending of INR1.35t on account of the welfare package (remaining INR0.5t is not new spending), and d) lower denominator (nominal GDP). Against these forces, the only offsetting factor would be the windfall gains from the collapse in crude oil prices, which would aid in reducing fuel subsidies and potentially also garnering more resources through a hike in excise duties on petrol/diesel in 2HFY21.

Our estimates suggest gross taxes could decline ~2% YoY to 9.6% of GDP in FY21 from 10% of GDP in FY20.

After working out these forces, we believe gross tax receipts in FY21 could witness a shortfall of INR2.8t on account of the COVID-19 lockdown. Against the FY21 budget estimate (BE) of INR24.2t, we had expected gross tax receipts to stand at INR22.6t. However, gross tax receipts could now be closer to INR19.8t *(Exhibit 2)*, weighed by the disruption caused by the COVID-19 lockdown. This implies gross taxes could decline ~2% YoY to 9.6% of GDP in FY21 from 10% of GDP in FY20. Segment-wise tax receipts suggest that while corporate profit tax could decline 7.6%, personal income tax could grow 2.4% (in line with nominal GDP growth of ~2%) and indirect taxes could fall ~5%. However, note that we believe the government could try to collect an additional INR400b through higher excise duties on petrol/diesel during the year, implying that indirect taxes could decline only ~1% YoY in FY21.

Net tax receipts, however, could decline 8.3% YoY as the effective devolution ratio this year is likely to be higher (35% in FY21, vis-à-vis 30.5% in FY20). Furthermore, with lower corporate profit and very weak economic activity, CPSEs' non-tax contribution to the exchequer would also be lower than otherwise *(Exhibit 3)*.

Finally, with financial markets remaining in turmoil, it seems unlikely that the government would be able to raise INR2.1t from divestment this year. We assume such receipts to be closer to INR1.0t in FY21 *(Exhibit 4)*.

Total fiscal receipts could stand at INR16.7t in FY21, against INR19.2t expected earlier (and the government target of INR22.5t).

Overall, the government's total receipts could amount to INR16.7t (or 8.1% of GDP) in FY21, against INR19.2t (8.6% of GDP) expected earlier [and the government's target of INR22.5t (10% of GDP)]. This implies 5.7% YoY decline in the total receipts in FY21, against 6% growth in FY20.

Exhibit 2: Fiscal deficit could slip by ~2 percentage points of GDP in FY21 without any additional stimulus

INR trillion	FY19	FY20				FY21			Factors
	P	RE	FY20-TD	Old est	New est	RE	Old est	New est	
Total receipts	16.7	19.3	14.3	18.0	17.7	22.5	19.2	16.7	
Net tax receipts	13.2	15.0	11.1	14.3	14.0	16.4	14.7	12.9	Effective devolution of 35% vs 31% in FY20
Gross tax receipts	20.8	21.6	16.8	20.5	20.2	24.2	22.6	19.8	
Corporate tax	6.6	6.1	4.2	5.8	5.7	6.8	6.6	5.2	1Q/1HFY21 losses to offset profits in 2HFY21
Personal income	4.6	5.6	3.9	5.0	4.9	6.4	5.6	5.1	Lost income / Higher unemployment
GST	5.8	6.1	5.5	6.1	6.0	6.9	6.7	5.5	In line with lower GDP growth
Customs duties	1.2	1.3	1.1	1.1	1.1	1.4	1.1	1.1	In line with sharp decline in imports
Excise duty	2.3	2.5	2.0	2.3	2.3	2.7	2.4	2.7	Including INR400b due to higher excise duties
Other tax	0.2	0.1	0.2	0.2	0.2	0.1	0.2	0.2	
Non-tax revenue	2.5	3.5	2.6	3.1	3.0	3.9	3.0	2.7	Dividends affected by lower corporate profits
Non-debt capital	1.0	0.8	0.5	0.7	0.7	2.3	1.5	1.2	
Disinvestment	0.8	0.7	0.3	0.5	0.5	2.1	1.4	1.0	Difficult financial markets
Total spending	23.1	27.0	24.7	25.7	26.3	30.4	27.1	28.2	Lower fuel subsidies, INR1t on fiscal support
Fiscal deficit	6.5	7.7	10.4	7.7	8.6	8.0	8.0	11.5	
Deficit (% of GDP)	**3.4**	**3.8**		**3.8**	**4.2**	**3.5**	**3.5**	**5.6**	
Nominal GDP	189.7	204.4		204.0	201.0	224.9	224.4	205.0	

Tax buoyancy may or may not be affected based on special factors mentioned

Source: RBI, MOFSL

Exhibit 3: CPSEs dividends expected to grow ~36% YoY to INR658b in FY21BE

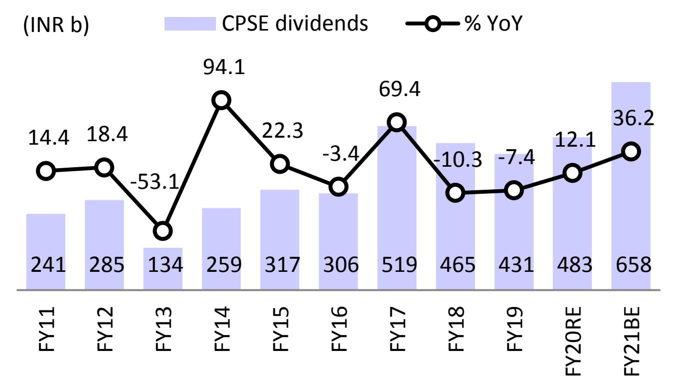
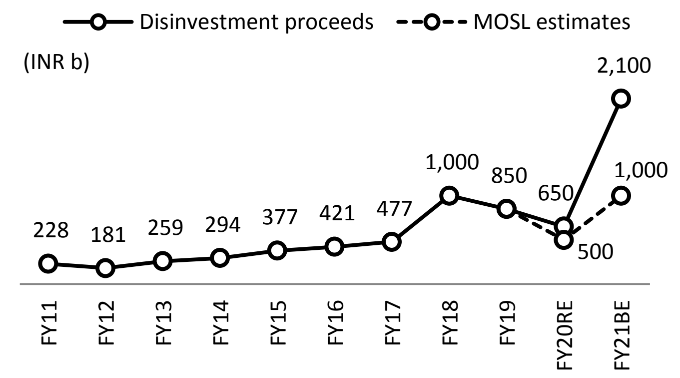


Exhibit 4: Center expects divestments in total receipts to grow sharply in FY21(BE)



Source: Department of Public enterprises, Union Budget, MOFSL

Prior to the COVID-19 outbreak, when we anticipated lower receipts, we also expected the central government to adjust its spending to meet the targeted fiscal deficit. Although the total receipts would now be much lower, it would not be possible for the government to reduce its spending proportionately. There are likely to be measures working in the opposite direction for spending as well. Two factors would lead to lower spending: a) lower fuel subsidies and b) lower capital spending. On the contrary, total spending would be higher on account of: a) the welfare package announced by the central government in late Mar'20 and b) larger compensation extended to the state due to the receipt shortfall *(Exhibit 5–6)*.

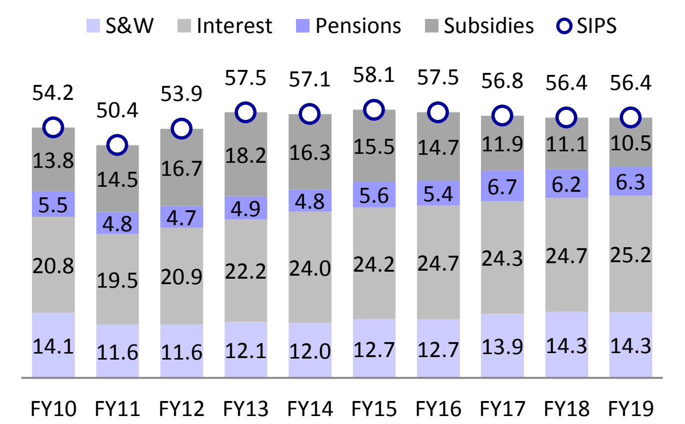
Fiscal spending could come in at INR28.2t in FY21, vis-à-vis the government target of INR30.4t.

All-in-all, our estimates suggest government spending could stand at INR28.2t (7.2% YoY higher) in FY21, higher than INR27.1t expected earlier (and much lower than its target of INR30.4t).

Exhibit 5: Government announces INR1.35t worth of new spending in FY21

Scheme	Cost to exchequer (INR b)	New Spending
Public distribution System	450	Y
Cash transfer in Jan Dhan Account	340	Y
MGNREGA	56	Y
PM Ujjwala Yojana	130	Y
Employee provident fund	50	Y
Higher health care spending	150	Y
PM Kisan Yojana	174	N
Welfare fund for construction workers	310	N
Insurance cover to health workers		Y
Self-help group	190	N
District mineral fund		N
Total cost	**1,850**	

Exhibit 6: Large part of fiscal spending non-discretionary in nature (% of total spending)



SIPS = Salary, Interest payments, Pension and subsidies
Source: Union Budget, MOFSL

Even if the government does not announce any further stimulus package, India's reported fiscal deficit target would slip by ~2 percentage points to 5.6% of GDP this year.

If that is the case, the central government's fiscal deficit, without any additional economic stimulus, could be ~5.6% of GDP, against the target of 3.5% of GDP. Therefore, even if the government does not announce any additional stimulus package, India's reported fiscal deficit target would slip by almost 2 percentage points of GDP this year on account of lower taxes, lower denominator (GDP), and the welfare package, which would be partly offset by windfall gains from lower crude oil prices (including the expected hike in excise duty).

Center's fiscal deficit could be at three-decade high of ~7.5% of GDP this year with economic stimulus: With fiscal slippage of about 2 percentage points of GDP, without any additional fiscal stimulus, the scope for a second economic package reduces considerably. However, we still believe that the government could introduce an economic fiscal stimulus package to support poor citizens, casual laborers, and MSMEs.

Additional stimulus could be worth ~2% of GDP, taking the center's deficit to ~7.6% of GDP in FY21, the highest in 30 years.

As we have discussed in detail in our recently released **report**, the economic stimulus could be worth ~2% of GDP, taking the center's deficit to ~7.6% of GDP in FY21, the highest in almost three decades since the early-1990s *(Exhibit 8)*. The details of our three-pronged 10-step approach with tentative cost to the exchequer are listed in *Exhibit 7* on the following page. Furthermore, the RBI would most likely fund this additional package by subscribing to one-off non-renewable COVID-19 support bonds on account of exceptional circumstances.

Exhibit 7: Our 3-pronged 10-step urgent toolkit might cost the exchequer ~INR4t (~2.0% of GDP) in FY21

	Prongs	Steps	Cost to exchequer INR T	Cost to exchequer % of GDP
1	For the most vulnerable working sections	Cash transfer to casual/migrant worker	1.1-1.4	
		Ex-gratia cash transfer to health workers/police officials	0.3	
		Smooth supply of free essential eatables, gas cylinders, water	0.5	
		Health/life insurance cover for all vulnerable sections of society	0.3	
Sub-total			**2.2-2.4**	**1.1-1.2**
2	For MSMEs and other hard affected sectors	Free 3 month rent/electricity charges to affected firms	0.3	
		12-month interest free uncollateralized loans to MSMEs	0.1	
		Bail-out package to aviation/hotels/tourism/trade	0.7	
Sub-total			**~1.0**	**~0.5**
3	To ensure financial stability	Open Market Purchases of central/state government securities to finance all these packages including the welfare package	5.0-6.0	
		Complete scrapping off of reverse repo window	-	
		6-months interest free un-collateralized conditional loans to non-MSMEs	0.5	
		Extension of 3-month moratorium to NBFCs as well		
Sub-total			**~0.5**	**~0.3**
Grand total			**~4.0**	**~2.0**

Please refer to our previous report for details Source: MOFSL

Combined fiscal deficit could stand at around five-decade high of ~12% of GDP in FY21: With the massive shortfall in gross tax collection, states would also receive a smaller share. Based on our estimates above, the devolution to states could fall by as much as INR1.0t (or 0.5% of GDP). Incorporating the shortfall in state's own tax receipts (SOTRs) and support packages announced by various state governments (assuming total cost of 0.5% of GDP), states' fiscal deficit would also be higher than estimated. While states have budgeted for a fiscal deficit of 2.7% for FY21, it is more likely to stand at ~4.4% of GDP, the highest in 21 years (it was 48-year high of 4.45% of GDP in FY00).

Combined fiscal deficit could be ~12% of GDP in FY21, the highest in at least the past five decades.

This implies the combined fiscal deficit could be ~12% of GDP in FY21, the highest in at least the past five decades, since the time that this data has been available, and higher than the previous peak of 9.6% of GDP in FY02 *(Exhibit 9)*.

Exhibit 8: Center's FY21 fiscal deficit could be highest in 30 years (% of GDP)

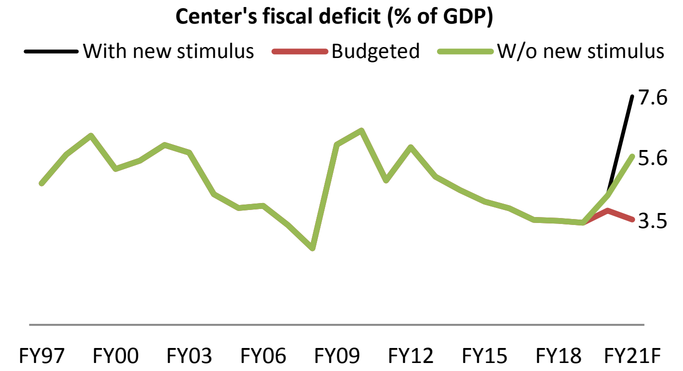
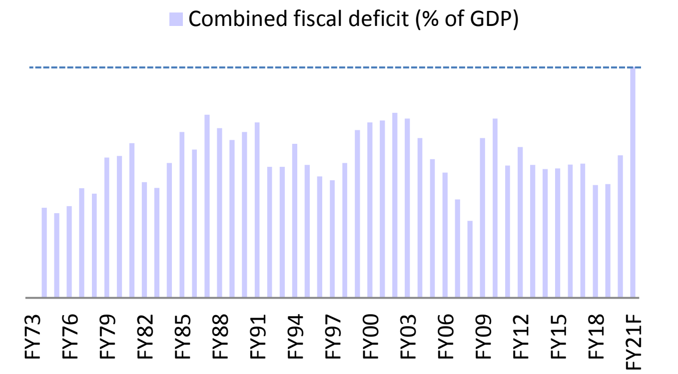


Exhibit 9: Combined fiscal deficit could top 12% of GDP, highest in five decades (% of GDP)



Source: RBI, MOFSL

Sensitivity analysis confirms combined fiscal deficit of 11–14% of GDP in FY21: As we have discussed earlier in our report, it is very difficult to ascertain the exact impact of lockdown on economic activity due to COVID-19 at this stage. Therefore, we have also conducted a sensitivity analysis to understand the likely connection between GDP growth and fiscal deficit *(refer to Exhibit 10 below)*.

The actual fiscal deficit of the center was likely to be ~4.3% of GDP, against the revised estimate of 3.8% of GDP last year.

Due to economic lockdown in the second half of March 2020, the government borrowed an additional INR1.3t in Mar'20. This suggests the actual fiscal deficit was likely to be ~4.3% of GDP, against the revised estimate of 3.8% of GDP last year. The sensitivity analysis implies if nominal GDP growth is nil (0%) in FY21, the central government's fiscal deficit could be 7.8% of GDP and combined fiscal deficit could be 12.5% of GDP. These estimates assume the new fiscal stimulus (apart from the recently announced welfare package) from the center amounting to ~2% of GDP. The higher/lower the new economic fiscal stimulus package is, the higher/lower the fiscal deficit would be.

Exhibit 10: Sensitivity analysis suggests combined fiscal deficit would stand at 11–14% of GDP in FY21

INR trillion, unless mentioned otherwise	FY19P	FY20E	FY21E Old est.	FY21F (Nominal GDP growth)				
				-5%	-2%	0%	2%	5%
Total receipts	16.7	17.7	19.2	15.8	16.2	16.5	16.7	17.1
Gross taxes	20.8	20.2	22.6	18.4	19.0	19.4	19.8	20.4
Net taxes	13.2	14.0	14.7	12.0	12.4	12.6	12.9	13.3
Government spending	23.1	26.3	27.1	28.2	28.2	28.2	28.2	28.2
Center's fiscal deficit	6.5	8.6	7.9	16.2	15.9	15.7	15.6	15.3
Center's deficit (% of GDP)	**3.4**	**4.3**	**3.5**	**8.5**	**8.1**	**7.8**	**7.6**	**7.3**
States' fiscal deficit	4.8	6.2	6.1	10.0	9.6	9.4	9.1	8.7
States' deficit (% of GDP)	**2.5**	**3.1**	**2.7**	**5.2**	**4.9**	**4.7**	**4.4**	**4.1**
Combined fiscal deficit	11.2	14.8	14.0	26.2	25.6	25.1	24.7	24.1
Combined fiscal deficit (% of GDP)	**5.9**	**7.4**	**6.3**	**13.7**	**13.0**	**12.5**	**12.1**	**11.4**
Nominal GDP	189.7	201.0	224.4	191.0	197.0	201.0	205.0	211.0

Including new economic stimulus worth ~2% of GDP announced by the center

Source: RBI, MOFSL

Gilt purchases by RBI could be worth 2.5–3% of GDP: In absolute terms, this means the central government's fiscal deficit could be INR15.6t (or 7.6% of GDP), against the target of INR7.9t (or 3.5% of GDP). Furthermore, states' deficit could increase from the budgeted estimate of INR6.1t (or 2.7% of GDP) to INR9.1t (or 4.4% of GDP), implying a combined fiscal deficit of about INR24.7t, against the target of INR14t. In light of these developments, the bond market fears a massive supply of government securities. The benchmark 10-yr bond yield is back to ~6.5%, similar to where it was in early-Feb'20 and higher than its trough of ~6.05% in early Mar'20.

We believe the RBI would resort to buying gilts worth INR5–6t (or 2.5–3% of GDP) this year.

If the authorities want to keep bond yields under check, the RBI's purchase of government securities would have to be much higher. Considering foreign capital inflows remain weak in FY21, we believe the RBI would resort to buying gilts worth INR5–6t (or 2.5–3% of GDP) this year. If not, then notwithstanding the COVID-19 lockdown and very weak economic activity, the bond yield could move higher.

Appendix 1: Summary of various features of fiscal stimulus announced by select world economies

Countries	Fiscal stimulus (% of GDP)	Cash transfers to households[1]	Other benefits to households[2]	In-kind support to households[3]	Monetary benefits to businesses[4]	Compliance relief to businesses[5]
Australia	16.2	Y	Y	N	Y	N
Brazil	3.5	Y	Y	N	Y	Y
Canada	8.4	Y	Y	N	Y	Y
China	1.2	N	Y	N	Y	Y
Hong Kong	5.3	Y	N	N	Y	Y
France	1.6	N	Y	N	Y	Y
Germany	4.9 (8.4)[5]	N	Y	N	Y	Y
India	0.9 (1.1)[5]	Y	Y	Y	N	Y
Indonesia	0.2	N	Y	N	Y	N
Italy	1.4	N	Y	N	Y	Y
Japan	20.0	Y	Y	Y	Y	Y
Malaysia	19.1	Y	Y	N	Y	Y
Pakistan	3.1	Y	Y	Y	Y	Y
Philippines	1.3	Y	Y	N	Y	Y
Russia	1.2	N	Y[6]	N	Y	Y
Saudi Arabia	2.7	N	N	N	Y	Y
Singapore	12.0	Y	Y	N	Y	Y
South Africa	0.0	Y	N	N	Y	Y
South Korea	0.8	@[7]	Y	Y	Y	Y
Taiwan	5.5	N	Y	N	N	N
Thailand	3.0	Y	Y	N	Y	Y
UAE	2.0	N	Y	N	Y	N
UK	3.0	N	Y	N	Y	Y
USA	11.0	Y	Y	Y	Y	Y

Source: MOFSL, Company

[1] Unconditional one-off cash transfers to either selected class of society or to all citizens

[2] In terms of pension, unemployment allowances, lower prices of essential items, wage subsidies, etc.

[3] Subsidized/Free food supplies, gas cylinders, etc.

[4] Tax relief, social security relaxations, wage subsidies to SMEs or general corporate sector

[5] Non-monetary benefits (extension of tax-filing period or other compliance-related matters)

[6] Including state/provincial fiscal stimulus

[7] Some cash transfer and other benefits to quarantined/sick people; only those directly affected by COVID-19

[8] Stimulus worth KRW9t, including cash transfers to individuals, is announced but yet to be approved

Updated up to 15th April 2020

Appendix 2: Summary of various features of monetary easing announced by select world economies

Countries	Cut in policy interest rate	Additional liquidity[1]	Purchases of gilt securities	Purchases of non-gilt papers	Moratorium to borrowers[2]	Compliance relaxation[3]	Directed lending to SMEs[4]
Australia	Y	Y	Y	Y	Y	Y	Y
Brazil	Y	Y	Y	N	Y	Y	N
Canada	Y	Y	Y	Y	N	N	N
China	Y	Y	N	Y	Y	Y	Y
Eurozone	Y	Y	Y	Y	N	Y	Y
Hong Kong	Y	Y	N	N	Y	Y	Y
India	Y	Y	N	N	Y	Y	Y
Indonesia	Y	Y	N	N	Y	Y	N
Italy			n/a		Y	Y	Y
Japan	N	Y	Y	Y	N	Y	Y
Malaysia	Y	Y	N	N	Y	Y	N
Pakistan	Y	Y	N	N	Y	Y	Y
Philippines	Y	Y	Y	N	Y	Y	N
Russia	Y	Y	N	N	Y	y	Y
Saudi Arabia	Y	Y	N	N	Y	Y	Y
Singapore	N	N	N	N	Y	Y	Y
South Africa	Y	Y	Y	N	Y	Y	N
South Korea	Y	Y	Y	Y	N	N	Y
Taiwan	Y	Y	N	N	Y	Y	Y
Thailand	Y	Y	Y	Y	Y	Y	N
UAE	Y	Y	N	N	Y	Y	Y
UK	Y	Y	Y	Y	N	N	Y
USA	Y	Y	Y	Y	Y	Y	Y

Source: MOFSL, Company

[1] Provision of liquidity through repo operations, cut in reserve requirements, etc.

[2] One to three months moratorium on loan repayment for individuals or businesses

[3] Easing rules under investments like share buybacks, regulatory compliance to banks to support loan deferment, etc.

[4] Special credit lines for lending directly to small and medium enterprises

Updated up to 15th April 2020

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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