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FY20 BUDGET PREVIEW

24 January 2019

Rural India to remain at the fore

We believe the FY20 Interim Budget will carry forward the government's focus on bolstering rural & farm incomes and infrastructure. Allocation to the rural/farm sector in the form of income support, crop procurement, subsidies, subventions and housing is thus likely to see a large boost. In our view, sustained buoyancy in direct taxes will support this fiscal largesse, containing the FY20E fiscal deficit at 3.3% of GDP, at the same level as FY19.

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FY19E fiscal deficit to stay on target: Even with the 16.5% YoY rise in direct tax revenues over Apr-Nov'18 (vs. the budgeted estimate of 14.4%), the government's overall revenue collection has risen only 9.3% as indirect taxes have increased by a mere 5.2% (BE: 19.2%). The Centre, however, has managed to cut its borrowing programme because of a shift from market borrowings to the National Small Savings Fund (NSSF). Hence, we believe the government will stick to its stated fiscal deficit target of 3.3% of GDP in FY19.

Rural theme to remain a priority: In FY19, the government has focused on increasing rural incomes through higher MSPs and farm procurement, interest subventions and building rural infrastructure (roads). Healthcare has also received attention with implementation of the Ayushman Bharat insurance scheme. Ministry-wise spends in FYTD19 have been geared towards the above objectives. We believe the FY20 Budget will continue to train a spotlight on these key areas.

FY20E fiscal deficit to hold at 3.3% of GDP: With corporate taxes surprising positively in FY19, we expect overall receipts to rise 10.1% in FY20 (vs. 8.4% in FY19E). Indirect taxes will likely remain lukewarm as the 28% GST slab is pruned further. Non-tax revenues should benefit from higher dividend and 5G auctions. On the spending front, the rural and agri sectors are expected to see a boost of Rs 1.1tn (0.5% of FY20 GDP); roads and health too could see higher allocations. This translates to an unchanged fiscal deficit of 3.3% in FY20, implying gross/net borrowing of Rs 5.7tn (Rs 5.35tnin FY19E)/Rs 4.2tn (Rs 3.9tn in FY19E).

Fiscal impulse to be neutral: Central fiscal deficits have been imparting a negative-to-neutral fiscal stimulus in the last eight years. However, states have seen a positive fiscal impulse with deficits now at 3% of GDP. This along with a rising tax-to-GDP ratio for the Centre has resulted in higher government spending. In FY20, we expect the consolidated fiscal impulse to remain neutral.

KEY HIGHLIGHTS

- Rural, infrastructure and health sectors to be key focus areas of FY20 Budget
- Fiscal deficit for FY19/FY20 estimated at 3.3% of GDP
- Gross/net borrowings in FY20 estimated at Rs 5.7tn/Rs 4.2tn

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Rural to take centre stage

Farm-centric approach: A push for higher consumption

Over the past year, the government has focused on improving farm incomes through higher crop prices (MSP) and better rural infrastructure (roads, railways). In the FY19 Union Budget, allocation to Food Corporation of India (FCI) for procuring food grain from farmers was increased by Rs 360bn. Healthcare received an added impetus with the implementation of national health insurance scheme Ayushman Bharat. Ministry-wise data shows much higher spending on agriculture, rural development, health and internal security. We believe this budget will carry on the mantle of last year with higher fund allocations for farmers, infrastructure and health.

Expect 21% increase in rural/farm allocation

Allocation to the rural and farm sector is estimated to increase from 2.6% of GDP in FY19E to 2.9% in FY20E, directed towards interest subvention, subsidies, farm procurement, income support and rural health & sanitation measures. This translates into a 21% YoY increase in rural/farm allocation in the budget. Apart from this, focus on the government's newly minted Ayushman Bharat health insurance scheme would continue. In addition, the roads sector is likely to remain a priority, as seen in the last five years (18% CAGR in allocation).

Fiscal slippage unlikely despite rural largesse

While indirect taxes will be rationalised through the GST mechanism, we believe the budget may lay down a roadmap for increasing tax exemption for middle-class Indians. At the same time, the government's thrust on the rural and middle-class segments is unlikely to come at the expense of fiscal slippage.

We believe the higher direct tax collection trajectory would continue in FY20, with corporate tax collections continuing the growth seen in FY19 – this translates into a 13.1% increase in the Centre's revenue. Dividend from public sector units (PSU) and the RBI will add to the kitty, as would 5G telecom auctions.

On the expenditure front, we estimate that overall spending will increase by 11.6% in FY20, led by the rural and road sectors. Health and internal security should also see reasonably higher allocation. But the fiscal math suggests the government is likely to hold the fiscal deficit at 3.3% of GDP and lower it to 3% of GDP in FY21 as envisaged in the NK Singh committee report.

FY19 outlook

Lower GST collections undermining Centre's revenue targets

In the FY19 Budget, the government had estimated a 16.6% rise in tax revenues led by a 19.2%/14.4% increase in indirect/direct taxes. While direct taxes have been ahead of budgetary estimates (BE), indirect collections have fallen woefully short due to muted CGST inflow. We estimate that the Centre's total revenue is likely to grow by 8.4% in FY19 vs. BE of 10.1%, leading to a shortfall of 0.2% (of GDP) in overall receipts.

Direct tax revenue could surprise positively

Within direct taxes, corporate tax collections have surprised positively, showing an increase of 16.6% in Apr-Nov'18 (FYTD19) vs. BE of 10.2%. Income tax collections have risen 16.4% (FYTD19) vs. BE of 19.9% but should pick up in Q4. Last year too, income tax collections showed an improvement in the fourth quarter to 25.4% from the 17% increase seen during Apr-Dec'18, which took FY18 revised estimates (RE) in line with the BE of 21% growth. Hence, the government could see a positive surprise in direct tax collections.

FIG 1 – POOR INDIRECT TAX COLLECTION ADDING PRESSURE ON REVENUES, EXPENDITURE GROWTH SLOWING

(Rs bn)	FY17 YTD	FY18 YTD	Chg (%)	FY19 YTD*	Chg (%)	FY19BE	Chg (%)**
Tax revenue (net)	9,333	9,872	5.8	10,911	10.5	14,806	16.6
Direct taxes	4,089	4,650	13.7	5,417	16.5	11,500	14.4
Corporate Tax	2,223	2,498	12.4	2,913	16.6	6,210	10.2
Income Tax	1,867	2,152	15.3	2,504	16.4	5,290	19.9
Indirect taxes	5,243	5,222	(0.4)	5,494	5.2	11,160	19.2

Source: CEIC, Union Budget Documents, Bank of Baroda Research | Note: BE-Budget Estimates; RE-Revised Estimates | *Apr-Nov'18 | **FY19BE over FY18RE

Diametrically opposite story in indirect taxes

With underperformance on GST collections (FYTD19 CGST collections at Rs 2.97tn vs. BE of Rs 6tn), indirect taxes have risen only 5.2% in FYTD19 vs. BE of 19.2%. Notably, other components of indirect tax collections such as compensation cess and IGST have not seen such a large shortfall. Hence, overall tax revenue collection for FY19 is likely to undershoot the government's target by Rs 865bn (0.5% of FY19 GDP).

FIG 2 – NOV'18 GST COLLECTIONS SLIPPED BELOW MONTHLY AVERAGE RUN-RATE OF RS 959BN

(Rs bn)	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	FYTD19	FY19BE
CGST	321	281	309	579	360	299	480	344	2,973	6,039
% change	-	-	-	-	-	97.3	53.8	44.3	-	172.8
IGST	200	169	102	(399)	52	148	(142)	90	220	500
% change	-	-	-	-	-	(51.5)	(177.4)	(51.5)	-	(69.1)
SGST*	333	433	473	678	455	481	561	433	3,847	4,882
% change	-	-	-	-	-	15.8	97.9	27.0	-	-
Cess	85	72	80	80	74	79	77	79	626	900
% change	-	-	-	-	-	(2.2)	(3.8)	11.7	-	46.7
Total GST	**940**	**956**	**965**	**940**	**944**	**1,007**	**976**	**947**	**7,676**	**-**
% change	-	-	-	-	-	5.9	13.6	13.2	-	-

Source: CEIC, PIB, Bank of Baroda Research | Note: BE-Budget Estimates | *Computed from PIB and CGA data

PSU/RBI dividends to bolster non-tax revenues

In case of non-tax revenues, the government is expected to collect a higher-than-budgeted amount of Rs 2.5tn. This will be on account of higher dividend from PSUs and in particular, the RBI. The central bank has already announced the transfer of Rs 500bn as dividend to the government this year (vs. Rs 307bn in FY18; additionally Rs 100bn was transferred as interim dividend in Mar'18). This year too we expect the RBI to pay interim dividend in Mar'19. Given the jump in annual payout, the interim dividend is also projected to be higher than last year.

FIG 3 – NON-TAX GOVERNMENT REVENUES TO COME IN ABOVE BUDGET

(Rs bn)	FY17	FY18RE	FY19BE	FY19E
Dividends & Profits	1,230	1,064	1,073	1,272
Others	1,498	1,295	1,378	1,401
Non-Tax Revenues	2,728	2,360	2,451	2,673

Source: Union Budget Documents, Bank of Baroda Research | Note: E-Bank of Baroda Estimates; BE-Budget Estimates; RE-Revised Estimates

Disinvestment receipts to push capital receipts close to target

The government had budgeted for capital receipts of Rs 7.2tn in FY19. Actual inflows are likely to be Rs 7.1tn due to lower-than-budgeted market borrowing. In case of disinvestment, during FYTD19 (as of 17 Jan 2019), the government has collected Rs 351bn against the disinvestment target of Rs 800bn. Future pipeline is also strong: the Power Finance Corporation (PFC)-Rural Electrification Corporation (REC) merger will reap Rs 150bn, the National Thermal Power Corporation (NTPC)-Satluj Jal Vidyut Nigam (SJVN) merger should garner Rs 70bn, and Bharat-22 ETF is expected to fetch Rs 80bn.

The remainder will be met via IPOs of Mazagaon Docks, Rail Vikas Nigam Limited (RVNL), Indian Railway Finance Corporation (IRFC) & Metal Scrap Trade Corporation (MSTC) and buyback of shares of state-owned enterprises (Rs 120bn-150bn). We thus expect the government to meet its targeted level of disinvestment for FY19.

Government has also managed to reduce its gross G-Sec issuances by ~Rs 700bn in FY19 to Rs 5.35tn as against the BE of Rs 6.1tn. This has been made possible by a higher reliance on the National Small Savings Fund (NSSF) rather than market borrowings (Rs 3.9tn vs BE of Rs 4.6tn). During FYTD19, the government has borrowed Rs 850bn from NSSF compared with Rs 541bn during the same period last year. Consequently, the ratio of internal debt market borrowing to total capital receipts is estimated to decline from 68% in FY17 to 55% in FY19.

FIG 4 – CAPITAL RECEIPTS TO FALL MARGINALLY SHORT OF TARGET

(Rs bn)	FY17	FY18RE	FY19BE	FY19E
Internal Debt Market Borrowing	4,082	4,594	4,621	3,915
Disinvestment	477	1,000	800	800
Others	1,450	1,529	1,744	2,415
Total capital receipts	**6,010**	**7,123**	**7,165**	**7,130**

Source: Union Budget Documents, Bank of Baroda Research | Note: E-Bank of Baroda Estimates; BE-Budget Estimates; RE-Revised Estimates

Revenue shortfall at 0.2% of GDP

Based on the above inflows, we estimate that the Centre's total receipts are likely to grow by 8.4% in FY19 vs. BE of 10.1%, leading to a shortfall of 0.2% of GDP.

Expenditure managed by pruning capital spending

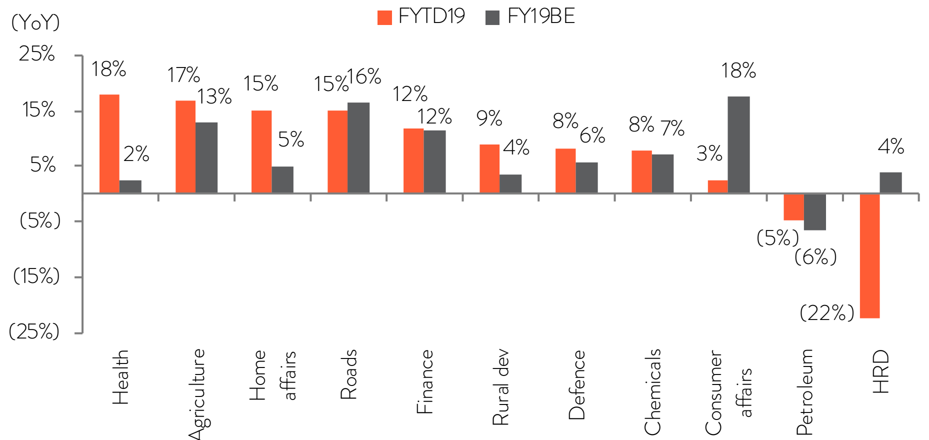
The Centre had estimated a 10.1% increase in its overall expenditure for FY19 led by a 10.2% rise in revenue spend and 9.9% increase in capital outlay. In the first eight months of the year (Apr-Nov'18), the government's revenue expenditure has increased by 9.8%, in line with annual projections. However, capex has been lower than BE at 4%, and we believe this trend will continue for the year. We thus expect the government to restrict its spending to Rs 24tn vs. BE of Rs 24.4tn.

Priority areas seeing above-budget spends…

While presenting the FY19 Budget, the Finance Minister had raised the food subsidy allocation by 21% to implement the government's promise of 50% gross margin to farmers – to this end, MSPs of paddy and wheat were subsequently increased by 12.9% and 6% respectively. In addition, the roads programme also received a boost with a 16% increase in BE. NHAI was expected to raise Rs 620bn from the market to fund its expansion programme (vs. Rs 593bn in FY18RE).

Reflecting the government's priority areas, the FYTD19 increase in spending on health stands at 18% vs. 2% BE, agriculture at 17% vs. 13%, home affairs at 15% vs. 5%, rural development at 9% vs. 4%, and defence at 8% vs. 6%.

FIG 5 – EXPENDITURE BREAKDOWN REFLECTS PRIORITY SECTORS



Source: CEIC, Union Budget Documents, Bank of Baroda Research

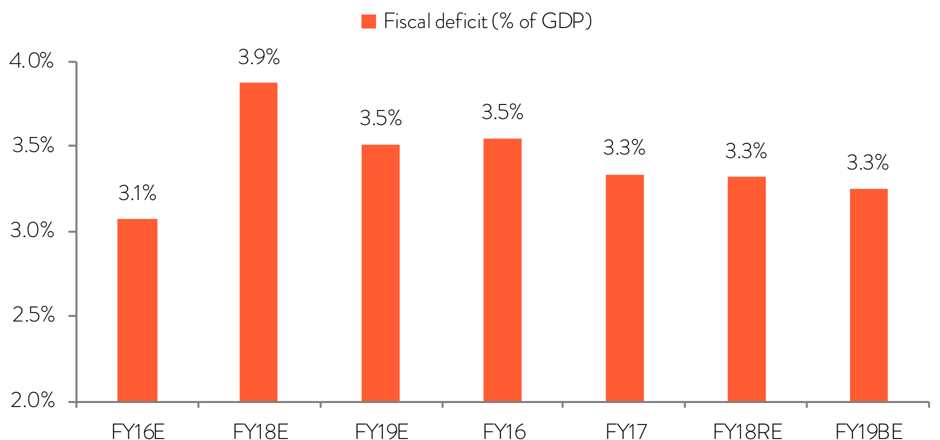
…funded by select cuts in subsidy/education outlay

In the two supplementary demands this year, the net cash outgo is estimated at Rs 211bn led by public sector bank (PSB) recapitalisation, the MNREGA rural employment programme and equity infusion into Air India. The Centre has been able to curb expenditure on some subsidies and education to meet its priorities. Overall, we expect the government to restrict its spending to Rs 24tn vs. BE of Rs 24.4tn, thus implying savings of 0.2% of GDP.

Fiscal deficit pegged at 3.3% in FY19E

With the government expected to cut its proposed expenditure by Rs 400bn in FY19 in light of lower revenue receipts, we estimate the fiscal deficit for the year at 3.3% of GDP or Rs 6.25tn vs. BE of Rs 6.24tn. This is positive for the bond markets but implies a lower growth impulse in H2FY19.

FIG 6 – FISCAL DEFICIT TO MEET TARGET IN FY19E



Source: Union Budget Documents, Bank of Baroda Research | Note: E-Bank of Baroda Estimates; BE-Budget Estimates; RE-Revised Estimates

FY20 outlook

Direct tax collections to continue growing

We estimate strong 16% growth in direct tax collections in FY20, buoying overall receipts to Rs 26.8tn compared with Rs 24tn in FY19E. This gives the government additional room to spend on its key schemes without driving an increase in fiscal deficit from current levels.

Continued buoyancy seen in direct taxes

In FY20, we estimate direct tax collections to increase to Rs 13.8tn (+16.3% over FY19E), led by both corporate and income tax collections. On the corporate tax front, the growth would be led by the banking sector where a steady decline in non-performing loans should translate to higher profitability. Income tax collections should also remain buoyant because of higher compliance and an increase in wages and the workforce. While we expect direct tax collections to grow at a slower pace than FY19E, this is on account of the base effect and a likely increase in tax sops for the middle class.

Limited growth prospects for indirect revenues

The government is aiming to further reduce the number of products in the 28% GST tax slab (already down from 229 to 28 products as of Dec'18). This will continue to impact indirect tax collections in FY20, which we estimate will grow by 8.3% compared with 6.1% in FY19E.

Spectrum auctions to elevate non-tax revenues

We expect the government's non-tax revenues to increase by 15.4% in FY20 compared with 13.3% in FY19E. This will be driven by (1) 5G spectrum auctions (likely in the latter half of 2019) and (2) dividends and profits from PSUs, in particular PSBs which are seeing a decline in non-performing loans. Transfer of surplus funds from the RBI is forecast to continue at the FY19 run-rate, but may rise if the Bimal Jalan committee recommends transfer of additional reserves.

Higher G-Sec issuances to boost capital receipts

Capital receipts in FY20 are estimated at Rs 7.7tn compared with Rs 7.1tn in FY19E. The increase will likely be led by higher gross and net issuances of government securities (internal borrowing) at Rs 5.7tn (Rs 5.35tn in FY19E) and Rs 4.2tn (Rs 3.9tn in FY19E) respectively.

Rural and roads – key focus areas

We believe the FY20 Budget will carry forward the government's impetus on rural & farm incomes and infrastructure. Allocation to the rural/farm sector in the form of income support, farm procurement, subsidies, subvention, housing, health and sanitation is thus likely to see a large boost, with spends estimated to rise to 2.9% of FY20 GDP.

Farm/rural sector could see Rs 1.1tn stimulus

The government is already running ahead of its rural spending trajectory for FY19BE. The overall rural spend from the ministries of agriculture and rural development was budgeted at Rs 1.8tn in FY19. We expect a 40% spike in budgetary allocation for agriculture followed by a 30% rise for rural development. In addition, the allocation toward subsidies for procuring food grains is also likely to be augmented.

Thus, the farm/rural sector is likely to see a stimulus of Rs 1.1tn through direct spending or higher subsidies in FY20. Overall, we estimate that total farm sector spending will rise from 2.6% of GDP to 2.9% of GDP in FY20.

Different game plans for Rural India

- One potential scheme that could be announced this budget is a financial assistance programme to farmers along the lines of 'Rythu Bandhu' in Telangana (direct transfer of Rs 4,000 per acre per season). Compared to price support and loan waiver schemes, measures to enhance farmer income are more far-reaching and provide a long-term solution to farm distress.

- The government is also likely to focus on e-NAMs (online agri trading markets) so as to bridge the gap between farmers and consumers. This scheme could get a boost with higher allocation for linking 'mandis' with farmers.

- The budget could raise allocation towards crop insurance and subvention schemes which lower farmers' cost of borrowing.

Roads – expect 25% rise in allocation

For the roads sector, we forecast a 25% increase in allocation, ensuring that the government's focus on this sector remains visible. Apart from this, rural health and sanitation could see a jump in spending. Already the Ayushman Bharat scheme has clocked 685,000 beneficiaries in 100 days of implementation.

Total expenditure to rise 11.6%

Overall, we expect the government's total expenditure to rise by 11.6% in FY20 compared with an 8.4% increase in FY19E. Allocation toward capital investments is projected to remain at 10%, while revenue spending is forecast to rise to 11.8% from 8.9% in FY19E.

Fiscal deficit to hold at 3.3% of GDP in FY20E

In our view, sustained buoyancy in direct taxes will support the Centre's likely largesse towards rural development, containing the FY20E fiscal deficit at 3.3% of GDP. We note that central fiscal deficits have been imparting a negative-to-neutral fiscal stimulus in the last eight years. However, states have seen a positive fiscal impulse with deficits now at 3% of GDP. In FY20, the consolidated fiscal impulse is likely to remain neutral.

Fiscal impulse to be neutral

The share of central government spending in the economy has been steadily declining from 15.8% of GDP in FY09 to 13.8% in FY14 and 13.1% in FY19BE. The decline has slowed in the last five years as the government has been able to increase income tax buoyancy from 2% of GDP in FY13 to 2.8% in FY19BE. A similar increase has been seen in the Centre's overall tax revenue.

Given the backdrop of sharp deceleration in global growth and farm distress in the Indian economy, a positive fiscal stimulus may do more good than harm. Notably, the fiscal impulse requires an additional borrowing of only Rs 350bn while ensuring that the deficit remains at the FY19E level of 3.3% of GDP.

FIG 7 – FISCAL ESTIMATES

(Rs bn)	FY17	FY18RE	FY19BE	FY19E	FY20E	% Increase FY19E	% Increase FY20E
Tax Revenue							
Corporation Tax	4,849	5,637	6,210	6,572	7,558	16.6	15.0
Taxes on Income	3,646	4,413	5,290	5,290	6,242	19.9	18.0
Indirect Taxes	8,620	9,364	11,160	9,933	10,753	6.1	8.3
Total - Tax Revenue	**17,158**	**19,461**	**22,712**	**21,848**	**24,611**	**12.3**	**12.6**
Less: State's Share	6,080	6,730	7,881	7,581	8,540	12.6	12.6
Centre's Tax Revenue	11,014	12,695	14,806	14,242	16,044	12.2	12.7
Total Non-Tax Revenue	2,728	2,360	2,451	2,673	3,083	13.3	15.4
Centre's Revenue (net)	13,742	15,054	17,257	16,915	19,128	12.4	13.1
Capital Receipts							
Internal Debt Market Borrowing	4,082	4,594	4,621	3,915	4,200	(14.8)	7.3
Disinvestment	477	1,000	800	800	750	(20.0)	6.3
Others	1,450	1,529	1,744	2,415	2,747	57.9	13.7
Total Capital Receipts	**6,010**	**7,123**	**7,165**	**7,130**	**7,697**	**0.1**	**7.9**
Draw-down of Cash Balances	(89)	(394)	431	650	500	-	-
Total Receipts	**19,752**	**22,178**	**24,422**	**24,045**	**26,824**	**8.4**	**10.1**
Expenditure							
Interest Payments	4,807	5,308	5,760	5,866	6,452	10.5	10.0
Defence Expenditure	2,518	2,671	2,827	2,805	2,945	5.0	5.0
Subsidies	2,040	2,297	2,643	2,590	2,913	12.8	12.5
Transfer to States	1,327	1,203	1,429	1,383	1,577	15.0	14.0
Rural Development	1,139	1,356	1,381	1,478	1,922	9.0	30.0
Transport	1,022	1,071	1,346	1,339	1,673	25.0	25.0
Home Affairs	784	881	935	970	1,033	10.0	6.5
Education	720	819	850	761	803	(7.0)	5.4
Agriculture	502	566	638	651	911	15.0	40.0
Others	4,893	6,005	6,613	6,203	6,596	3.3	6.3
Total Expenditure	**19,752**	**22,178**	**24,422**	**24,045**	**26,824**	**8.4**	**11.6**
Revenue	16,906	19,443	21,418	21,174	23,666	8.9	11.8
Capital	2,846	2,734	3,004	2,871	3,158	5.0	10.0
Revenue Deficit	3,164	4,389	4,160	4,259	4,539	(3.0)	6.6
Fiscal Deficit	**5,356**	**5,948**	**6,243**	**6,252**	**6,797**	**5.1**	**8.7**
% of GDP	**3.5**	**3.5**	**3.3**	**3.3**	**3.3**	**-**	**-**

Source: Union Budget Documents, CEIC, Bank of Baroda Research; E-Bank of Baroda Estimates; BE-Budget Estimates; RE-Revised Estimates

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