Press Release

Union Budget FY23: CAPEX set to be a booster shot for growth

Higher government borrowings, however to push up interest rates

2 February 2022

Against the backdrop of pandemic induced prolonged economic challenges, the FY23 Union Budget has focused on nurturing the nascent growth impulses by embarking on a massive public capital expenditure with the intention of crowding in private investment. The Budget's broad based thrust on infrastructure creation largely grouped under 'PM GatiShakti National Master Plan' is unequivocally commendable as the enhanced outlay on capital spending is visible across roads and highways, railways, airports, ports, urban infrastructure among other sectors. This master plan is aimed at making logistics connectivity seamless across not only the length and breadth of the country but also across different modes of transport.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings "Capex is the new OTP for India's fiscal policy. PM GatiShakti will not only give a strong boost to construction activities that will rev up the growth engine but the policy focus on expeditious movement of goods and passengers will clearly have a positive impact on easing of domestic supply constraints and also improve India's export competitiveness over the medium term."

From the fiscal perspective, the overall fiscal deficit for FY22 got pegged marginally higher at 6.9% of GDP from 6.8% reflecting the backloaded expenditure in FY22 which is budgeted to increase by 8.3% to INR 37.7 tn. Interestingly on disinvestment front, the centre in FY22 RE and FY23 BE has lowered its target significantly to INR 780 bn and INR 650 bn respectively. The achievability of the revised disinvestment target for FY22 still hinges on the IPO of the national insurer in the current fiscal, albeit for a relatively smaller size, as the government so far has garnered just INR 120 bn in FY22. For FY23, fiscal deficit is expected to consolidate marginally to 6.4% of GDP, premised on a relatively conservative nominal GDP growth of 11.1%. On the revenue front, tax revenue as well as non-tax revenue projections appear realistic with total receipts expected to ease from 9.4% of GDP in FY22 RE to 8.9% in FY23. On the expenditure side, the capital expenditure is likely to rise to a record high of 2.9% of GDP in FY23 which comes to INR 7.5 tn leading to a sharp improvement in quality of spending. This includes INR 1.0 tn in loans to states for capital expenditure (v/s INR150bn in FY22RE) which recognizes the importance of states in implementing public capex programmes. On the other hand, the budget has surprised by rationalization of total subsidies by 27% to INR 3.18 bn which was contrary to market expectations of a significant rise in food and fertilizer subsidies amidst several state elections being round the corner and surge in global fertilizer prices. Further, the allocation towards MGNREGA, India's largest rural jobs scheme has also been lowered by 25% from FY22 RE to INR 730 bn in FY23 on the expectation of an improvement in the employment scenario due to the wind down of the pandemic.

Says Suman Chowdhury "The budget has resisted populist expectations which not only included tax cuts for the salaried class but also a higher outlay for welfare programmes. Nevertheless, we believe that the government's expenditure policy will remain flexible depending on the economic scenario as well as the residual pandemic impact and such a dynamic fiscal approach has been well articulated in the Economic Survey. There is still an opportunity to explore measures for strengthening the currently weak consumption demand such as GST rationalisation for durable goods such as two wheelers. What we also find noteworthy in the fiscal print is the pragmatic approach towards disinvestment and asset monetisation, scaling down targets to levels that are more realistic and achievable."

With successive pandemic waves along with the pre-pandemic economic slowdown having a profound adverse impact on the MSMEs' businesses, the extension of ECLGS scheme up to Mar-23 along with expansion of the guarantee cover to INR 5.0 tn is a step in the right direction to provide further liquidity relief to the sector. Additionally, plans to revamp the CGTMSE scheme (Credit Guarantee Trust for Micro and Small Enterprises) will further aid in facilitating additional credit and expand employment opportunities.

Further, in an endeavour to promote cleaner mobility and strengthening the whole ecosystem of the EV industry, battery swapping policy and interoperability standards have been announced in the Budget that will enhance charging infrastructure and incentivise EV ownership. The orientation of public policy towards sustainable energy is evident through the proposal of increased use of EVs in mass transportation. One of the challenges in renewable energy capacity augmentation in India has been the import dependence for solar modules. The announcement of a PLI scheme of INR 195 bn for indigenous manufacture of solar PV modules will not only ease supply constraints but also speed up private sector investments in the solar energy space.

Adds Suman Chowdhury "Another important step towards sustainability is the plan to issue Sovereign Green Bonds to fund clean energy and green infrastructure projects undertaken by the public sector. The green bond market is globally expanding at a fastest pace, and this will help India access long term funds at a competitive rate. This will also improve the ESG climate in the country."

While the fiscal deficit projected for FY23 has been as per our expectations, the market borrowings for funding the fiscal deficit surprised negatively as the centre pegged the gross and net borrowings via G-sec significantly higher at INR 14.95 tn and 11.2 tn respectively, which is set to be significantly higher than the current year. However, the reliance on small savings is budgeted to be relatively less at INR 4.25 tn as compared to the current year in order to bridge the fiscal deficit of 6.4%. The spillover risks from higher market borrowing, government's decision of prioritizing growth over fiscal consolidation and uncertainty on India's inclusion in global bond indices got reflected in 10-year bond yields which hardened significantly closing at 6.8% post budget. Going forward, the sentiment in the bond market, however will get influenced by the monetary policy stance post Budget. Given that the adverse spill over from Omicron is expected to be limited, the central bank could consider moving reverse repo rate up by 20 bps in the Feb-22 policy review to signal the start of interest rate normalization cycle, thereby validating the visible upside to bond yields. As such, we expect bond yields to further move towards 7.25% by Mar-23.

Concludes Suman Chowdhury "Overall, Union Budget 2022 is designed to deliver long term structural growth to the economy through a sustained capex cycle that will involve both public and the private sector, provide short term relief to the pandemic impacted smaller businesses and bring in a slew of policies to ensure the adoption of clean energy and sustainability on an increasing scale. While we believe that the government has built a cushion through high expenditure levels and the actuals can be lower depending on the revenue buoyancy, the projected jump in government borrowings is indeed a concern along with the ongoing inflationary pressures. It may be a challenge for the central bank to keep the bond yields under control over the next fiscal if such high borrowings fructify."

Annexure

Chart 1: Quality of spending to undergo a sharp improvement in FY23

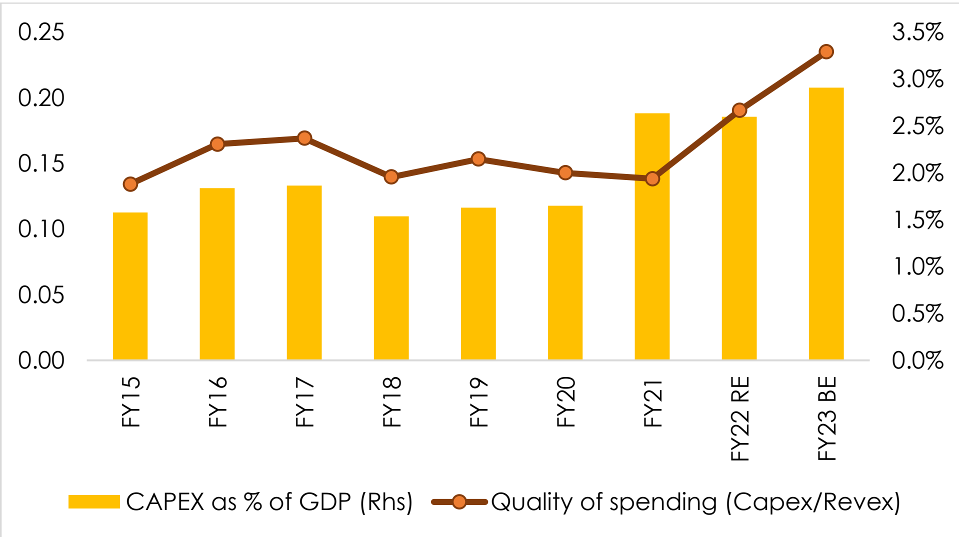

Table 1: Key Fiscal Figures

INR bn	FY21 A	FY 22 BE	FY22 RE	FY23 BE
Total Receipts	**16915**	**19764**	**21789**	**22837**
Revenue Receipts	16339	17884	20789	22044
Net Tax Revenue	14,263	15,454	17,651	19,348
Non-Tax Revenue	2,076	2,430	3,138	2,697
Non-Debt Capital Receipts	576	1,880	1,000	793
Disinvestments	379	1,750	780	650
Total Expenditure	**35098**	**34832**	**37700**	**39449**
of which, Subsidies	7582	3699	4879	3556
Food	5413	2428	2865	2068
Fertilizer	1279	795	1401	1052
Petroleum	385	141	652	581
of which, Interest payments	6799	8097	8138	9407
Revenue Expenditure	30835	29290	31673	31947
Capital Expenditure	4263	5542	6027	7502
Fiscal Deficit	**18183**	**15069**	**15911**	**16612**
Fiscal Deficit / GDP	**9.2%**	**6.8%**	**6.9%**	**6.4%**
Revenue deficit/GDP	6.9%	5.1%	4.7%	3.8%
Primary deficit/GDP	5.4%	3.1%	3.3%	2.8%

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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