The following is a redacted version of the original report.

India: Union Budget FY22: Tapering Fiscal impulse in FY22 After Bigger Near-term Boost

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Bottom line: India's FY21 and FY22 fiscal deficit was significantly higher than expectations, primarily due to a one-off move by the finance ministry to repay past arrears due to the Food Corporation of India (FCI), and include all food subsidies on the budget going forward. However, spending seems likely to ramp up significantly over the next few months even after factoring in this one-off impact. The underlying spending pace is projected to fall in FY22 despite robust capex spending – with a lower overall fiscal impulse to growth than in FY21. The budget was more positive for equities, less so for bonds given larger-than-expected supply and the slower pace of deficit normalization.

1. Today the finance minister unveiled India's FY22 budget (FY22 in India runs from April 2021- March 2022). The budget outlined six pillars (Exhibit 1) to further the *Atmanirbhar Bharat* or self-sufficient India initiative with a focus on healthcare (providing universal water supply, improving waste management, vaccine procurement, voluntary vehicle scrapping program), physical infrastructure (the establishment of a new development financial institution as well as sale of existing infrastructure assets to support new infrastructure projects), financial capital (additional public sector bank (PSB) capital infusions, and setting up of an asset reconstruction and management company to take stressed debt off PSB balance sheets), while furthering inclusive development via enhancing human capital (national education policy, higher education commission), innovation and R&D (grant to set up national research foundation).
2. **The FY21 fiscal deficit was significantly higher than expectations, despite taking a modestly more positive view on revenue growth through fiscal year-end...** The government reported a revised FY21 fiscal deficit estimate of 9.5% of GDP. This was ~6pp above initial budget estimates of 3.5% of GDP (Exhibit 2), and significantly above our forecast (7.5%) and median consensus estimates (7.6%). On the revenues side, total revenues missed budget targets by 1.8pp. The key drivers of the shortfall were (1) a large miss on the disinvestment target (84% below budget target) which contributed 0.8pp to the shortfall, (2) a fall in non-tax revenues which includes dividends and profits from public sector enterprises (45% below target), which contributed 0.6pp to the shortfall, and (3) a fall in net tax revenues (-18% versus budget target) due to large drops in corporate, personal and GST taxes, though this was offset somewhat by an increase in excise revenues due to the large fuel excise hike last year. However, the estimated shortfall was modestly smaller than we had estimated prior to the budget, which suggests there may be some downside

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risks to government targets through March should direct tax collections fall short of expectations.

3. **… primarily due to a one-off move to repay past arrears due to the Food Corporation of India (FCI) and include all food subsidy payments on the budget going forward**. The key driver of the fiscal deficit overshoot versus expectations however, was a 4.2pp increase in total expenditures to 17.7% of GDP, versus the initial budget estimate of 13.6% of GDP. This is more than 2pp above our revised spending estimate prior to the announcement, and accounts for most of the shortfall in the deficit versus our expectations (and likely consensus expectations as well). At first glance, this suggests a significant increase in total spending of 28% yoy in FY21, versus the initial budget estimate of 13.2%. However, looking more closely, a large portion of this increase in spending is due to the rise in the overall food subsidy bill to INR 4.22tn (2.2% of GDP), from INR 1.16tn (0.5% of GDP). This was a consequence of the finance ministry finally deciding to make provisions to retire losses of the Food Corporation of India (FCI) accumulated over prior years (for more detail on this see footnote 1)[1].

4. **However, spending seems likely to ramp up through March 2021 even after factoring in this one-off impact to retire FCI debt.** Even after accounting for this one-off provisioning to pay off FCI arrears – our estimate is that underlying government spending would still grow over ~17% this fiscal year (FY21) if the government met its spending targets. Given the spending increase in the fiscal year through December has been just 8.1% yoy YTD, the revised budget implies a pickup in government spending to over 50% yoy this quarter (from 29% yoy in Q4 2021) if the government meets its spending targets. This is a meaningful upside risk to our current Q1 GDP growth forecast.

5. **The FY22 fiscal deficit was also above expectations, however, the underlying spending pace is projected to fall in FY22 despite robust capex spending – with a lower overall fiscal impulse to growth than in FY21.** Beyond the current financial year, however, the government forecasts a lower fiscal deficit of 6.8% in FY22 (GS forecast: 6.2%, Consensus forecast: 5.5%) versus the revised FY21 estimate of 9.5% of GDP. Overall spending is expected to increase just 1% yoy (vs. the 28% yoy pace budgeted for FY21), with capex expected to grow the most at 26% yoy (vs. 31% yoy in FY21). As noted above, the FY21 base was affected by the one-off FCI arrears provisioning. If we adjust for this, the underlying spending pace would still be over 8.6% yoy in FY22. So the overall fiscal impulse to growth is likely to be lower than in FY21, although not as low as headline fiscal numbers would suggest.

6. **Ambitious disinvestment target, but conservative FY22 revenue assumptions**

[1] For some background, the Food Corporation of India buys food from farmers at the marginal support prices announced by the government each year, and distributes it at low prices via the public distribution system ration shops. Since it makes losses, the government usually provides subsidy allocations to FCI. However, in recent years, these subsidy transfers fell short of actual losses as the government strove to maintain respectable fiscal deficit metrics. The FCI borrowed the shortfall from the national small savings fund (NSSF). This year, in a bid to clean up the fiscal arithmetic, the government decided to take these arrears back on the balance sheet, and discontinue NSSF loans to the FCI – this led to the large jump in expenditures versus our and consensus expectations.

relative to prior years. As spending remains elevated, fiscal consolidation is expected to be driven by an increase in tax and non-tax revenues, as well as disinvestment proceeds. Total revenues are expected to grow 15% yoy as both net tax revenues and non-tax revenues rebound in line with the government's nominal GDP growth estimate. The overall tax and non-tax revenue assumptions seem reasonable to us, with some upside should nominal GDP growth overshoot government estimates, and be in line with our above-consensus GDP growth estimates. However, disinvestment proceeds are projected to rise to 0.8% of GDP in FY22, up from 0.2% of GDP in FY21. These estimates appear ambitious to us given that it is double the 0.4% of GDP that the government has gathered on average from disinvestments over the past five years.

7. **More negative outlook for bonds given larger-than-expected supply and slower pace of deficit normalization.** In terms of implications for bond markets, the extra INR0.8tn borrowing this fiscal year, higher-than-expected borrowing schedule for FY22 with the budget implying gross market borrowing of INR12tn (a Bloomberg survey suggests market participants were expecting INR10.6tn in gross borrowings for FY22 prior to the event), relaxation in state borrowing limits to 4% of state GDP, and a more gradual path of fiscal consolidation going forward (the fiscal deficit is now targeted to fall to below 4.5% of GDP over the next five years, versus the 3%of GDP fiscal deficit target that had been visualized under the previous medium-term fiscal consolidation path) further weighs on bond demand-supply dynamics. This on top of stretched valuations, and a host of other emerging risks including rising global commodity prices, inflation, and further increases in global rates makes us wary of receiving back-end rates.

8. **RBI to continue to lean against broad-based FX appreciation pressures.** Overall, the budget is likely to be more positive for equities inflows versus bonds, as witnessed in the price action during the day. However, in terms of the overall FX impact, we continue to expect RBI to lean against broad based FX appreciation pressures over the coming year, given the focus on manufacturing competitiveness and building buffers to soften pro-cyclical feedback loops between domestic financial conditions and the global financial cycle.

Exhibit 1: Key budget announcements

Sector	*Key Annoucements*
Healthcare	- **PM AtmaNirbhar Swasth Bharat Yojana:** New centrally sponsored scheme to support heath and wellness centers in urban and rural areas, setting up integrated public health laboratories, establishing critical care hospital blocks. (INR 642 bn over 6-years) - INR 350 bn for COVID-19 vacines
Urban Development	- **Vehicle Scrapping Policy:** Voluntary vehicle scrapping policy to phase out old vehicles; Fitness tests for personal vehicles after 20-years/commercial vehicles after 15-years - **Jal Jeevan Mission (Urban):** To promote univeral water supply in urban local bodies and liquid waste management in AMRUT Cities
Infrastructure	- Production-Linked Incentive Scheme to help manufacturing companies (INR1.97tn over 5-years) - National Infrastructure Pipeline (NIP) expanded to 7400 projects - **New Development Finance Institution (DFI)** to support infrastructure financing (INR 5 tn in 3 years) - Infrastructure asset monetization to generate more funds for new infrastructure projects. - To enable consumers to be able to choose from more than one distribution company in power sector. - National Rail Plan: Adequate rail infrastucture by 2030 to cater to traffic requirements until 2050 - Increase in overall capex budget by 26%
Banking and Credit	- **Bad Bank:** Asset reconstruction and management companies to consolidate and take over the stressed assets of public sector banks. - Recapitalization of Public Sector Banks by INR 200 bn - Increase in FDI limit in the insurance sector to 74% from 49%
Taxation	- Time-limit for re-opening of direct tax assessments reduced to 3 years from 6 years - Senior citizens above 75 years of age with only pension and interest income exempted from filing income tax returns
Disinvestment	- **Strategic Disinvestment Policy:** In strategic sectors such as atomic energy, space, defense, telecommunication, energy and banking sectors, there will be minimum presence of public sector enterprises. The remaning CPSEs in stragic sectors and all CPSEs in non-strategic sectors will be privatized or merged or clubbed with other CPSEs or closed. - **Disinvestment target** at INR 1.75 trillon: 2 PSU Banks + one general insurance company + LIC IPO + Air India + BPCL + SPV for PSU land sale
Social Security	- Online portal to provide social security benefits to gig, building and construction workers
Fiscal Position	- Fiscal deficit to reach below 4.5% of GDP by FY26. - States are allowed to borrow upto 4% of GSDP for FY22.

Source: Union Budget FY22

Exhibit 2: A lower fiscal deficit and slower spending growth in FY22

	INR bn.			% Year-over-year			% GDP		
Central government fiscal balance	**FY21 (BE)**	**FY21 (RE)**	**FY22 (BE**	**FY21 (BE) vs FY20 realized**	**FY21 vs. FY20 realized**	**FY22 (BE) vs. FY21 (RE)**	**FY21 (BE)**	**FY21 (RE)**	**FY22 (BE)**
Fiscal deficit (1-2-3-4)	***7963***	***18487***	***15068***	***-15***	***98***	***-18***	***3.5***	***9.5***	***6.8***
1) Expenditure	***30422***	***34503***	***34832***	***13***	***28***	***1***	***13.5***	***17.7***	***15.6***
Capital expenditure	4121	4392	5542	23	31	26	1.8	2.3	2.5
Revenue expenditure	26301	30111	29290	12	28	-3	11.7	15.5	13.1
Of which: Subsidies	2278	5954	3354	0	161	-44	1.0	3.1	1.5
Food	1156	4226	2428	6	289	-43	0.5	2.2	1.1
Fertilizer	713	1339	795	-12	65	-41	0.3	0.7	0.4
Petroleum	409	388	130	6	1	-66	0.2	0.2	0.1
Of which: Interest payments	7082	6929	8097	16	13	17	3.1	3.6	3.6
2) Revenue (net to centre)	***16359***	***13445***	***15454***	***21***	***-1***	***15***	***7.3***	***6.9***	***6.9***
Gross tax revenue	24230	19003	22171	21	-5	17	10.8	9.8	9.9
Corporation	6810	4460	5470	22	-20	23	3.0	2.3	2.5
Income	6380	4590	5610	30	-7	22	2.8	2.4	2.5
Customs	1380	1120	1136	26	2	1	0.6	0.6	0.5
Union excise	2670	3610	3350	12	51	-7	1.2	1.9	1.5
Services	10	14	10	-83	-77	-29	0.0	0.0	0.0
GST	6905	5151	6300	15	-14	22	3.1	2.6	2.8
Other	75	58	295	6	-18	410	0.0	0.0	0.1
Non-tax revenue	3850	2107	2430	18	-36	15	1.7	1.1	1.1
3) Recovery of loans	***150***	***145***	***130***	***-18***	***-21***	***-10***	***0.1***	***0.1***	***0.1***
4) Privatization receipts	***2100***	***320***	***1750***	***317***	***-36***	***447***	***0.9***	***0.2***	***0.8***
Nominal GDP	***224894***	***194820***	***222874***	***11***	***-4***	***14***	***100***	***100***	***100***

Source: Goldman Sachs Global Investment Research, Union Budget FY22

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