Budget FY22 – A Paradigm Shift

Feb 1, 2021

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Presentation flow

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- Macro Background – Global & India
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- Debt & Equity market outlook
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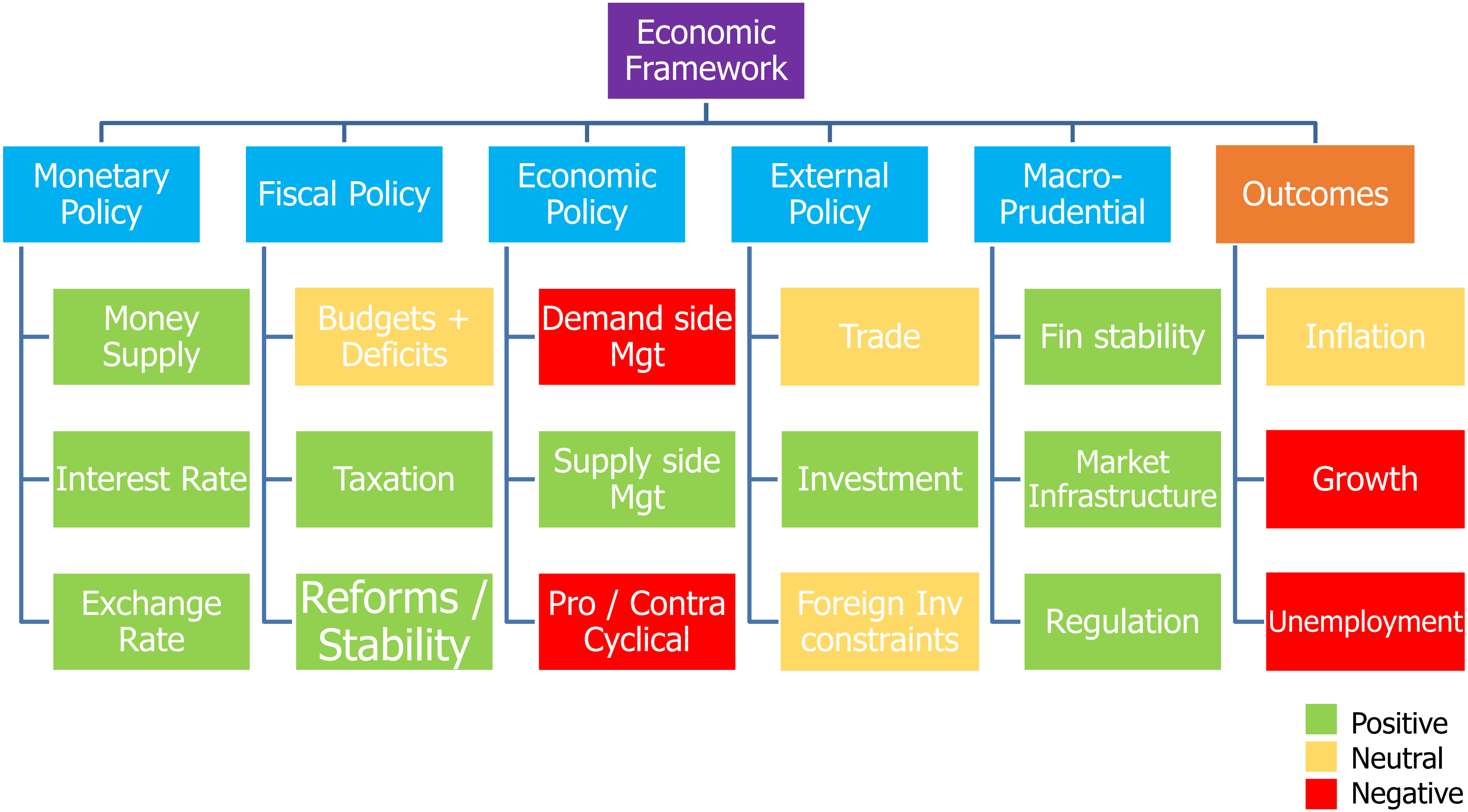
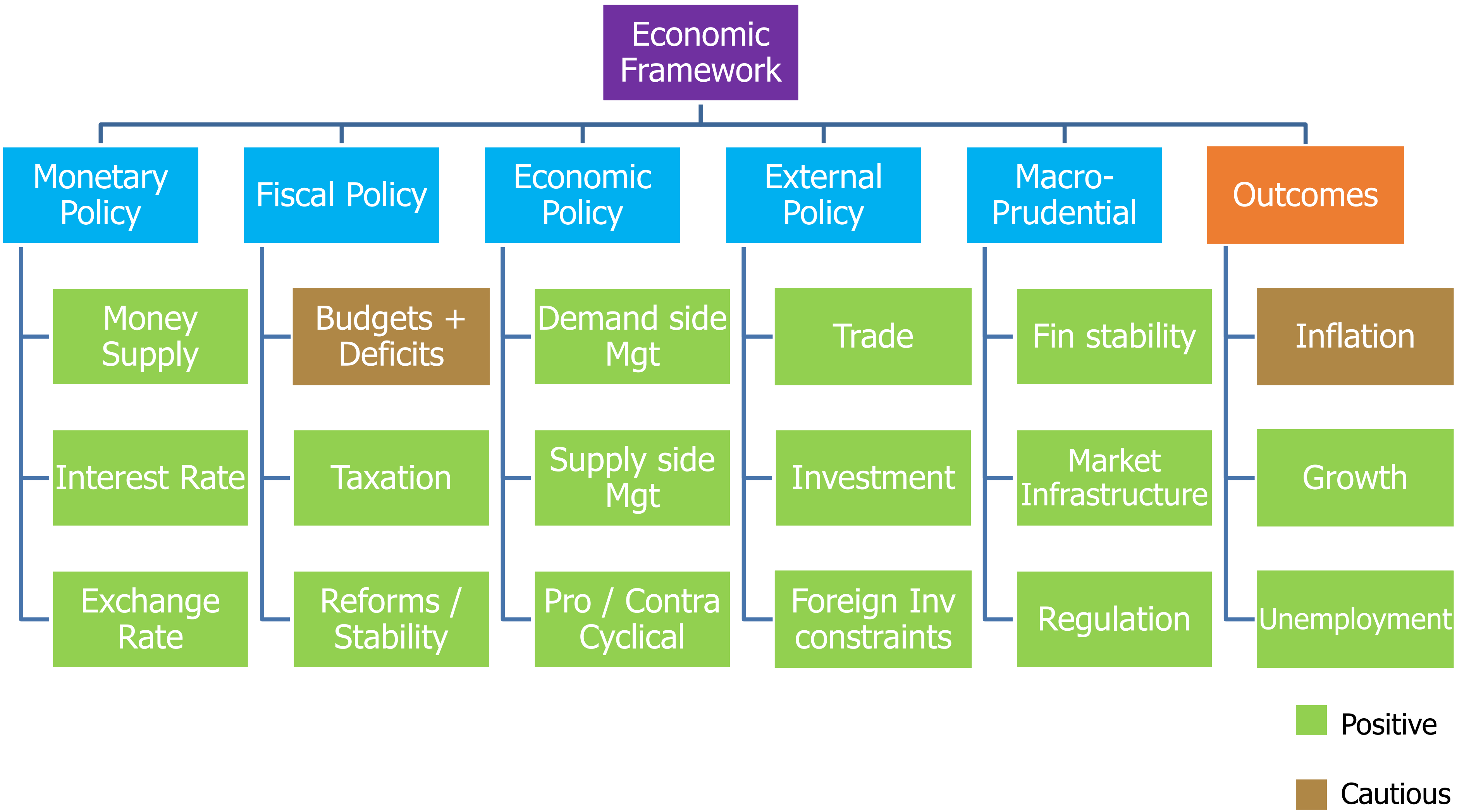
Economic Framework : Building Blocks – Pre Budget



Economic Framework : Building Blocks – Post Budget



Paradigm Shift Budget

- **Shift of focus to the demand side:** After focusing on the supply side for many years, the focus has now moved to the demand side. The Budget has taken the view that it is important to increase spending across all sectors to push household and investment demand. This is a continuation of the policy the government adopted since the onset of the pandemic.
- **Bold Budget:** Government has boldly overcome the constraints of FRBM & MPC in the context of post-covid economic challenges to stimulate demand – fiscal deficit pegged at 9.5% for FY20-21 & 6.8% for FY21-22. FRBM rate to be gradually brought down to 4.50% by FY2026- reflecting continued & committed pro-growth stance.
- **Unconstrained:** The government has acted boldly by ignoring overhangs such as concerns about sovereign rating downgrade, high fiscal deficit, elevated inflation due to low-interest rates & high liquidity, currency risk etc.
- **Policy Coordination:** Past budgets have not always worked well with monetary policy; however, this Budget builds on the significant liquidity support and benign rate environment provided by the RBI and boosts the economy in the current year and for the next several years based on the forward guidance until FY26.

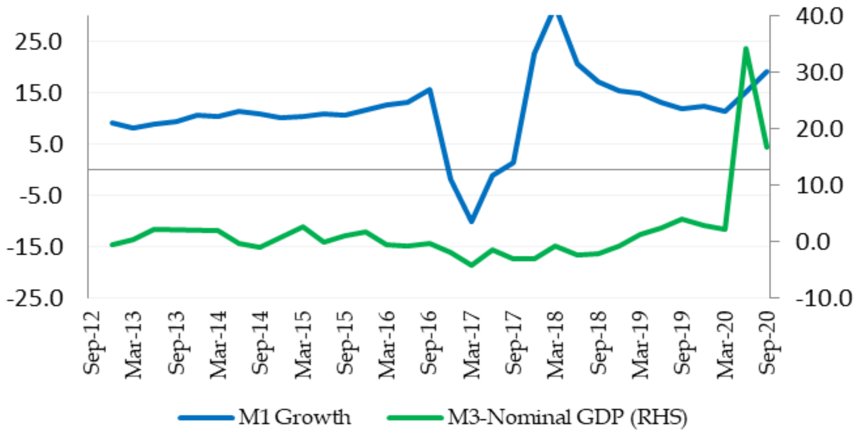
This paradigm shift has set aside historical constraints and allowed the government to boost the economy, which we expect will result in structural growth and return of animal spirits, triggering a new impulse to private capex and credit growth cycle.

Macro Background: Global Context

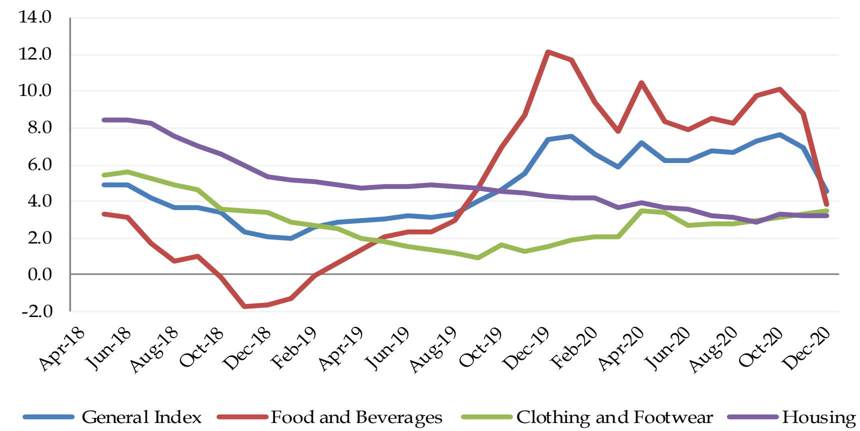
- Budget presented in a difficult but improving global environment
  - Following a contraction of 3.5% in 2020, global growth is estimated to be 5.5% in 2021 and 4.2% in 2022.
  - EMDE market economies are expected to grow faster than AE economics reflecting the more severe impact of the pandemic spread in AEs.
  - Oil prices are expected to rise from a low base in 2020 but will remain well below their average for 2019.
  - Global financial conditions are expected to remain benign with major central banks taking an accommodative stance and providing unprecedented liquidity support.
  - The pandemic has exacerbated the risks associated with global debt accumulation.
  - Debt burdens have increased as corporates faced a period of sharply reduced sales, and sovereigns have financed large stimulus packages.
  - Continued dollar weakness providing a boost to EM assets.
  - Key uncertainties and risks to the expected global recovery include the possibility of variant strains, delays in vaccine procurement and distribution, and financial stress triggered by high debt levels and weak growth.

Macro Background: Indian Context – Economy expected to overcome constraints and challenges

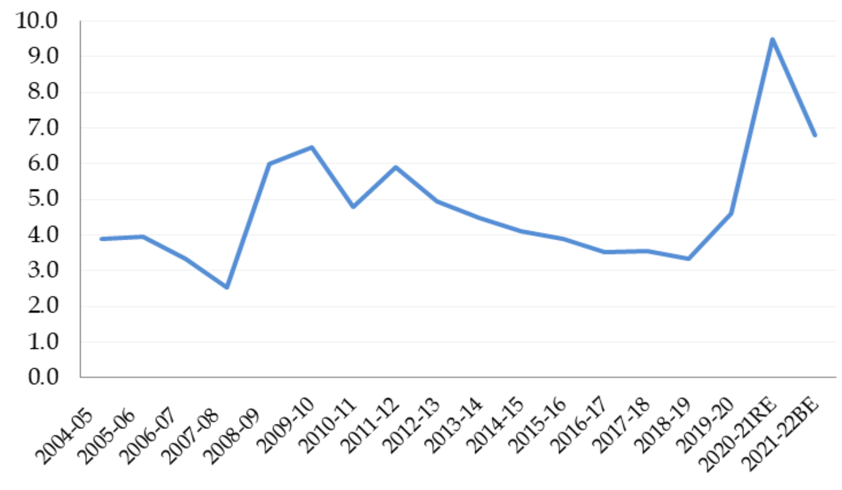
M1 Growth and Monetary Slack



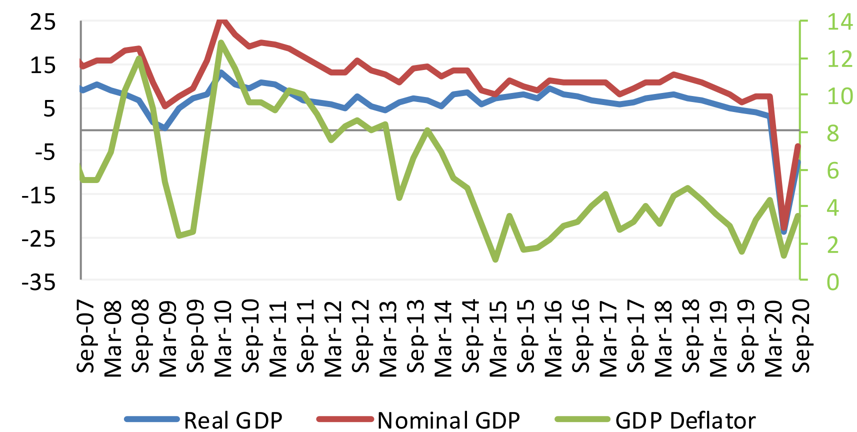
India CPI: Down from Recent highs



Centre Fiscal Deficit (%GDP): Significant Fiscal Stimulus



GDP Growth (2011-12 series): Significant Slowdown but recent upturn



FY22 nominal GDP growth pegged at 14.4% in the Budget

Macro View - INDIA

Indian financial markets have performed strongly since September 2013. However, the market environment has shifted since then with important implications

2013-2020	Current
CPI was running as high as 10.5% in Sept 2013 and has steadily declined over time	CPI had remained elevated despite the pandemic in 2020 but has started moving down in December 2020.
Reflecting the high inflation environment policy rates peaked out at 8% in 2014 but have been brought down steadily over time to 6.5%	The RBI has adopted an accomodative stance but is currently on hold. Government has also been providing fiscal stimulus.
Liquidity conditions were very tight and have improved over time with RBI's change in liqudiy management approach to keep in liquidity in surplus	The RBI has continued to keep systemic liquidiyt in large surplus. As the economy is starting to recover reserve money has increased signficantly driven by an increase in currency demand. This liquidity support has resulted in easy financial conditions.
Commodity prices fell signficantly benefiting the fiscal and current account deficits. Oil prices moved from $110 in Sept 2013 to $30/bbl by January 2016	Crude oil prices have picked up on optimism of demand recovery, continuation of OPEC plus production cuts and are expected to remain volatile in the near-term.
FII holdings espeially in debt markets were very low providing room for signficant inflows	FII inflows have initially been volatile reflecting the uncertainlty associated with pandemic but have gained momentum in recent month in synch with dollar weakness. There has also has been FDI increase despite the COVID challenge.

Budget Numbers

₹ crores

	Particulars	FY20 A	FY21 RE	% chg	FY22 BE	% chg	Comments
Receipts							
	Revenue Receipts	16,84,059	*15,55,153*	-7.7%	17,88,424	15.0%	
	Corporate Tax	5,56,876	4,46,000	-19.9%	5,47,000	22.6%	Achievable
	Taxes on Income	4,92,654	4,59,000	-6.8%	5,61,000	22.2%	
	Customs	1,09,283	1,12,000	2.5%	1,36,000	21.4%	Achievable. Customs duty has increase and imposition of Agriculture Infrastructure and Development Cess (AIDC).
	Excise	2,40,615	3,61,000	50.0%	3,35,000	-7.2%	Achievable. Moderate expectations
	GST	5,98,750	5,15,100	-14.0%	6,30,000	22.3%	
	Capital Receipts	9,97,301	19,12,510	91.8%	16,23,428	-15.1%	
	Disinvestments	50,304	32,000	-36.4%	1,75,000	446.9%	Achievable. Asset monetization, Ongoing and upcoming privatization transactions
	GDP		1,94,59,526		2,21,59,000	13.9%	
Expenditure							
	Revenue Expenditure	26,86,330	34,50,305	28.4%	34,83,236	1.0%	
	Capital Expenditure	9,77,280	10,84,651	11.0%	11,37,067	4.8%	
	Gross Budgetry Support	*3,35,726*	*4,39,163*	30.8%	*5,54,236*	26.2%	
	Ministry of Railways + IEBR	*6,41,554*	*6,45,488*	0.6%	*5,82,831*	-9.7%	
	Fiscal Deficit *(as per previous calc*	9,33,651	15,94,055	70.7%			
	NSSF Loan o/s with FCI	-	*2,54,600*				
	Fiscal Deficit		18,48,655		15,06,812	-18.5%	
	as % of GDP		9.5%		6.8%		
	Revenue Deficit	6,66,545	14,55,989	118.4%	11,40,576	-21.7%	
	Effective Revenue Deficit	4,80,904	12,25,613	154.9%	9,21,464	-24.8%	
	Primary Deficit	3,21,581	11,55,755	259.4%	6,97,111	-39.7%	

Debt Capital Market Takeaways

- Total net–borrowings in BE 2021-22 is projected at ₹9.7 lakh crore compared to ₹12.74 Lakh crore in RE 2020-21. It is important to note the higher deficit now includes loans to FCI and fertilizer subsidies which were not previously included.
- Given the higher fiscal deficit and the resulting borrowing requirement, the debt market will continue to be concerned with the market's ability to absorb the increased supply from the central and state government. Specifically, the FM has indicated the government will borrow ₹80,000 cr over the next two months.
- Looking ahead, we expect the steep yield curve to flatten in the coming months.
- We expect that the government's large borrowing program's market impact will be mitigated partially by RBI OMO and partly by India's inclusion global debt indices.
- The government has taken several steps to lay the groundwork to be included in the EMBI index.
- We believe EMBI index inclusion would be an important factor in the trajectory the bond market takes by facilitating large capital inflows and alleviating capital constraints.
- With index inclusion, we expect benchmark 10-year yields would be range-bound 6-6.25%, while without index inclusion, they could move up to 6.5% in the medium term.

Equity Capital market takeaways

- With most of the policy interventions behind us, there are no significant tax regime changes this year and no more policy volatility.
- GoI has proposed to amend the Insurance Act and hiked the Foreign Direct Investment limit in insurance from 49% to 74%; which shows the continuing reform mindset of the GoI. GoI has proposed privatizing two PSU banks (other than IDBI bank) and one General Insurance company in FY22.
- GoI has announced setting up an ARC and an AMC to consolidate and take over the existing stressed debt and then manage and dispose of the assets to Alternate Investment Funds and other potential investors for eventual value realization.
- With the paradigm shift in GoI’s stance, we expect robust system-wide growth in corporate earnings over next 2-3 years, especially in the backdrop of September 2019 corporate tax rate cut and benign interest rate environment. Aversion to capital intensive businesses would change as improved pricing power, and a higher degree of protectionism will improve cash flows.
- We remain constructive on commodity, capital intensive businesses, PSUs and resultant BFSI sector given lower than expected stress formation, healthy capital levels and improving economic activity.

Sector Impact

- All-around **Infrastructure** thrust in the coming years: Enhanced outlay of ₹1.2 lac crores for Roads; 3500kms corridor in Tamil Nadu, 1100km in Kerala, 675km in West Bengal and 1300 km in Assam proposed. National Monetization Pipeline of potential brownfield infra projects to be launched.
- **Healthcare**: Outlay for Healthcare is up 138% YoY to ₹2.2 lac crores; new central healthcare scheme to strengthen India's healthcare infrastructure.
- **Automobile**: GoI to announce voluntary scrapping policy; fitness test after 20 years for personal vehicles; after 15 years for commercial vehicles; would boost auto volumes in the long term.
- **Oil & Gas**: Asset monetization dashboard to be created to Monetize the gas pipeline of GAIL, HPCL. One hundred more cities to be added to the gas distribution network.
- **Metals**: ~₹1.10 lac crore outlay for railways capital expenditure. Railways to monetize dedicated fright corridor assets for operations and maintenance after commissioning.
- **Insurance**: Proposal to amend the Insurance Act to hike FDI limit to 74% from 49% and allow foreign ownership & control with safeguards.

Sector Impact

- GoI announced a 2.5% hike in customs duty on certain mobile phone parts and power banks
- Customs duty on solar inverters raised from 5% to 20%
- Duty on solar lanterns increased from 5% to 15%
- Customs duty on certain auto parts has gone up to 15%
- Customs duty on cotton increased from nil to 10%
- Customs duty on raw silk and silk yarn increased from 10% to 15%
- Prawn feed to attract customs duty of 15% from earlier rate of 5%
- Agriculture cess increased by 2.5% on Petrol and 4% on Diesel
- Duty increased on steel screws and plastic builderware from 10% to 15%
- For compressors used in AC and refrigerators, customs duty hiked to 15% from 12.5%

Conclusion

- The existing accommodative monetary policy, combined with a strong fiscal stimulus, will provide growth impetus to the economy. The government has also given a steroid shot for economic expansion by increasing the velocity of money and money multiplier.
- The government has signalled that significant policy volatility is behind us, with no intervention on direct or indirect taxes.
- We can now see complete alignment between monetary policy, fiscal policy & economic reforms.
- We expect corporate earnings growth to sustain in their 20s in the coming two years, which has not happened anytime since 2014.
- We expect to get into the next year with a robust economy and a healthy growth rate.
- Given this paradigm shift budget, we believe it is more important to focus on the direction and the vision of an aspirational India rather than scribble about budget numbers. We expect growth to come back, followed by inflation, but that is challenge policymakers seem to address sometime in the future. Currently, the focus is clearly on growth.

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