A quick fix interim Budget

ANALYSIS

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The Interim Budget presented on Feb 01, 2019 was not expected to be a reform-oriented budget in any way. All the 12 interim budgets presented in India since Independence had avoided making any big bang structural reforms, as the government in power is a custodian for a few months.

Yet, the Interim Budget offered a good opportunity to the ruling government to address some of the lingering concerns on the ground ahead of the general elections, albeit in the form of quick fixes than any tough measures to get the economy back on track.

It's common knowledge that increased farm sector & rural distress, a slowdown in MSMEs (especially from the unorganised sector), a growing sense of joblessness among the youth and the overall weakness in aggregate demand formed the backdrop for this Budget.

Along the expected lines, the Budget made a few direct announcements to address some of these issues. For instance, a direct income support has been offered to farmers having cultivable land up to two hectares; interest subvention benefit is being extended to other agri/rural activities like animal husbandry & fisheries and crop loans are being subsidised for farmers affected by severe natural calamities. To support workers from the unorganised sector (with monthly income up to Rs 15,000), a mega pension scheme has been launched. By raising the tax rebate, by raising standard deduction, by extending tax exemption to those who own a second house, by granting no TDS on a certain portion of postal deposits & rental income, by further raising capital gains tax exemption and by granting tax relief to developers on unsold inventory for two years, etc. a definite attempt has been made to boost a feel- good factor for consumers.

But a deeper analysis of fiscal math shows significant deterioration in the quality of public spending. While "current expenditure" (comprising spending on interest expenses & subsidies) is estimated to grow at 14.4% in 2019-20 (FY20), the growth in "capital expenditure" is placed at a meager 6.2% in FY20 versus the previous year's growth of 20.3%. Moreover, the capex growth for the sector "Road Transport & Highways", which is a growth engine for the economy, is reduced to just 5% in FY20 from a massive 35.1% in FY19.

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Unfortunately, India's fiscal deficit target is again missed for the current financial year (as was the case in the past two years), primarily on the back of a shortfall in GST collections and higher public investment to compensate for the lacklustre private investment. The Budget has pegged the fiscal deficit for FY19 at 3.4% of GDP against the earlier target of 3.3%. For the year FY20 also, the deficit has been pegged at 3.4% of GDP – signaling a weak fiscal consolidation path. This has attracted negative attention of some of the global rating agencies and the Moody's has already issued a statement saying "Ongoing slippage from the government's budgeted fiscal deficit targets over the past two years, and our expectation that the government will face challenges meeting its target again this coming fiscal year (ending March 2020) does not bode well for medium term fiscal consolidation. We view this continued slippage as credit negative for the sovereign".

Higher fiscal gap in absolute terms for the year FY20 has given rise to much higher market borrowings next year - Rs 7.10 trillion (gross) and Rs 4.73 trillion (net) – both of which are significantly higher than the consensus market estimates. This has created a strong upside bias in bond yields, which can be controlled only via aggressive open market operations (OMOs) of RBI during FY20 also. Currently, "uncertainty" about the next year's OMOs has been heavily weighing on the bond market sentiment. Bond yields have already moved up by 12 to 13 bps due to heightened nervousness.

A hardening bias in bond yields is certainly not a desirable phenomenon for India, when food inflation has crashed, crude oil prices have trended lower, high frequency growth indicators have weakened and the global monetary policy environment has turned favourable.

Given the current state of economic affairs, we do not see any "inflation potential" in the Interim Budget announcements. "A cut in the Repo rate of 25 bps with a neutral policy stance and a transparent guidance on OMOs for FY20" by the Monetary Policy Committee on Feb 7th would go a long way in giving a boost to investment and growth. Moreover, this will complement the Budget's efforts to stimulate aggregate demand.

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