Life after Budget – Get the big picture right !

The Union Budget for 2020-21 had a difficult backdrop – slowing growth with both consumption and investments moderating, weak global trade growth adversely impacting exports, falling household savings, subdued returns of equities, rising remittances under LRS (Liberalised Remittance Scheme) and limited headroom with government to provide fiscal stimulus. Given this backdrop, in our opinion, government has done a remarkable job with FY21 budget. **The initial adverse reaction of equity markets was probably a result of heightened expectations, rather than anything negative in the budget.**

A careful study of the past budgets / policy actions / views expressed by various government leaders suggests 6 key themes / objectives that are being pursued by this government. These are

1. Simplification & moderation of taxes and improvement in ease of doing business
2. A large scale up of Infrastructure spends facilitated by long term foreign capital
3. Promoting "Make in India" for employment generation and reducing current account deficit
4. Fiscal discipline
5. Social development covering health, education, sanitation etc.
6. Improving internal and external national security

The Union Budget for 2020-21 fits in nicely with the aforesaid strategic themes. In this note, we have limited our discussion to first four objectives.

Theme 1: Simplification & moderation of taxes

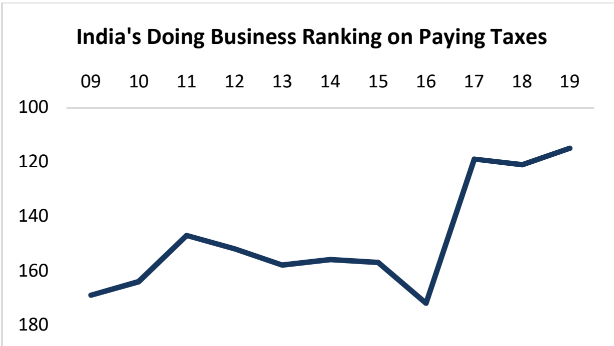
Over the past few years, Government has made concerted efforts to simplify the tax structure. Following table highlights the major steps taken to simplify tax structure

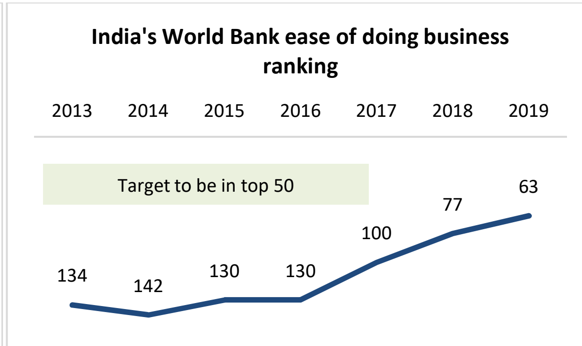
	Steps taken so far	Steps in budget 2020-21
Indirect taxes	• Introduced GST, a single indirect tax across India, subsuming more than 17 taxes • Rationalization of tax rates in GST • Simplification and reduction in no. of returns (refer table below) • Dispute resolution scheme "Sabka Vishwas"	• Simplified GST return • Automated GST refund • Electronic GST invoicing
Corporate taxes	• Phasing out of exemptions and deductions • Reduction of tax rates from 30% to 22%/15% • E-filing of returns, refunds and assessment	• Dispute resolution scheme "Vivaad se Vishwas" • Faceless appeals • Abolishing dividend distribution tax
Personal taxes	• E-filing of returns, refunds and assessment	• Reduction in tax rates for individuals opting to forego exemptions/deductions. • Option to individuals to choose between two regimes • Plan to phase out exemptions and deductions • Faceless appeals

- Overtime, government has indicated that all exemptions on corporate and personal tax will be phased out. Tax rates can be further moderated for the individuals. However, the peak rate of personal taxation has gone up to 43% from 37%.
- India's tax administration has improved significantly (refer table below), while there is still some room for improvement. India has also climbed on the ranking of ease of doing business and aims to be in top 50.

Comparing India on Paying Tax parameters

	India		China	Brazil	Indonesia	New Zealand
	2009	2019	2019	2019	2019	2019
No. of payments per year	59	10 / 12	7	10	26	7
Time spent (hours per year)	271	250 / 254	138	1,501	191	140
Total tax payable (% of Gross Profit)	64.7	49.7	59.2	65.1	30.1	34.6





Source for above 3 charts: Economic Survey 2019-20, publicly available information

Theme 2: Driving Infrastructure Investments

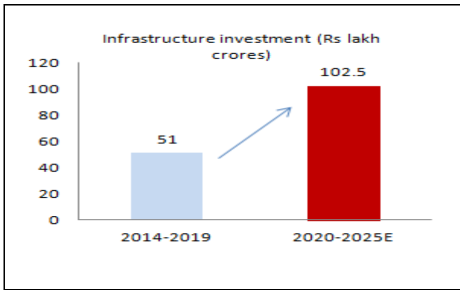
Over the years, Government has shown relentless focus on improving growth by pushing infrastructure development. Good quality infrastructure aids manufacturing competitiveness, supports growth, generates employment and improves quality of life. India's investment needs are large and National Infrastructure Pipeline (NIP) of INR 103 lakh crore (till 2025) is a significant step-up (versus INR 51 lakh crore invested in last 5 years). It is also commendable that government has already identified over 6,500 projects across sectors under NIP.

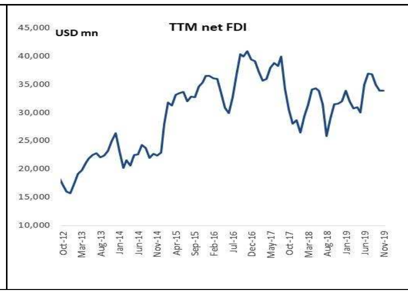
However, falling household savings, limited capacity of domestic businesses especially in infrastructure space and limited fiscal space, made it imperative to attract sizeable foreign capital flows to fund the infrastructure outlay. Recognizing this, over the past few years, Government has rightfully undertaken multiple measures to attract long term foreign capital flows. These include:

- Tax exemption to Sovereign Wealth funds: Union Budget 2020-21 provides tax exemptions to Sovereign Wealth funds on income earned (through interest, dividend and capital gains) on developing, operating or maintaining infrastructure facility in India. The investment is required to be made before March 31, 2024 and must be held for at least 3 years.
- Lower tax rate of 15% for new manufacturing units. Reduction in corporate tax rates to 15% for new manufacturing units set up before March 2023 is aimed at attracting MNCs which are looking to relocate their factories given the rising labour & land cost in China (refer section on "Make in India" for more details). In this budget, Government has extended the benefit of this 15% tax rate to domestic power generation companies as well. NIP envisages investment of INR 22.6 lakh crore in power sector till 2025.
- Removal of Dividend Distribution Tax. The removal of dividend distribution tax (DDT) will also incentivise foreign capital inflows. Earlier, foreign shareholders were not able to claim tax credit towards DDT paid (~20.56%) in their home countries. Removal of DDT will aid return profile for (a) Multi National Companies investing in India through subsidiaries and (b) FPIs
- Limit for FPI investments in corporate bonds raised from 9% to 15% of outstanding amount.

- INR 22,000 crore budgetary support through equity for Infrastructure Finance companies such as India Infrastructure Finance Company Ltd (IIFCL) and National Investment and Infrastructure Fund (NIIF) can create financing of Rs 1 lakh crore through leverage.

Fortunately, global environment is conducive for long term foreign capital inflows into India. The prevailing low interest rates, surplus global liquidity, ability of India to absorb large amount of capital at attractive yields, improving regulatory and business environment, makes us believe that these efforts should yield meaningful results in medium to long term.





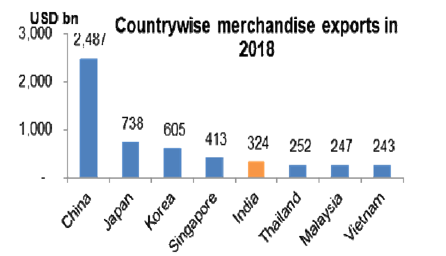
Recent institutional investments routed to Indian infrastructure assets

Fund	Investment in	Investment (Rs bn)
Canada Pension Plan Investment Board	L&T, Sadbhav	20
Caisse de dépôt et placement du Québec	Oriental Infra	NA
Goldman Sachs	Essel Infra	6
Brookfield AMC	Gammon Infra	6
Govt of Singapore Investment Corp	IRB Infra	44
Abu Dhabi Investment Authority	L&T, PNC, IRB	NA
SBI-Macquarie	Ashoka, NHAI TOT	107
Cube Highway	Multiple deals	41
IDFC Infrastructure	Multiple deals	1
Shrem Group	Dilip Buildcon	16
Cube Highway	NHAI TOT	50

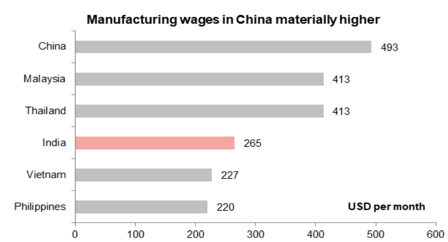
Source: NIP documents, CMIE, PhilipCapital

Theme 3: Make-in-India

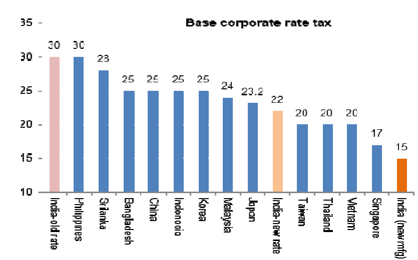
- In the past 2 decades, India lagged China in capitalizing on sharp rise in global trade in manufacturing sector. In 2018, share of China in global merchandise trade stood at ~13% as compared to only 1.7% of India. Even Vietnam, which is 1/10th the size of India, has manufactured exports comparable to India's manufactured exports (refer adjacent chart)



- However, due to high wage growth in China in last few decades, China has become relatively less cost competitive compared to other regional countries (including India). This again presents a unique opportunity for India as many global MNCs are looking to relocate / diversify their manufacturing from China to other Asian countries.



- India's labour cost is comparable to other countries in the region and is significantly lower than China. Despite that, in our view, India was not able to attract MNC manufacturing primarily due to high corporate tax rates. With reduction in corporate tax rate to 22% (before surcharge) and to 15% (before surcharge) for new manufacturing units set up before March 2023, India's tax rate is now amongst the lowest in the region. This is a significant step towards boosting manufacturing in India. India also has the added advantage of a large domestic market and availability of skilled resources, unlike many others.

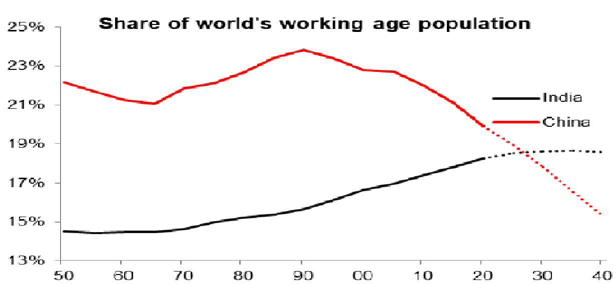


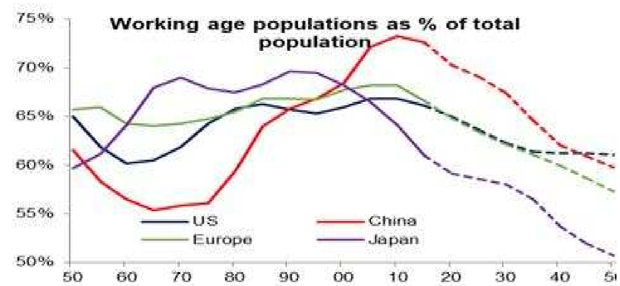
Basic custom duty (BCD) on certain items - %	Earlier	2018	2019	2020
Mobile phones and similar equipment				
Mobile phones	15		20	
Parts of mobile phones	5		15	
PCBA	0		10	20
Items like charger, adapter etc.	10		15	20
Display panels for mobiles	0			10
CCTV/IP cameras	15	20		
Charges for CCTV/IP cameras	0	15		
Electric vehicle				
Completely build unit for commercial	25			40
Semi-knocked down (SKD) passenger	15			30
SKD bus, trucks and two wheelers	15			25
CKD* pass., 3&2 wheelers, bus, trucks	10			15
Specified medical devices	7.5		10	
Imitation jewellery	15		20	
Furniture and parts	10		20	
Radical tyres for bus and trucks	10		15	

- Given that the general time taken to set up a new unit is 2 to 4 years and deadline of March-2023 to avail tax benefits, private capex should pick up in FY21, especially by MNCs.

With these measures, we believe a large number of MNCs will consider India favourably and will be attracted to shift their manufacturing to India.

- The current budget takes further steps to give a push to Make-in-India. These are
  - Increase in custom duty on various products, particularly in electronics and automobiles, to promote domestic manufacturing (refer adjacent table)
  - Strengthen the provisions relating to safeguard duty, dumping and import of subsidized goods.
  - Misuse of Free Trade Agreements (FTA) benefits are also proposed to be curbed by reviewing the rules of origin requirements.
  - Threshold for tax exemptions for start-ups is increased from turnover of INR 25cr to INR 100cr. The period of eligibility to claim deduction is increased from 7 years to 10 years
- In a comprehensive approach, skill development is also getting focus with internship opportunities in urban local bodies, apprenticeship embedded degree/diploma, special bridge courses designed to improve skills of teachers, nurses and para-medical staff amongst others. Given its unique demographic profile, India is presented with an opportunity again and can become a key supplier of skilled human capital to the world. On one hand, India's share of working age population will be highest globally by 2030 and on the other, most large economies are ageing and their working age population is falling.

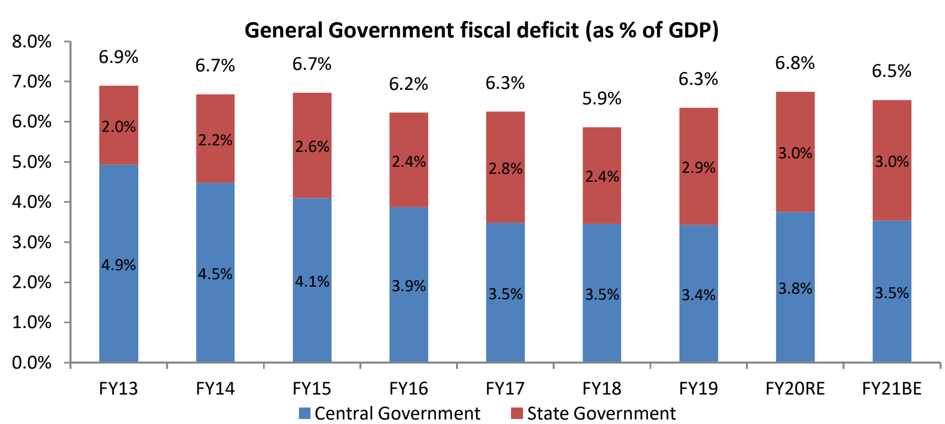




Sources: United Nations, World Bank

Theme 4: Fiscal Prudence

Maintaining fiscal discipline is critical for the long term economic wellbeing of a country like India that has persistent current account deficits. It is the key to maintaining macroeconomic stability. Despite social / political pressures and reduction in corporate & individual taxes, government has done a reasonable job of maintaining fiscal deficit within reasonable limits.



Source: Kotak Institutional Equities

Note: (1) The above fiscal deficit does not include borrowings of Food Corporation of India (FCI)

2) State government deficit is excluding UDAY equivalent to 0.7% of GDP in FY16 and FY17.

As widely anticipated, given the weak revenue collections & growth slowdown, Government has rightly used the maximum headroom available under the Fiscal Responsibility and Budget Management Act, 2003 and relaxed the fiscal deficit target to 3.8% (FY20BE: 3.3%) for FY20. However, the fiscal deficit is moderately understated to the extent of FCI borrowings done through external sources. Despite the sharp rise in fiscal deficit, bond yields rallied by 10 bps (on first trading day after budget) as the entire incremental borrowing will be met from National Small Savings Fund (NSSF) flows and no incremental supply of market borrowings is expected.

Apart from weak direct tax collections, one of the reasons for fiscal slippage is the weak collections under GST. We believe that muted growth in GST revenues should be seen in the context of GST rate cuts in last 2 years, which is estimated to have an annual impact of INR 1 lakh crore. Further, revenues from GST are now showing some encouraging signs of pick up and once invoice matching under GST is implemented, revenue mobilization should improve further. Government is also actively targeting larger divestments to fund the deficit in FY21. Though, Government has been criticised for selling assets, it should be noted that proceeds from asset sale are being used to create new assets. The government intends to reduce fiscal deficit to 3.5% in FY21 and to 3.1% by FY23. Please refer annexure 1 for our comments on the fiscal position and FY20 & FY21 estimates.

In summary, FY21 budget fits well with the key strategic objectives being pursued by this government and it should be read in the context of these.

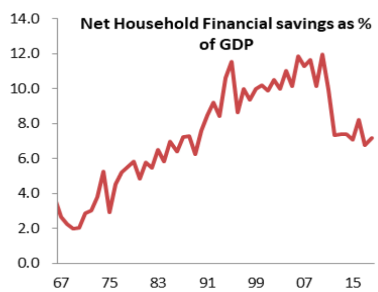
In the next section, we present our views on the economic growth, equity & debt markets outlook.

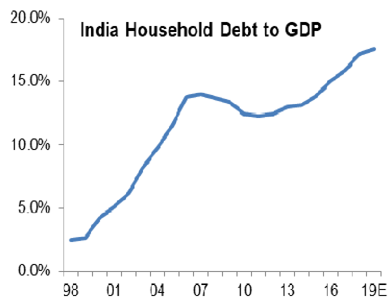
Economic Outlook

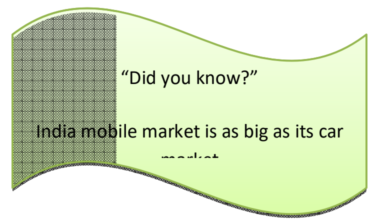
Shift in government strategy – From boosting consumption to encouraging investments

Over last few years, Indian economic growth was mainly led by consumption. **This was supported by falling household savings and rising household debt (refer charts below), improved access to credit and not by growth in real wages. In fact, in our assessment the real wages for a wide section of white collar employees have been weak over past 15 years. (refer table below).**

A leading IT Company (INR lakh per annum)	FY04	FY19	CAGR (%)	Real growth	Cumulative real growth
Typical Entry level (approx.)	2.0	4.0	4.7	-2.1	-27%
Average salary	11.5	17.7	2.9	-3.9	
Average inflation	6.8				





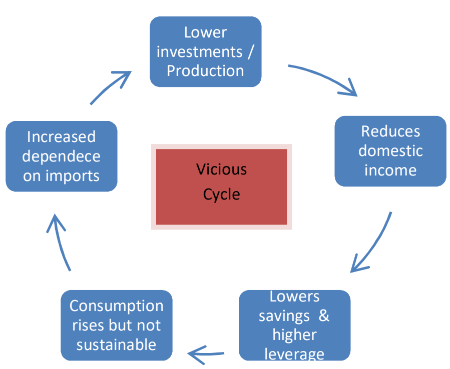


Source: Kotak Institutional Equities, Morgan Stanley and publicly available information

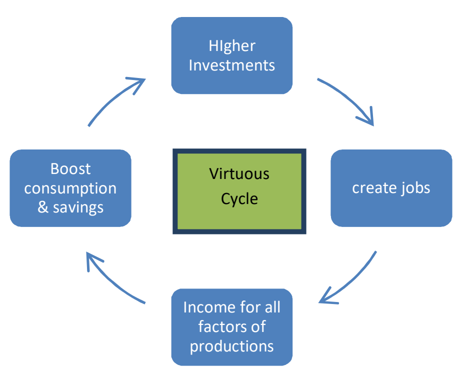
Interestingly, as the consumption grew mainly led by items which are imported like mobiles, electronics etc. it increased India's dependence on imported goods stretching the current account deficit. This kind of growth was not sustainable and it was leading to a vicious cycle of rising leverage, increasing external dependence and falling savings.

Given this backdrop, there is a welcome change in strategy to prioritise investments over consumption. Government is now prioritising a long & difficult but more sustainable route of boosting growth through increasing investments. Investments led growth will lead to higher incomes and boost consumption over time. As already highlighted, government has reduced corporate tax rates, provided tax incentives to foreign capital, raised customs duty, rationalised GST, simplified taxation and is encouraging make in India as well as improving ease of doing business, etc. to support investments. Thus, we believe that going forward, investments are likely to grow faster than consumption.

Past



Future?



We also believe that GDP growth is bottoming out. One of the major reasons of slowdown in FY20 was deresulted in GDP growth dropping by ~60bps (-15% multiplied by 4%) because of auto sector alone. Fall in auto volumes was driven by (1) inventory correction by distributors and Original Equipment Manufacturers (OEMs) and (2) transition into BSVI (Bharat Stage VI) norms scheduled to be implemented by April 2020, besides weak retail sales. Aforesaid factors necessitated inventory liquidation and thus lower auto production. Going forward, as these factors are largely behind us, it is reasonable to expect normalisation of auto volumes in FY21. Even assuming flat auto volumes, this drag of ~60 bps will not be there on GDP growth. Thus, this alone should improve GDP growth by ~60 bps in FY21.

Further, government efforts to attract foreign investments and push make in India (details given in earlier sections) should start reflecting in FY21 given the deadline of March 2023 to avail concessionary tax rate of 15% for new manufacturing units. Another important catalyst to boost growth is the resolution of cases stuck under IBC post Supreme Court verdict in Essar steel case. It is now expected that a large number of cases will be resolved by March 2020 which should result in reduction in supply of ready assets. Thus, companies will have to start planning for new units for growth. Also, new owners of IBC assets are likely to incur capex to optimise efficiency of the acquired assets. For e.g. ArcelorMittal indicated an immediate capex of INR 8,000 crore in Essar steel.

Finally, multiple steps taken by government and RBI like reduction in corporate tax rates, lowering policy rates, lower EMIs that increase affordability, measures for NBFCs, etc should also support economic recovery.

We are now observing some early signs of pickup in economic activities with manufacturing Purchasing Manager Index (PMI) accelerating to an eight-year high and services PMI to seven year high in January 2020, improving incremental credit to deposit ratio etc. For more on our views on economy, please refer the section on Indian economy (Slide 20 to 24) in HDFC Yearbook 2020 (available on www. https://www.hdfcfund.com/investor-desk/market-update).

Equity Markets Outlook

The initial adverse market reaction to the Budget 2021 on Feb 1, 2020 is actually encouraging going by the past experience ! The following table summarizes the budget day returns and returns one year later.

Date of Budget	Budget Day Return	1 year Return
8-Jul-04	-2.3%	48.9%
28-Feb-05	2.2%	54.5%
28-Feb-06	0.9%	24.8%
28-Feb-07	-4.0%	37.8%
29-Feb-08	-1.4%	-49.4%
6-Jul-09	-5.8%	25.4%
26-Feb-10	1.1%	7.7%
28-Feb-11	0.7%	-0.5%
16-Mar-12	-1.2%	11.2%
28-Feb-13	-1.5%	12.0%
10-Jul-14	-0.3%	9.0%
28-Feb-15	0.5%	-21.1%
29-Feb-16	-0.7%	25.0%
1-Feb-17	1.8%	27.6%
1-Feb-18	-0.2%	1.6%
5-Jul-19	-1.0%	

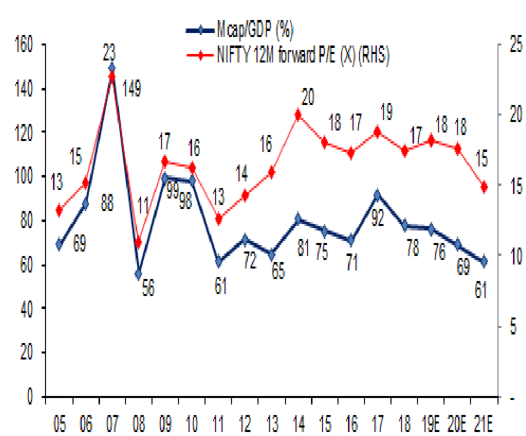
Source: Bloomberg; All the above are returns of NIFTY50 Index

It is interesting to note that out of the 9 instances of negative market returns on the Budget day in the last 15 years, markets ended positive in 8 instances one year later! 2008 was the only year when markets were negative on budget day & remained in red one year later as well. However, 2008 was the year of Lehman crisis.

Notwithstanding the initial reaction of the markets, we are positive for the market over the medium to long term. As we have been consistently highlighting in our monthly market updates, markets are reasonably valued. **10 year NIFTY 50 returns have lagged the 10 year growth in nominal GDP (9% CAGR Nifty returns vs 13% CAGR growth in nominal GDP), (refer table below). This has led to market cap to GDP falling to 61% for CY21E, which is below long term averages.**

Historically, whenever this has happened, market returns tend to catch up in future by delivering higher returns.

Year	Trailing 10 year NIFTY Return (CAGR)	Trailing Nominal GDP Growth (10 year CAGR)	Next 10 year NIFTY Return (CAGR)
2001	7%	13%	16%
2002	4%	13%	18%
2003	6%	12%	13%
2004	6%	12%	15%
2006	16%	12%	8%
2007	19%	12%	6%
2016	8%	14%	?
2017	6%	13%	?
2018	14%	13%	?
2019	9%	13%	?



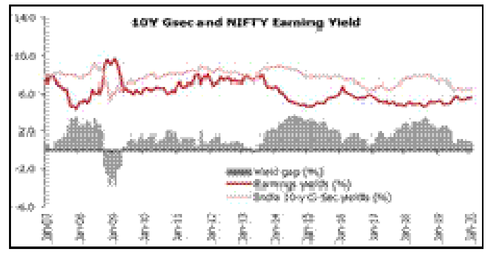
Source: Kotak Institutional Equities, updated till January 31, 2020; India market cap to GDP ratio (%) for calendar year-ends 2005-21E from 2005-18, NIFTY50 PE is based on 12 month forward estimated EPS. For 2019E, by Kotak Institutional Equities has calculated PE based on EPS numbers as of Mar-20 end, 2020E based on EPS of Mar-21 end and for 2021E based on EPS of Mar-22 end

Further, markets seem to be overly concerned with slower GDP growth in current year. We would like to highlight that in each of the last 3 decades, there have been few years of sub 5% growth. This suggests that year on year volatility / variance in the growth is common and one should not be excessively concerned about it. This is neither the first slowdown India has encountered nor the last one. Finally, in any case, the impact of 3% lower growth for a year, on fair value of equities is only ~3%!

Decade (FY ending)	**1990-00**	**2001-10**	**2011-20E**
Average GDP growth	5.5%	6.4%	6.9%
Number of Years of sub 5% growth	3	4	1

Source: CMIE

Also, with focus on slowing GDP growth, markets seem to be ignoring the positive impact of lower interest rates on equities. As we have been highlighting for sometime now that the gap between 10Y Gsec and 1Y-Forward NIFTY 50 Earning yield [(Earning yield = 100 / (one year forward P/E)] has reduced significantly and it is now below 10 year average of 1.7%. This also indicates that equity markets are attractively priced.



As legendary investor Warren Buffet said ***"Interest rates are like gravity in valuation. If interest rates are nothing, values can be almost infinite. If interest rates are extremely high, that's a huge gravitational pull on value".***

One characteristic of current market is the sharp polarisation in valuations across sectors. While near to medium term forecasting is challenging, past experience suggests that sectors with good returns in the past, mostly delivers moderate returns in the future and vice versa. Below two tables highlight some of the outperformers and underperformers in last 3 decades

Sector	Period of O/P	% Return (CAGR)	% Return (CAGR) SENSEX	Valuation at beginning of cycle	Trailing Valuation based on
IT	1993-1999	**155%**	**7%**	14.5	P / E
Capital Goods	2002-2007	**95%**	**43%**	0.5	P / B
Corporate Banks	2002-2007	**58%**	**43%**	0.4	P / B
Pharma	2002-2015	**38%**	**17%**	9.5	P / E
FMCG	2007-till date	**23%**	**6%**	19.2	P / E

Sector	Period of U/P	% Return (CAGR)	% Return (CAGR) SENSEX	Valuation at beginning of cycle	Trailing Valuation based on
IT	1999-2007	**10%**	**19%**	116.9	P / E
Capital Goods	2007-till date	**4%**	**6%**	15.0	P / B
Corporate Banks	2007-2016	**2%**	**5%**	3.9	P / B
Utilities	2007-till date	**-3%**	**6%**	3.0	P / B
Pharma	2015-till date	**-12%**	**12%**	42.6	P / E

O/P – Outperformance; U/P – Underperformance; P / E = Price to earing, P / B = Price to Book value

Source: Data compiled from Bloomberg, data is indicative in nature; Company with largest market capitalization as on 31st Dec, 2019 has been selected to indicate sector return / valuations; Historical indicators are no guarantee of future results

Currently the valuations of consumption oriented sectors are way above long term averages and most other sectors are either in line or below long term averages. Outlier sectors trading below long term averages are Utilities, Corporate Banks and PSUs. In our judgement, going by the past experience of mean reversion and improving profit growth outlook of corporate banks, slower growth in consumption, government's focus on strategic sales in PSUs compared to ETFs in the past, do create an enabling environment for new winners in 2021 & beyond.

In view of the above, in our judgement, there is merit in increasing allocation to equities in a phased manner or in staying invested as the case may be (for those with a medium to long term view and in line with individual risk appetite). Adverse global events, rise in crude oil prices, sharp moderation in equity oriented mutual funds flows, delays in NPA resolution under NCLT are key risks in the near term. Please refer annexure 2 for likely impact of budget proposals on key sectors.

Debt Markets Outlook

In FY20, fiscal deficit is set to widen by 0.5% of GDP driven by weaker revenue collections. However, no additional supply of dated government securities has been proposed as the same will be funded through National Small Savings Fund (NSSF). This came as a relief for debt markets and yields rallied by 10 bps on the first day after budget. For FY21, the net market borrowings are expected to increase by ~INR 70,000 crore to INR 5,45,000 crore, which is largely in line with market expectations. However, large amount of switches proposed (FY21BE: INR 2.7 lakh crore; FY20RE: INR 1.65 lakh crore) could result in higher supply of longer duration Gsecs. This may result in Gsec yield curve remaining steep.

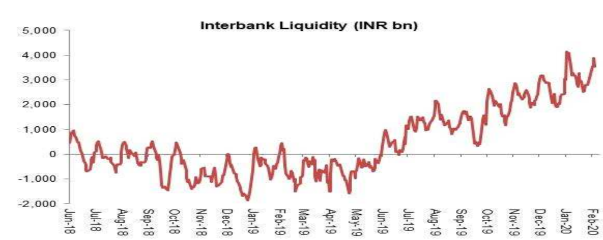
To increase participation of non-resident Investors, some categories of government securities will be opened fully for non-resident investors, apart from being available to domestic investors as well. This could be a significant step towards opening up of government bond market and may eventually lead to inclusion in global bond index. The timing is opportune as the PSU banks are holding excess SLR securities and thus investments by non-resident investors can be a new source of demand for Gsecs. However, the details are still awaited.

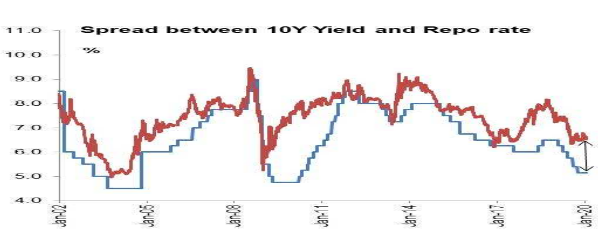
Additionally, lower borrowing under extra budgetary resources (FY20RE: 3.5% and FY21BE: 3% of GDP) and relaxation of investment limits in corporate bonds from 9% to 15% for FPIs is likely to be favourable for corporate bond yields.

Going forward, with inflation expected to remain over target of 4%, in our view, RBI is likely to stay put in the near term. With regard to yields at the longer end, we maintain our view that opposing forces are at play. Easing stance of major global central banks, ample interbanking liquidity, steepness of yield curve, no additional market borrowing for FY20 and weak credit growth favour lower yields. On the other hand, aggressive revenue assumptions leading to risk of fiscal slippage for FY21, excess SLR (Statutory Liquidity Ratio) investments within banking system, high near term headline inflation, possible bottoming out of growth, etc. are likely to impact yields adversely. In view of the above, yields at the longer end of the curve are likely to trade within a range in foreseeable future.

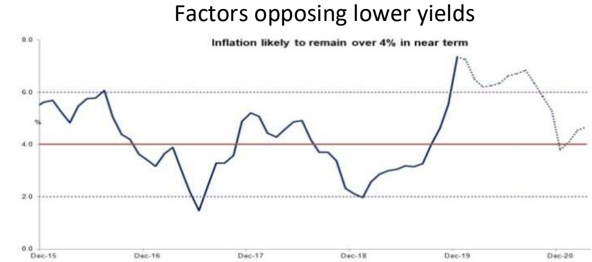
Considering the aforesaid factors, in our view, the short to medium end of the yield curve offers better risk adjusted returns. Hence, we continue to recommend investment in short to medium duration debt funds . Further, the prevailing high credit spreads also creates a favourable risk rewards opportunity in select pockets, in our opinion.

Factors favouring lower yields





Factors opposing lower yields



Source: Bloomberg, RBI, CMIE, Kotak Institutional Equities. CPI forecast beyond Dec19 are estimates of Kotak Institutional Equities
* Adj SLR = Investments in Statutory Liquidity Ratio (SLR) Securities adjusted for securities under LAF
# Regulatory Requirements = SLR + Liquidity coverage requirement requirements (~15-17% of NDTL) – carve out allowed from SLR

Annexures

Annex: 1 - A brief snapshot of fiscal position

Government finance Summary (INR bn)	FY19	FYTD20*	FY20RE	FY21BE		FYTD20/FYTD19	FY20RE/ FY19A	FY21BE / FY20RE
Gross tax collection	20,805	13,830	21,634	24,230		-2.9%	4.0%	12.0%
Total Direct Tax	11,251	6,872	11,575	13,060		-5.8%	2.9%	12.8%
Personal Income tax	4,615	3,177	5,470	6,250		5.1%	18.5%	14.3%
Corporate Tax	6,636	3,695	6,105	6,810		-13.6%	-8.0%	11.5%
Total Indirect Tax	9,554	6,959	10,059	11,170			5.3%	11.0%
GST	5,816	4,564	6,123	6,905		7.4%	5.3%	12.8%
Custom duties	1,178	852	1,250	1,380		-12.3%	6.1%	10.4%
Excise duties	2,310	1,532	2,480	2,670		-2.0%	7.3%	7.7%
Service tax & other taxes	250	11	206	215			-17.6%	4.5%
Less: State shares & Others	7,633	4,781	6,588	7,871		-2.2%	-13.7%	19.5%
Net Tax collection	13,172	9,049	15,046	16,359		-3.4%	14.2%	8.7%
Non- Tax Revenue	2,357	2,420	3,455	3,849		63.8%	46.6%	11.4%
Total Revenue Receipts	15,529	11,469	18,501	20,208		5.8%	19.1%	9.2%
Total Capital Receipts	1,128	310	816	2,250		-33.3%	-27.6%	175.7%
Divestments	947	181	650	2,100		-47.1%	-31.4%	223.1%
Total Revenue Expenditures	20,074	18,541	23,496	26,301		14.4%	17.0%	11.9%
Interest payments	5,826	4,243	6,251	7,082		0.7%	7.3%	13.3%
Others	14,248	14,298	17,245	19,219		19.2%	21.0%	11.4%
Total Capital Expenditures	3,077	2,555	3,489	4,121		20.6%	13.4%	18.1%
Total expenditure	23,151	21,096	26,986	30,422		15.2%	16.8%	12.7%
Revenue Deficit	-4,545	-7,072	-4,995	-6,093				
Primary Revenue Deficit	-668	-2,829	-1,417	-882				
Gross Fiscal Deficit	-6,494	-9,317	-7,668	-7,964				
Revenue Deficit as % of GDP	-2.4%	-3.6%	-2.4%	-2.7%				
Fiscal Deficit as % of GDP	-3.4%	-4.7%	-3.8%	-3.5%				

* updated till Dec19;

Source: CMIE, Budget documents. RE – Revised estimates, BE – Budgeted Estimates, FY19A – Financial year 2019 Actual, FYTD20 – Financial year to date 2020 (upto Dec19)

Our observations for FY20 and FY21 estimates

- **FY20RE:** Given the reported numbers so far, the FY20RE numbers appear to be somewhat aggressive. However, response to the direct tax dispute settlement scheme "Vivaad se Vishwas" is still uncertain and thus progress needs to be closely monitored. Further, while some acceleration can be expected in collections from custom duties, but the collection estimates seem slightly aggressive.
- **FY21BE:** Based on this high base, the FY21 growth estimates seem reasonable though there are some risks of slippage still present.

Assumptions based on Revised estimates	Remarks
Nominal GDP : 10.0%	• Government has assumed tax buoyancy of 1.2x for gross tax revenue which is reasonable
Corporation Tax : 12%	

Personal Taxes : 14% Custom & Excise: 8.6% GST : 12.8% Non-tax revenue – 11.4% Disinvestments: 223%	• Corporate tax revenue assumptions appear reasonable given the low base and expected growth recovery. • The expected revenue under personal income tax seems higher by ~INR 55,000 crore considering the collection under the scheme “vivad se vishwas” may not recur next year. • Growth in GST collections seem reasonable as compliance improves and expected implementation of invoice matching in FY21. • Growth in non-tax revenue seems aggressive as it includes high collection from spectrum auction, which is uncertain. • Divestment target seems ambitious but could be within reach on back of planned strategic disinvestments of Bharat Petroleum Corporation limited, Air India, Container corporation, stake sale in Life Insurance Corporation of India (LIC), IDBI Bank, etc.

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Annex 2: Sectoral Impact

Sectors	Budget proposals	Impact on sectors
Consumer	▪ Increase in NCCD Duty on cigarettes ▪ Increase in customs duty on electrical appliances such as fans, mixer-grinders, water heaters, ovens, cookers, coffee /tea makers, etc from 10% to 20%. ▪ Increase in customs duty on footwear from 25% to 35%. ▪ Reduction in customs duty on newsprint, lightweight uncoated paper used for printing magazines from 10% to 5% ▪ Thrust on standalone solar pumps in farms and encouragement for farmers to solarize their grid connected pumps. ▪ Reduction in personal tax rate for those opting for the proposed new tax regime. ▪ Reduction in MNREGA allocation from INR 710b in FY20RE to INR 615b in FY21BE.	**Negative:** Earnings growth rate of cigarette industry may be impacted. **Positive**: Domestic manufacturers likely to benefit from this protective measure. **Negative**: Prices of sports footwear and certain non-leather footwear, which have high import element, likely to go up. **Negative**: Domestic paper mills selling the specified grades of paper to see higher competition from imports. **Positive**: Positive for domestic appliance manufacturers engaged in solar-based pumps. **Positive**: Rise in disposable income for a section of the consumers is positive for consumption. **Neutral**: No major stimulus.
IT Services	▪ Govt to build Data Centre Parks throughout India ▪ National Mission for Quantum Technology to be funded with INR 80b over next 5 years.	No immediate / major impact **Positive:** Removing DDT is beneficial to high dividend paying companies; also the effective dividend yield in the hands of institutional investors will increase.
Education	▪ FDI and External Commercial Borrowings to be allowed for Education Sector. ▪ 150 higher education institutes to start job related training programs ▪ Budget allocation of INR 993b for the Education sector (+4.75% yoy); within this overall limit, INR 30b to be provided for Skill Development programs ▪ 150 new courses to be introduced in various Universities ▪ New Education policy to be finalised shortly	No major impact on sector
Power	▪ Tax rate for new power generation plants set-up before March 2023 reduced to 15% ▪ Promote solar pumps for farmers ▪ Advise states to close old thermal plants with high emission levels ▪ Encourage states to adopt smart meters and provide choice of suppliers ▪ Amount allocated for centrally sponsored capex schemes increased from INR 152b in FY20RE to INR 172b in FY21BE	**Positive:** Lower tax rate for new power generation companies will help in reducing tariff and/or improve IRRs. Closure of old high emission thermal power plants will help reduce the over-supply in conventional generation. Promotion of smart meters will help in reducing DISCOM losses and improve their financial health, however the government has not allocated any amount for the scheme.
Pharmaceuticals	▪ Janaushadi store allocation increased from INR 0.4b to INR 0.5b, Plan to increase medicines available at Janaushadhi stores from 900 currently to 2000 by March 2024	**Neutral**: Small part of the market and do not pose a significant threat to the private players.
Healthcare	▪ Viability gap funding for hospitals in tier 2/ tier 3 cities with preference to districts that currently do not have Ayushman Bharat hospitals. ▪ Ayushman Bharat allocation at INR 64b	**Neutral**: Ayushman Bharat is making treatment available to the "bottom of the Pyramid". Allocation is similar to last year.
Auto	▪ Announcements of new roads and rise in rural road allocation are positive. The income tax cut at lower end puts more money in hand of buyers in urban areas. ▪ The duty on CBUs/CKDs/SKDs for buses and	**Neutral:** Sector has its own BSVI issues for next few quarters. In CVs, no scrappage scheme was announced. Govt trying to encourage EV production in India.

	electric vehicles has been raised by 5-15% (on base duty of 10-30%)	
Defense	▪ Allocation for modernization and buying new weapon systems has been increased to INR 1,107b for the FY21, which is an increase of INR 103b from the previous year. ▪ The total allocation for defence expenditure was announced to be INR 4,713b in FY21. This marks a 9% increase. ▪ The defence pension budget has been increased to INR 1.33 lakh crore in FY21 from the INR 1.17 lakh crore announced the previous year	**Neutral**: Increase in outlay is modest**.**
Banks	▪ Increase in deposit insurance from INR 1 lac to INR 5 lac. ▪ Increase in deposit insurance from INR 1 lac to INR 5 lac	**Positive**: Increased confidence in the banking system.
NBFC & HFC's	▪ Applicability of SARFAESI Act to smaller NBFC. ▪ Allocation for Credit link subsidy scheme for affordable housing under EWS and MIG	**Positive:** Would bring NBFC sector at par with banks**.** **Positive:** Would support demand for affordable housing.
Insurance & Capital market	▪ Increase in FPI limit in corporate bonds from 9% to 15% of outstanding bonds ▪ Removal of deduction for individuals towards contribution for Life Insurance premium and Medical insurance premium, if opt for new tax regime	**Positive:** This would revive the corporate bond market **Negative**: Would impact the flows of Insurance companies.
Oil & gas	▪ LPG DBTL subsidy provision for FY21 at INR 356bn – increase of 20% yoy.	**Positive:** It covers FY21 subsidy and perhaps will help run down rollover amount as well. Positive for upstream companies.
Telecom	▪ Receipt from communication services hiked from INR 590bn to INR 1,330bn in FY21	**Negative:** Such a steep hike implies large spectrum auction proceeds, which is negative given the financial health of sector.
Media	▪ Customs duty on imported newsprint reduced from 10% to 5%	**Positive:** for print media companies as it reduces key cost item by 5%.
Metals	▪ Basic custom duty on calcined pet-coke reduced to 7.5% from 10% ▪ Basic custom duty on lead bars, rods, profiles and wires increased to 10% from 5%	**Positive:** Marginally positive for non-ferrous companies as they are mostly import dependent for calcined pet-coke **Positive:** Higher import duty will aid domestic prices and earnings for lead producers
Real Estate	▪ Extension of date for allowance of INR 1.5 lakh extra deduction for housing loans taken for affordable homes by another one year. ▪ Tax holiday for developers of affordable housing has been extended by another year	**Neutral**: Affordable housing remains focused area for government
Fertilizers	▪ Total fertiliser subsidy allocation reduced by INR 90bn (Urea reduced by INR 58.24bn and Complex by INR 28.65bn)	**Neutral**: Govt will likely reduce the subsidy rates for fertilisers in near term
Cement	▪ Focus on rural economy, affordable housing and infra continues with marginal increase in allocation ▪ 80-IBA tax benefit for affordable housing projects extended till Mar-21	**Positive:** This can aid demand from housing sector
Infrastructure	▪ Roads: (a) Total outlay is stable at Rs 1.56 lakh crore, (b) gross budgetary support has	**Neutral:** Revival of ordering after muted period of last 18 months

	increased to INR 820b in FY21 from Rs721b (c) NHAI outlay reduced marginally by 3.7% to INR 1,080b, (d) allocation for Pradhan Mantri Sadak Yojna is up 39% yoy to INR 195b ▪ Railways: Capex marginally increased by 3% to INR 1,600b. Capex spend will increase for (a) New lines (INR 125b, +47%), (b) Track renewals (INR 106b, +25%), but decline for (c) rolling stock (INR 351b, -16%) ▪ Urban Development: Increase in allocation for metro projects by 8% to INR 196b while Smartcity and AMRUT stable at INR 138b ▪ Jal Shakti: (a) Increase in allocation for National Rural Drinking Water Mission by 15% to INR 115b, (b) increase in allocation for Pradhan Mantri Krishi Sinchai Yojna by 19% to INR 89b ▪ 100% tax exemption on income on investments (all forms – dividend, interest, capital gains) by sovereign fund in infrastructure	**Positive:** Higher capex will aid demand for industrial and EPC companies. Also, steel companies will benefit from higher demand for rails led by new lines, track renewals **Positive:** Higher capex in Urban development to aid demand for EPC companies **Positive:** Higher allocation to state governments will drive water infrastructure capex and aid demand for EPC companies **Positive:** It will attract more foreign capital into infrastructure sector

Note: INR 1b = 1 billion = INR 100 crore; EPC – Engineering, Procurement & Construction; CV – Commercial vehicles; EV – Electric vehicles

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