Quickonomics

February 5, 2021

The shift in math

The budget for next fiscal offers a new spreadsheet for growth, assuming the pandemic is on its last legs in India.

Reading these numbers against the pre-pandemic trend can tell us what to look for in the tricky triangulation of growth, inflation and yields ahead.

Essentially, the budget replaces fiscal consolidation as a priority with expansion, well into the medium term. The fiscal glide path itself has become footloose – with fiscal deficit at 9.5% for fiscal 2021, 6.8% targeted in the next and 4.5%, by fiscal 2026.

Why the deficit surge

One obvious reason is, in a pandemic year, expenditure couldn't be held back too long and has caught up with trend. But revenue has not. This divergence is expected to hold for the next fiscal too.

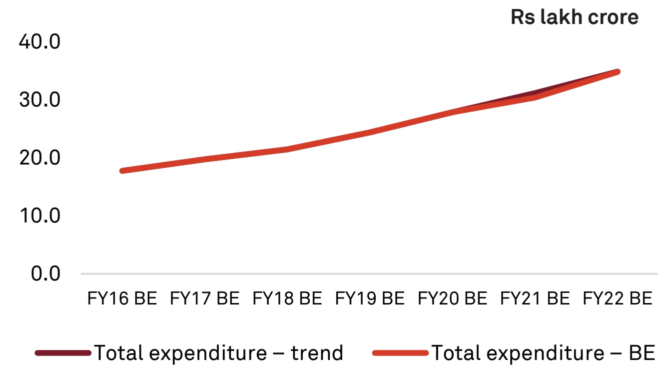
The other is more 'reformist.' The budget reduces dependence on extra-budgetary resources (bonds fully serviced by the government, NSSF loans, among others) and rather spend from the budget, ushering in greater transparency.

The widening expenditure-revenue gap

- The Centre has spent enough so as to lead budgetary expenditure close to the pre-pandemic trend this fiscal and most likely fully catch up in the next (see chart on the right). Not only that, the quality of expenditure is improving, with capex rising and revenue expenditure staying below trend

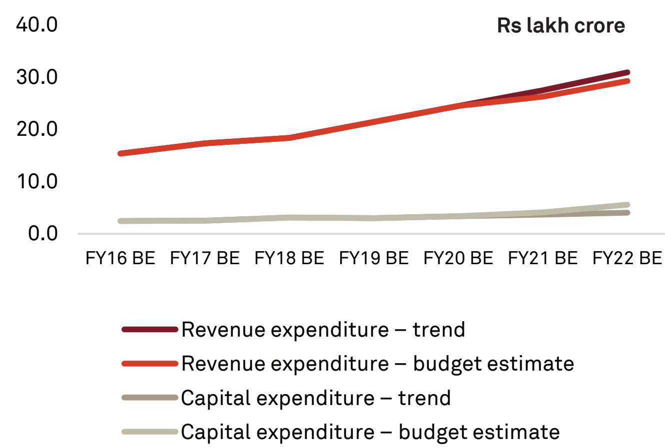
- Receipts, on the other hand, are estimated to remain 27% below the trend in fiscal 2022. To be fair, this also partly reflects the somewhat conservative revenue targets for fiscal 2022.

Expenditure has caught up to the trend

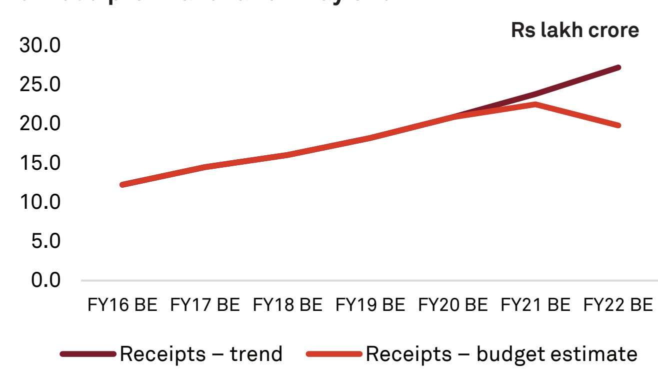


Notes: BE = budget estimate

..helped by a greater focus on capex



But receipts* have fallen way short...



**Sum of tax (net to Centre), non-tax and non-debt capital receipts*

- Government revenue, particularly tax collections, go up due to either base effect or rate effect. Nominal gross domestic product (GDP) in fiscal 2022 is estimated at 10% below the trend seen before the pandemic. The government, for good reasons, has also not introduced tax proposals. Thus, while the base has shrunk, rates have not changed. This will lead to underperformance of revenue continuing beyond fiscal 2022, unless compliance goes up substantially.

More transparency

- Hitherto off-budget expenditures such as Food Corporation of India's loans from the National Small Savings Fund and government fully serviced bonds will now get accounted for when calculating the fiscal deficit. Excluding these two items, fiscal deficit could have been lower by 0.5-1.0% in fiscal 2021 and ~0.6% in fiscal 2022. That is to say, in the more transparent schema, the fiscal consolidation path may stretch longer.

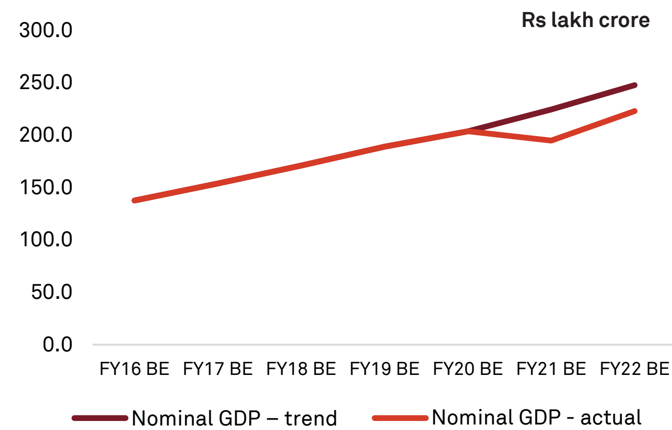
What does this imply for macroeconomic management?

1) **Growth:** The thrust on public investment will be positive for growth, not only in the short but also the medium term as it has a higher multiplier effect than revenue spending and augurs well for jobs.

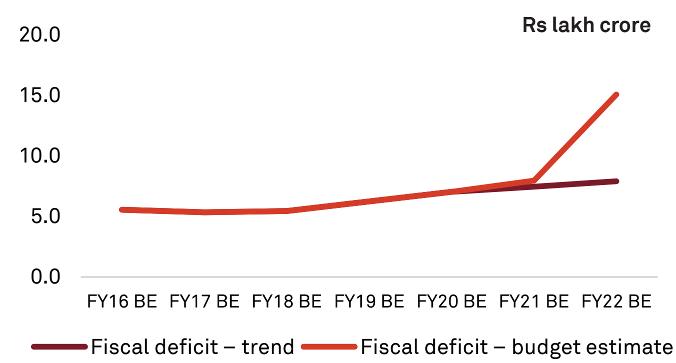
2) **Inflation:** A large fiscal deficit could be inflationary but given there are underutilised capacities and the economy continues to grow below potential, this may not be an immediate threat. But sticky inflation, especially core, and surplus liquidity sloshing around can potentially breed trouble.

3) **Yields:** G-sec yields are expected to come under pressure as the market borrowing programme remains huge. Since the central bank plans to stay accommodative, it would also need to keep a close tab on yields, using a broad range of tools as it has been doing so far

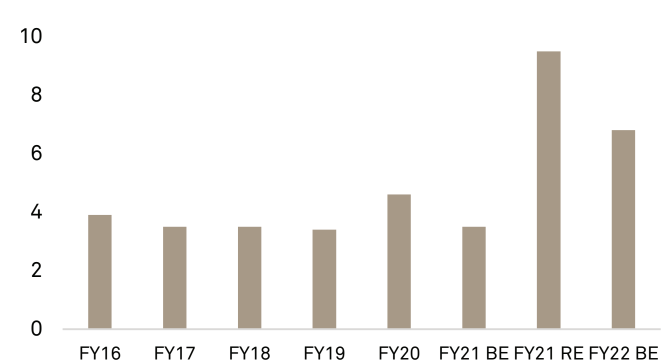
..largely on account of lower GDP size



..which shoots up the fiscal deficit



Never-seen-before fiscal deficit (% of GDP)



Source: Ministry of Finance, CRISIL

Analytical contacts

Dharmakirti Joshi
Chief Economist
dharmakirti.joshi@crisil.com

Adhish Verma
Senior Economist
adhish.verma@crisil.com

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