ICRA

UNION BUDGET 2019-20: EXPECTATIONS

Extent of revision in tax revenue estimates to influence deviation in fiscal deficit from Interim Budget Estimate for FY2020 of 3.4% of GDP

June 2019

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APRIL-MARCH FY2019 PROVISIONAL FISCAL BALANCES

In its Revised Estimates (RE) for FY2019, the GoI had pegged its fiscal deficit at Rs. 6.3 trillion (3.4% of GDP; based on the assumption that the nominal GDP for FY2019 would be Rs. 188.4 trillion). Provisional data released by the Controller General of Accounts (CGA) indicates that the GoI's fiscal deficit stood at Rs. 6.5 trillion during FY2019, modestly higher than the absolute amount indicated in the RE. This overshooting was led by lower-than-anticipated revenue receipts, the impact of which was partly offset by curtailment of expenditure below the RE. However, the fiscal deficit-to-GDP ratio stood at 3.39% of GDP in the FY2019 Provisionals (Prov.; based on the CSO's subsequently released provisional estimate of nominal GDP of Rs. 190.5 trillion for FY2019), in line with the level included in FY2019 RE (3.4% of GDP; refer Exhibit 1).

Revenue Trends: CGA data indicates that the GoI's revenue receipts rose by 8.9% in YoY terms to Rs. 15.6 trillion in FY2019 Prov. from Rs. 14.4 trillion in FY2018 Actuals (refer Exhibit 2). While non-tax revenues rose by a healthy 27.7% to Rs. 2.5 trillion, net tax revenues rose by a subdued 6.0% to Rs. 13.2 trillion in FY2019 Prov. In particular, the provisional revenue receipts were equivalent to 90.4% of the RE for FY2019, reflecting lower-than-estimated inflows of tax revenues (88.7% of FY2019 RE), even as non-tax revenues exceeded the RE (100.4% of FY2019 RE). Notably, the actual revenue receipts have trailed the amount indicated in the RE consistently for the past five years (refer Exhibit 3). However, the gap between the RE and provisional receipts increased considerably to ~Rs. 1.7 trillion in FY2019 from an average of ~389 billion in FY2015-FY2018 (refer Exhibit 4)

Tax Revenue: Net of refunds (gross of devolution to States), the GoI's tax revenues rose by 8.4% in FY2019 Prov. (refer Exhibit 5) to Rs. 20.8 trillion, equivalent to only 92.5% of the FY2019 RE of Rs. 22.5 trillion, and significantly undershooting the growth of 17.1% estimated in the latter. The GoI's direct tax collections rose to Rs. 11.3 trillion in FY2019 Prov. (93.8% of FY2019 RE) from Rs. 10.0 trillion in FY2018. The lower-than-estimated direct tax revenues reflected the trend for income tax (87.3% of FY2019 RE), as well as corporate tax inflows (98.9% of FY2019 RE).

Provisional indirect taxes (customs duty, excise duty, service tax, Central GST or CGST, Integrated GST or IGST and Union Territory Goods and Services Tax or UTGST) recorded a YoY contraction of 1.1% to Rs. 8.4 trillion, and accounted for a limited 88.2% of the FY2019 RE. The combined CGST and IGST collections stood at Rs. 4.9 trillion in FY2019 Prov., accounting for 87.8% of the RE. The combined inflows from customs duty, excise duty and service tax contracted by 24.2% to Rs. 3.6 trillion in FY2019 Prov., equivalent to 89.2% of the RE. The steep YoY contraction in the combined

Exhibit 1: Fiscal Balances for GoI for FY2018, FY2019 and FY2020

	FY2018 Actual		FY2019 Prov		FY2020 IBE	
	Rs. billion	% GDP	Rs. billion	% GDP	Rs. billion	% GDP
Revenue Receipts	14,352.3	8.4%	15,631.7	8.2%	19,776.9	9.4%
Tax Revenues	*12,424.9*	*7.3%*	*13,169.5*	*6.9%*	*17,050.5*	*8.1%*
Non Tax Revenues	*1,927.5*	*1.1%*	*2,462.2*	*1.3%*	*2,726.5*	*1.3%*
Revenue Expend.	18,788.4	11.0%	20,084.6	10.5%	24,479.1	11.7%
Revenue Balance	**-4,436.0**	**2.6%**	**-4,452.9**	**2.3%**	**- 4,702.1**	**2.2%**
Capital Receipts	1,156.8	0.7%	850.5	0.4%	1,025.1	0.5%
Capital Exp, Net Lending	2,631.4	1.5%	2,851.2	1.5%	3,362.9	1.6%
Fiscal Balance	**-5,910.6**	**3.5%**	**-6,453.7**	**3.4%**	**-7,040.0**	**3.4%**

IBE: Interim Budget Estimates

**GDP for FY2018, FY2019 as per CSO's data released on May 31, 2019; GDP for FY2020 as per the estimates Rs. 210.1 trillion included in Interim Budget 2019-20*

Source: GoI Budget Documents; CSO; ICRA Research

Exhibit 2: GoI's Fiscal Balances in FY2019

	FY2019 RE		FY2019 Prov.			
	Rs. billion	Growth*	Rs. billion	% of RE	Growth*	Var (Prov.-RE)
Revenue Receipts	17,296.8	20.5%	15,631.7	90.4%	8.9%	-1,665.1
Tax Revenues	*14,844.1*	*19.5%*	*13,169.5*	*88.7%*	*6.0%*	*-1,674.6*
Non-Tax Revenues	*2,452.8*	*27.3%*	*2,462.2*	*100.4%*	*27.7%*	*9.4*
Revenue Expenditure	21,413.5	14.0%	20,084.6	93.8%	6.9%	-1,328.9
Revenue Balance	**-4,116.7**		**-4,452.9**	**108.2%**		**336.2**
Miscellaneous Capital Receipts	800.0	-20.0%	850.5	106.3%	-15.0%	50.5
Capital Exp, Net Lending	3,027.3	22.3%	2,851.2	94.2%	15.2%	-176.1
Fiscal Balance	**-6,344.0**		**-6,453.7**	**101.7%**		**109.7**

**YoY growth over FY2018 Actuals*

Source: GoI Budget Documents; Controller General of Accounts (CGA), Ministry of Finance, GoI; ICRA Research excise and service tax collections in FY2019 reflected the reduced basket under these taxes after the complete transition to GST; since GST was not implemented in the Q1 FY2018, the inflows from these three taxes were much higher in FY2018.

Non-Tax Revenue and Disinvestment Proceeds: The GoI's non-tax revenues expanded by a significant 27.7% on a YoY basis to Rs. 2.5 trillion in FY2019 Prov., and accounted for 100.4% of the FY2019 RE. Dividends and profits of the GoI stood at Rs. 1.1 trillion in FY2019 Prov., equivalent to 95.1% of FY2019 RE. Of this, the GoI received Rs. 400.0 billion as surplus from the RBI in FY2019, as per the RBI's Annual Report, and an additional interim dividend of Rs. 280.0 billion (as per news reports). As a result, the aggregate surplus from RBI to the GoI rose to Rs. 680.0 billion in FY2019 Prov. from Rs. 500.0 billion in FY2018. This implies that the rise in RBI's surplus to the GoI accounted for Rs. 180.0 billion of the Rs. 534.7 billion YoY rise in non-tax revenues.

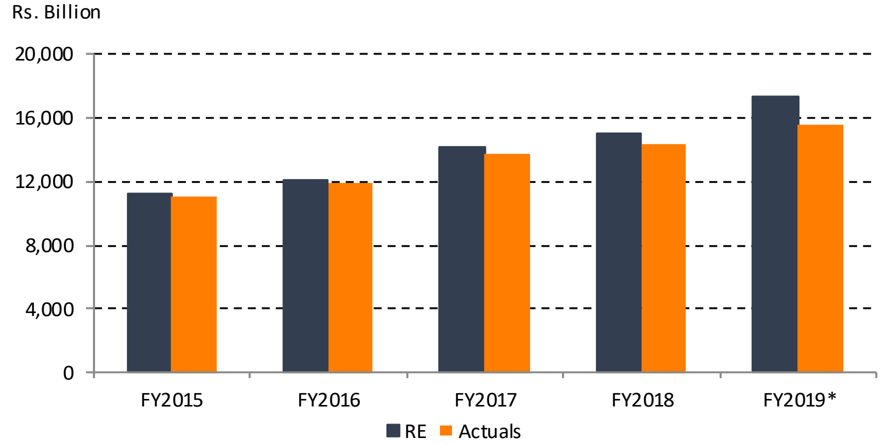
The cumulative disinvestment proceeds of the GoI stood at Rs. 850.5 billion in FY2019 Prov., exceeding the RE for FY2019 (Rs. 800.0 billion), albeit 15.1% lower than the year-ago level of Rs. 1.0 trillion.

Expenditure Trends for FY2019: The GoI's revenue expenditure rose by a modest 6.9% in FY2019 Prov. and stood at 93.8% of the FY2018 RE. Total subsidies rose by a low 3.1% to Rs. 2.0 trillion in FY2019 Prov., equivalent to only 74.6% of FY2019 RE. Subsidy outlay for the Department of Food and Public Distribution was significantly lower than the FY2019 RE, at Rs. 1.0 trillion in FY2019 Prov. (60.2% of FY2019 RE); notably, the unaudited data up to February 2019 had pegged the same at a higher Rs. 1.7 trillion. It is unclear whether the dip in the month of March 2019 is on account of some short-term debt extended to the Department of Food and Public Distribution or the Food Corporation of India. The lower-than-estimated outgo of food subsidy accounted for more than half of the cutback in provisional revenue expenditure compared to the RE. In terms of the other major subsidies, the outlay for the Ministry of Petroleum and Natural Gas, and Department of Fertilisers stood at 98.5%, and 100.7% of FY2019 RE, respectively.

The taxes transferred to state governments in FY2019 were 13.1% higher than the same in FY2018, in line with the RE included by the GoI for FY2019.

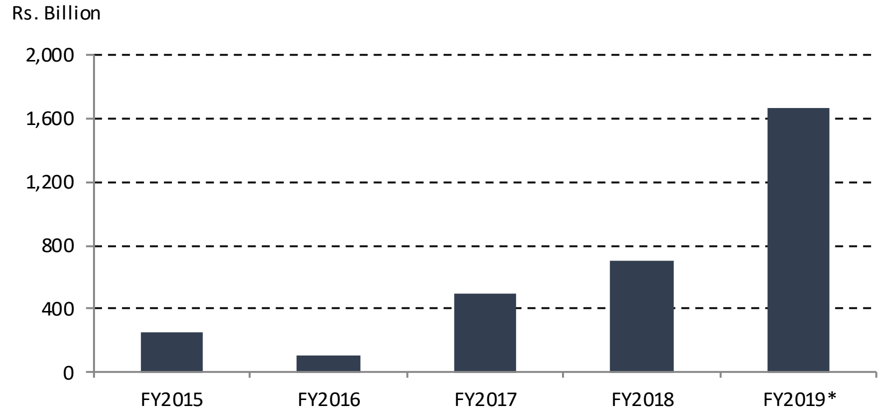
Capital expenditure and net lending rose by 15.2% in FY2019 Prov. to Rs. 2.9 trillion and stood at 94.2% of the RE for FY2019. Capital outlay recorded a 13.9% growth in FY2019 Prov. to Rs. 2.9 trillion (97.3% of FY2019 RE), whereas loans disbursed accounted for a lower 82.1% of FY2019 RE,

Exhibit 3: Comparison of Revenue Receipts in RE vs. Actuals (Rs. Billion)



**FY2019 provisional receipts used since Actuals are not yet available*
Source: CGA; ICRA Research

Exhibit 4: Trends in Magnitude of Gap of Revenue Receipts in RE vs. Actuals (Rs. Billion)



**FY2019 provisional receipts used since Actuals are not yet available*
Source: CGA; ICRA Research

albeit with a sharp expansion of 27.2% relative to FY2018. The undershooting of capital expenditure relative to the FY2019 RE level was led by capital transfer to states (57.5% of FY2019 RE), Department of Economic Affairs (63.3% of FY2019 RE), Department of Telecommunications (61.2% of FY2019 RE) etc. which accounted for ~69% of the gap in the capex between FY2019 Prov. and FY2019 RE. Nevertheless, the quality of expenditure of the GoI improved to 87.6% in FY2019 from 88.4% the previous fiscal.

Fiscal Balances in FY2019: At an absolute level, the GoI's revenue deficit increased marginally to Rs. 4.5 trillion in FY2019 Prov. from Rs. 4.4 trillion in FY2018 Actuals, while exceeding the Rs. 4.1 trillion included in FY2019 RE (refer Exhibit 6). The fiscal deficit increased considerably to Rs. 6.5 trillion in FY2019 Prov. from Rs. 5.9 trillion in FY2018 Actuals, and exceeded the Rs. 6.3 trillion targeted in FY2019 RE. Accordingly, the GoI's revenue and fiscal deficits for FY2019 stood at 108.2% and 101.7%, respectively, of FY2019 RE.

As a percentage of GDP (based on the figures released by the CSO on May 31, 2019), the GoI's revenue and fiscal deficits for FY2019 Prov. stood at 2.3% of GDP and 3.4% of GDP, respectively. Additionally, the fiscal deficit in FY2019 (as a percentage of GDP) was in line with the level targeted in the RE, however the revenue deficit exceeded the RE (2.2% of GDP). Moreover, the quality of the fiscal deficit improved in FY2019 Prov., with the share of the revenue deficit in the total fiscal deficit declining to 69.0% from 75.1% in FY2018 Actuals.

FISCAL SITUATION AS PER FY2020 INTERIM BUDGET ESTIMATES

The Interim Budget for 2019-20 had pegged the fiscal deficit at Rs. 7.0 trillion or 3.4% of GDP, with the latter being in line with the level included in FY2019 RE (refer Exhibit 7). Compared with the FY2019 Prov. data, the FY2020 IBE indicate a steep growth of 26.5% for the GoI's revenue receipts (20.5% compared to FY2019 RE), 21.9% for revenue expenditure (13.9% compared to FY2019 RE) and 11.0% for capital expenditure (6.2% compared to FY2019 RE).

Tax Revenue: The Interim Budget Estimates (IBE) for tax revenues were placed at Rs. 17.1 trillion for FY2020, a steep 29.5% higher than Rs. 13.2 trillion in FY2019 Prov. This suggests the possibility of a downward revision in the targeted level of tax revenues in the upcoming budget, which would be critical in assessing the credibility of the overall fiscal math. In particular, the projected growth rate of CGST stood at 33.3% in FY2020 IBE relative to FY2019 Prov., which is optimistic. The IBE

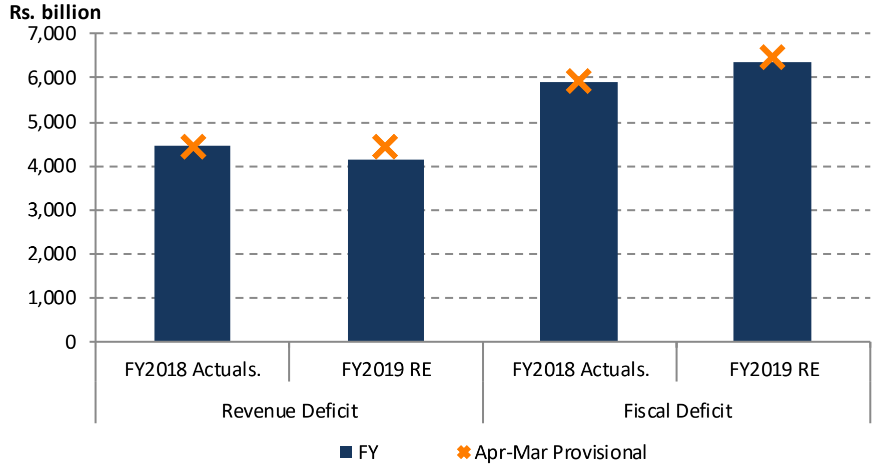
Exhibit 5: Tax Collections (Net of Refunds, Gross of States' share in Central Taxes)

	FY2019 RE		FY2019 Prov.		
	Rs. billion	Growth	Rs. billion	% of RE	Growth
Gross Tax Revenues^	**22,481.8**	**17.1%**	**20,802.0**	**92.5%**	**8.4%**
Direct Taxes	12,000	19.8%	11,252.3	93.8%	12.3%
Corporation Tax	*6,710.0*	*17.5%*	*6,635.7*	*98.9%*	*16.2%*
Income Tax	*5,290.0*	*22.8%*	*4,616.5*	*87.3%*	*7.2%*
Indirect Taxes	9,581.8	12.2%	8,447.0	88.2%	-1.1%
CGST	*5,039*	*147.9%*	*4,575.4*	*90.8%*	*125.1%*
UT- GST	*53*	*13.2%*	*24.1*	*45.1%*	*-49.0%*
IGST	*500*	*-71.7%*	*289.5*	*57.9%*	*-83.6%*
Customs Duty	*1,300.4*	*0.8%*	*1,179.3*	*90.7%*	*-8.6%*
Union Excise Duty	*2,596.1*	*0.1%*	*2,310.0*	*89.0%*	*-11.0%*
Service Tax	*92.8*	*-88.6%*	*68.8*	*74.2%*	*-91.5%*
GST Compensation Cess	900	NA	950.8	105.6%	51.9%

^Net of Refunds, Gross of States' share in Central Taxes

Source: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA Research

Exhibit 6: Trends in the GoI's Revenue Deficits and Fiscal Deficits



Source: CGA, Ministry of Finance, GoI; ICRA Research included Rs. 6.1 trillion as CGST target for FY2020, indicating average monthly collections of Rs. 508.3 billion, which is considerably higher than monthly run-rate of the provisional CGST inflows of Rs. 381.3 billion in FY2019, as per CGA's data. Moreover, provisional data released by the CGA placed CGST inflows at Rs. 468.5 billion for April 2019, lower than the IBE's monthly target. In addition, the Ministry of Finance indicated vide a press release dated June 1, 2019, that gross CGST collection (after settlement of IGST, but before refunds) stood at Rs. 359.1 billion for May 2019, which again undershot the monthly average of Rs. 508.2 billion included in the FY2020 IBE.

Direct tax collections were projected at Rs. 13.8 trillion, 22.6% higher than the FY2019 Prov. with income tax and corporate tax being projected to grow at 34.3% and 14.5%, respectively. While news reports have suggested that the advance tax collections have reported a sharp uptick in Q1 FY2020, it remains to be seen whether this would be sustainable for the remainder of the fiscal.

Non-Tax Revenue and Disinvestment Proceeds: Non-tax revenues were estimated at Rs. 2.7 trillion in FY2020 IBE, a growth of 10.7% relative to FY2019 Prov. Dividends and profits of the GoI were placed at Rs. 1.3 trillion in FY2020 IBE, a considerable 20.0% higher than Rs. 1.1 trillion in FY2019 Prov. In particular, the surplus transferred from the RBI, nationalised banks and financial institutions was placed at Rs. 0.9 trillion in FY2020 IBE, relative to Rs. 0.7 trillion in FY2019 RE. The impending report of the Jalan Committee Report, which was appointed to review the economic capital framework for the RBI, is likely to be finalised by end-June 2019. The recommendations of this committee, particularly, with respect to the transfer of RBI's surplus to the GoI, will crucially influence the GoI's collections from this source in the ongoing fiscal.

The target for disinvestment and strategic divestment proceeds was raised to Rs. 900.0 billion in FY2020 IBE from Rs. 850.0 billion in FY2019 Prov. The latter had benefitted from the inflows of Rs. 145.0 billion, from the sale of the GoI's stake in PFC to REC. While the target for disinvestment proceeds for FY2020 is unlikely to be changed in the upcoming budget, in our view, the achievement of the same would crucially depend on how quickly big-ticket disinvestment activity commences.

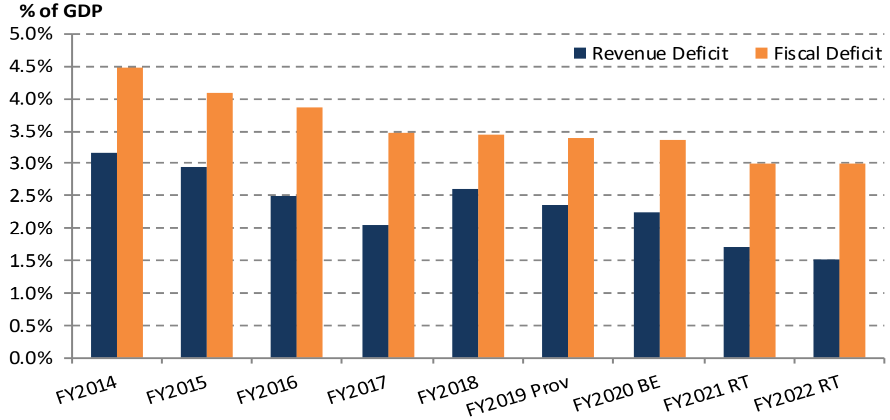
Expenditure Trends for FY2020: The Ministry of Finance indicated vide a press release dated May 29, 2019 that the allocations presented in the Interim Budget 2019-20 would largely not be altered. The GoI would only make provisions for additional funds for unavoidable commitments which have not been fully been accounted for in the Interim Budget 2019-20. Accordingly, most expenditure allocations are unlikely to change meaningfully in the Union Budget 2019-20, in our view.

Exhibit 7: GoI's Fiscal Balances

	Rs. Trillion			Growth	
	FY2018 Actual	FY2019 Prov.	FY2020 BE	FY2019 Prov.	FY2020 BE
Revenue Receipts	14.4	15.6	19.8	8.9%	26.5%
Tax Revenues	12.4	13.2	17.1	6.0%	29.5%
Non-Tax Revenues	1.9	2.5	2.7	27.7%	10.7%
Revenue Expenditure	18.8	20.1	24.5	6.9%	21.9%
Revenue Balance	**-4.4**	**-4.5**	**-4.7**		
% of GDP	*2.6%*	*2.3%*	*2.2%*		
Capital Receipts (Non-Debt)	1.2	0.9	1.0	-26.5%	20.5%
Capital Expenditure	2.6	3.0	3.4	15.1%	11.0%
Fiscal Balance	**-5.9**	**-6.5**	**-7.0**		
% of GDP	*3.5%*	*3.4%*	*3.4%*		

**GDP for FY2018 and FY2019 as per CSO's data released on May 31, 2019; GDP for FY2020 as per the estimate of Rs. 210.1 trillion included in Interim Budget 2019-20*
Source: CGA, Ministry of Finance, GoI; ICRA Research

Exhibit 8: GoI's Revenue and Fiscal Deficit as a Percentage of GDP



RT: Rolling Target
Source: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA Research

Revenue expenditure was placed at Rs. 2.5 trillion in FY2020 IBE, 21.9% higher than the provisional amount of Rs. 2.0 trillion in FY2019. In the Interim Budget 2019-20, the GoI had launched PM-KISAN with an allocation of Rs. 750.0 billion for FY2020. This scheme was an income support scheme for small and marginal farmers with landholding up to 2 acres. Subsequently, the Union Cabinet approved the extension of this scheme to include all farmers. As per the press release by Ministry of Agriculture & Farmers Welfare, the revised expenditure on this scheme would be Rs. 872.2 billion for FY2020. This is likely to increase the revenue expenditure outlay of the GoI in the upcoming budget.

In addition, the expenditure outlay for various subsidies incurred in FY2019 were rolled over to FY2020, which would also add to the GoI's expenditure burden in the ongoing fiscal. ICRA estimates that there was a backlog of Rs. 320-350.0 billion in fertilizer subsidy outlay in FY2019, which would need to be accounted for in FY2020. Similarly, ICRA estimates the carryover of fuel subsidy from FY2019 to be ~Rs. 167 billion, which would need to be disbursed in FY2020.

Capital expenditure was budgeted to rise to Rs. 3.4 trillion, as per the FY2020 IBE, 11.0% higher than Rs. 3.0 trillion in FY2019 Prov. Several news reports have suggested that the GoI may earmark additional funds for bank recapitalisation in the upcoming budget. However, the imposition of the model code of conduct in the first two months of the ongoing fiscal may curtail capex below the IBE for FY2020.

Fiscal balances: The GoI had indicated a fiscal deficit of 3.4% of the GDP in the IBE for FY2020. Limited changes are expected in the expenditure allocations, aside from higher outlays for schemes such as PM-KISAN and for certain subsidies. However, the revenue growth assumptions in the FY2020 IBE appear optimistic in light of the FY2019 Prov. If the same are revised in the upcoming budget, there is likely to be an increase in the targeted fiscal deficit relative to the FY2020 IBE.

The Interim Budget for FY2020 had included rolling targets to curtail the fiscal deficit to 3.0% of GDP in FY2021 and in FY2022 (refer Exhibit 8), which are unlikely to change in the upcoming budget. However, the GoI's fiscal glide path would need to be revisited after the Fifteenth Finance Commission's (FFC) recommendations are published. In addition, the trend for states' share of tax revenues, which would crucially affect the net tax revenues of the GoI, would also be determined by the FFC's report.

Summary*: *With few expenditure allocations expected to be altered from the interim budget estimates, the upcoming budget for 2019-20 is unlikely to reveal the revised priorities of the new government. Since the revenue growth assumptions in the FY2020 IBE appear optimistic in light of the FY2019 Prov., there is a possibility of a downward revision in the targeted level of tax revenues in the upcoming budget, which would likely result an increase in the targeted fiscal deficit relative to the FY2020 IBE. The longer-term path for fiscal consolidation would become clear after the recommendations of the FFC become available. Moreover, the magnitude of central transfers to states, particularly through tax devolution, would also become clear after the FFC's report, which would significantly impact the GoI's fiscal balances in the future.

BANKING AND FINANCE

- Capital infusion of Rs 350-450 billion to support 12-13% domestic credit growth for banks
- Merger of PSBs with PCA banks being merged with relatively better PSBs
- Increased refinancing for NBFCs including HFCs
- Fiscal incentives to spur demand for housing sector

With a large capital infusion of Rs 1.96 trillion during FY2018 and FY2019, the core equity capital position of public sector banks (PSBs) improved to 9.2% as on March 2019 compared to 8.4% as on March 2018. However, in our view, the PSBs will still require growth capital, which shall remain at around Rs 350-450 billion during FY2020. This, however, will be driven by the GoI's intention to take five PSBs (including IDBI bank) out of the RBI's prompt corrective action framework (PCA), in the absence of which the GoI's capital obligation is likely to reduce significantly.

Moreover, the GoI has stated its intention of merging the various PSBs to create relatively larger sized banks and in such a case, the PSBs under the PCA are likely to be merged with other relatively better ones. Hence, if the GoI was to go along with its plan for consolidation of the PSBs, we expect the GoI to announce a capital infusion of Rs 350-450 billion in its upcoming budget. This capital infusion, we hope will enable the merger of some of the PSBs and support a domestic credit growth of 12-13% for FY2020, enabling them to meet the enhanced regulatory capital requirements.

These apart, the recent funding issues for non-banking financial companies (NBFCs) have impacted their ability to disburse fresh loans, which is also reflected in the slowing consumer demand, which is likely to affect the growth of the other sectors. Though banks, including the PSBs, have supported many of the NBFCs (including housing finance companies) by funding them against the purchase of their retail loan portfolios, however, additional measures need to be taken to provide refinancing lines for the sector. Additionally, fiscal incentives for spurring housing demand by allowing full exemption of the interest paid on the purchase of a second house could be considered, even if it is for a temporary period. Such exemption can be extended on a selective basis to prevent speculation by considering the exemption for fully completed houses or with other suitable caveats. This may improve the cash flow of various real estate developers, which in turn can reduce the funding stress being witnessed by the NBFCs (including the HFCs).

FERTILISER

- Adequate and timely provision of subsidy for both urea and NPK fertilisers, given the large backlog of subsidy outstanding
- Budgetary allocation for enhancement of farm incomes and ensuring crop realisations
- Allocation for investment in irrigation projects, better farm credit availability and stimulating agrarian growth - measures to alleviate the agri-stress prevalent in the key agrarian regions
- Reduction of import duty on LNG to nil from 2.5% currently

The fertiliser industry continues to reel under liquidity stress, driven by the delay in the subsidy receipts from the GoI and the large subsidy backlog, which ICRA estimates to be around Rs. 32,000-35,000 crore at the end of FY2018-19. Consequently, the working capital borrowings and interest costs remain elevated for the industry, resulting in weak cash generation and subdued credit metrics. The industry also awaits the pay-out of revised fixed costs under the modified NPS-III, which was notified in April 2014 but is yet to be paid out. The budget is expected to focus on enhancing farm incomes as has been the focus in the last couple of years. ICRA also expects the budget to focus on certain short-term measures to alleviate the significant agri-distress in some of the key agrarian regions of the country.

ICRA expects rationalisation of the subsidy under the Nutrient-based Subsidy (NBS) scheme for NPK fertilisers as international prices of fertilisers have moderated along with raw material prices. ICRA also expects a reduction of the import duty on LNG to nil from 2.5% currently, resulting in lowering of the cost of production and the subsidy outgo for the GoI, as the reliance on imported LNG has been rising in a scenario of stagnant domestic gas production.

INFRASTRUCTURE

- Increased public sector spending and incentivising private sector to take up new projects; increase in budgetary allocation for key implementing agencies like NHAI a necessity
- Measures to attract private sector investments by easing regulatory environment, speedier resolution of issues and incentives in the form tax holiday, etc.
- Measures to further improve availability of long-term funds to the sector including allocation towards National Investment and Infrastructure Fund (NIIF)
- Select infrastructure companies/finance companies to be allowed to raise long-term funds in the form of infrastructure and tax-free bonds

Infrastructure/Construction

The infrastructure sector expects continued thrust from the Government towards revival of the investment cycle in the form of a further increase in budgetary allocations with focus on roads, railways and urban infrastructure. Dedicated allocations for specified large infrastructure projects announced such as Bullet trains, Bharatmala, Sagarmala, smart cities, inland waterways development etc can also be made to expedite these projects. Further, the budgetary allocation towards the NHAI can be increased, keeping in view the increased capital outlay on national highway development. To revive private sector interest in taking up new projects, measures towards resolution of bottlenecks and further improving the regulatory environment are expected. Further, some incentives like the extension of tax holiday for infrastructure projects can be provided. The infrastructure sector is also looking at further steps to improve long-term funding availability for the sector. In this regard, higher allocation towards the National Investment and Infrastructure Fund (NIIF) is expected. Some reputed public sector enterprises can also be allowed to raise long-term funds by way of Infrastructure Bonds or tax-free bonds.

Real Estate

The Interim Budget for FY2020 included certain announcements to support the demand for real estate - such as extension of capital gains rollover benefit for purchase of a second house and removal of income tax on notional rent on second self-occupied house. In the upcoming Budget for FY2020, the sector will be expecting further tweaks to the income tax rules, which can incentivise home buying, including expanding the interest and principal-deduction available for home loans for first-time buyers or affordable housing. Increase in the budgetary allocation for the Government's flagship schemes for expanding home ownership such as Pradhan Mantri Awas Yojana will support the implementation of ambitious targets. Grant of infrastructure status to the overall industry will enable better access to debt-funding at affordable costs. Measures taken to ease the availability of capital for the NBFCs will have a positive impact on the real estate sector, which is dependent on financing from the NBFCs to a large extent. Other steps to facilitate faster regulatory approvals through single window clearance and release of Government-owned land for affordable housing are also likely to support industry prospects.

IRON AND STEEL

- Continued thrust on steel-intensive end-user industries such as construction, housing, railways, roads, urban infrastructure, and power transmission
- Fast-tracking iron ore mine allocation through auctions and withdrawal of 2.5% import duty on iron ore lumps, fines and pellets, likely to facilitate greater ore availability to steel mills post March 31, 2020 when licences of many merchant mines expire

Following two back-to-back years of healthy growth rates, at the start of FY2020, domestic steel demand growth has seen some weakening. Growth in steel consumption in April 2019 decelerated to 6.4% against 7.5% and 7.9% achieved in FY2019 and FY2018 respectively. Initial indicators on accelerated slowdown in auto sales in May 2019, weak consumer sentiment, sub-6% GDP growth rate in the fourth quarter of FY2019 and continued tight liquidity conditions following the NBFC crisis remain key headwinds that could temper domestic steel demand growth in FY2020.

Public spending in infrastructure and construction, which accounts for over 50% of the domestic steel demand, has been the primary engine that has led to steel demand recovery in the previous two years. Consequently, ICRA believes that supportive policies in steel intensive sectors like construction, housing, railways, roads, urban infrastructure and power transmission are likely to help the domestic steel industry.

Post March 31, 2020, iron ore mining leases of many merchant miners are scheduled to expire. The slow progress in auctioning iron ore mines puts a question mark on around 52-55-million tonnes per annum of ore supplies being churned out from these mines at present.

Given this narrow window, any delay in mine auctions could lead to a supply squeeze in FY2021, potentially leading to a sharp increase in domestic ore prices. In this backdrop, ICRA believes that the elimination of 2.5% import duty on iron ore lumps, fines and pellets would provide some cost relief to steel mills, post March 31, 2020.

MUNICIPAL

- Extension of incentive scheme for municipal bond issuances and expansion of its scope
- Incentive for faster implementation of key municipal reforms and timely completion of projects under AMRUT/SCM

Municipal bond issuances increased in India in the recent past, helped by the incentive scheme of the Government of India. Therefore, an extension of the incentive scheme is desirable to facilitate further development of the municipal bond market for meeting large funding requirements towards urban infrastructure creation. Also, expansion in the scope of the incentive scheme to other entities in the municipal sector, including area development authorities and state pooled finance entities, would be preferred.

Incentivising the state governments and the urban local bodies (ULBs) for faster implementation of key reforms required under the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and Smart Cities Mission (SCM) would be a welcome step. Besides, incentivising the ULBs for timely completion of the projects already approved under AMRUT and SCM, especially water supply and sewerage projects, would be preferred.

OIL AND GAS

- Rationalisation of cess, which currently stands at an ad valorem rate of 20%
- Exemption of exploration activity from the levy of GST
- Reduction in MAT rate for exploration and production operations
- Natural gas and other four petroleum products to be brought under GST
- Reduction in customs duty on LNG import to encourage consumption in various sectors, especially in view of the GoI's efforts to increase gas consumption in total energy mix and low prices of competing liquid fuels
- Increase of fuel subsidy for sensitive petroleum products from Rs. ~336 billion for 2019-20 (BE)
- Benefit of deduction under Section 35AD to be extended to the city gas distribution entities

At the current elevated crude oil prices, the ad valorem cess of 20% limits the realisations and cash accruals of upstream companies as compared to the earlier fixed cess per MT. Thus, a downward revision in the cess on crude oil production from the current level of 20% may help upstream companies improve their earnings in a higher crude oil price regime.

Additionally, one of the prominent demands of the industry has been the exemption of exploration activity from the levy of GST. Also, the sector has been demanding the reduction in the Minimum Alternate Tax (MAT) rate for exploration and production operations, which, at about 20% of book profits, is a significant deterrent for investment. The GoI should also clarify the eligibility for a tax holiday under Section 80-IB of the Act and the definition of "mineral oil" which would include natural gas retrospectively, a long-running demand of the industry.

Further, the industry has been demanding that natural gas and other four petroleum products be brought under the GST to enable free flow of credits and avoid stranded taxes. To promote the use of natural gas as fuel, liquified natural gas (LNG) imports should be exempt from customs duty as crude attracts nil duty in comparison to LNG, which attracts 2.5% duty. Additionally, with a large number of city gas distribution (CGD) projects being executed across the country, the industry is demanding that the benefit of deduction under Section 35AD may also be extended to the city gas distribution entities to encourage investment in the CGD business. For the downstream segment, the industry demands include the GoI's adequate provision of subsidy. ICRA projects the gross under recoveries (GURs) of the oil marketing companies (OMCs) at ~Rs. 259 billion for FY2020 (assuming the average Indian basket crude price of US$65/bbl and the forex rate at ~Rs 70/US$) as against a subsidy provision of Rs 336 billion. However, there is likely to be a subsidy gap of Rs 90 billion in FY2020 owing to the carry-over of Rs 167 billion subsidy from FY2019. In the absence of that, the OMCs would have to bear additional interest costs on higher working capital borrowings.

PORT

- Policy changes support Sagarmala project and its interlinked development plans
- Plans to speed up inland waterways development
- Private sector participation crucial for execution; focus on higher budgetary allocation

Over the last few years, the Government has reiterated its support towards the plans under the Sagarmala project to develop the ports and coastal areas of the country by making several policy changes.

Further, already significant work is under way for the development of National Waterway-I and the Government has also announced plans to speed up the development of other inland waterways.

However, in the past, the allocation to the Sagarmala and the inland waterway projects in terms of budgetary support has remained low (about Rs 500-600 crore) as compared to the cost of planned initiatives under these schemes, indicating that the reliance on execution of the plans is largely on private sector participation.

In this context, even if the Government continues with its past policy and does not provide higher budgetary allocation to these plans, some incentives or other measures to boost the private investor interest that facilitate active participation could be expected.

POWER

- Increased funding allocation to strengthen the transmission and distribution infrastructure
- Measures to augment funding avenues for renewable energy projects
- Clarity on safeguard duty on imported PV an important factor for solar bid tariffs

ICRA expects higher budgetary allocation to meet funding requirements of state-owned distribution utilities to strengthen the distribution infrastructure under centrally-sponsored schemes and to enable an improvement in their operating efficiencies.

Further, the funding allocation needs to be enhanced for the renewable energy sector to support the development of renewable energy parks and for augmentation of inter-state transmission infrastructure. This is in view of the capacity addition requirement of close to 100 GW to achieve 175 GW renewable energy capacity target by FY2022 and to ensure the grid stability, given the rising share of renewable energy-based generation in the overall energy consumption mix.

ICRA also expects Government measures to enable the availability of additional financing avenues for renewable energy projects.

Moreover, clarity is required on the status of safeguard duty on imported photo-voltaic (PV) modules post July 2020, which would have a bearing on the solar bid tariffs by the developers as well as on the development of domestic PV module-manufacturing capacity.

ROAD

- Government likely to look at equity-raising plans to fund Bharatmala project
- Revival of private sector interest in BOT (Toll) road projects a key factor
- Provision to renegotiate projects a necessary suggestion to balance risk-sharing in a PPP project

The total budgetary allocations (including PBFF, CRF and GBS) to fund the ambitious new highway development programme is estimated at Rs. 3,43,045 crore over FY2019-FY2022 – averaging around Rs. 86,000 crore per annum. While the NHAI borrowing programme is on track, the allocation in the last budget was lower than required (at Rs. 70,544 crore in FY2019) thereby necessitating dependence on other funding avenues. Therefore, to bridge the shortfall in budgetary allocations, the NHAI is expected to raise equity by monetising more assets through the toll-operate-transfer and the Infrastructure Investment Trust (InvIT) routes (by transferring mature assets to special purpose vehicles). Therefore, ICRA expects the Government to make an announcement on equity raising plans / or launch of the InvIT to fund the ambitious Bharatmala programme.

The fact that the BOT (Toll) awards have been at low levels in last four years (compared to the past where most of the awards were through the BOT (Toll) route) is a reflection of the reduced risk appetite for the private sector. Therefore, revival of the private sector's interest in toll road projects is the need of the hour. The provision to re-negotiate the contracts is an important suggestion made by the Kelkar Committee to balance the risk-sharing among the stakeholders in the PPP model. Therefore, setting up of the PPP Project Review Committee and the Infrastructure PPP Adjudication Tribunal for re-negotiating concessions if there is evidence of distress in projects (not because of aggressive assumptions/irrational bids) which may result in a default (if the direct cost implications on account of re-negotiation are less than the financial outcome of doing nothing) would be a step in the right direction.

TELECOM

- Reduction in levies paid by the telecom sector like licence fee and spectrum usage charges
- Steps to boost infrastructure in rural and remote areas and stimulus on broadband penetration
- Removal of the telecom equipment from basic customs duty

The Indian telecom industry has been facing headwinds in terms of intense competition and pricing pressure, which in addition to the need for continued capex, have kept the industry saddled with elevated debt levels, estimated at Rs. 4.75 lakh crore as on March 31, 2019.

This led the industry to seek financial incentives from the Government, time and again, which can lower costs of equipment or services. The industry has been asking for a reduction in the overall charges paid by the operators (mainly licence fee and spectrum usage charges) to ease the financial burden on the already stressed sector. Apart from the levies, the industry is also looking forward for a resolution on pending issues like clarity on levy of service tax on spectrum acquired in auctions prior to October 2016, one-time spectrum charges, resolution of retrospective taxation matters and rebate on levy of withholding tax on mobile SIM distributors. The industry has been long asking for removal of the sector from the ambit of TDS and removal of telecom equipment from the basic customs duty.

The 2018 Budget focused on increased impetus on promoting new technologies like Artificial Intelligence, Internet of Things, Machine Learning etc. Fiscal incentive schemes for driving domestic innovations and promoting the development of ecosystem around these technologies should be looked upon. Further, steps to boost infrastructure in rural and remote areas should remain in focus, with stimulus on broadband penetration.

The telecom tower industry, besides other things, has sought accelerated depreciation benefits on lithium ion batteries to promote its usage and allowance of 20% funding through external commercial borrowings.

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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