ICRA

GOVERNMENT OF INDIA FINANCES

GoI's fiscal deficit for Q1 FY2020 records mild YoY uptick in absolute terms, stands at 61.4% of budget estimate

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Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Soumyaditya Pal
+91 124 4545 848
soumyaditya.pal@icraindia.com

Medha Sinha
+91 124 4545 399
medha.sinha@icraindia.com

HIGHLIGHTS

- *The fiscal deficit of the Government of India (GoI) stood at Rs. 4.32 trillion in Q1 FY2020, a mild 0.7% higher than the level in Q1 FY2019, with a modest 6.4% expansion in revenue receipts and a significant 27.6% contraction in capital expenditure, offsetting the mild 6.1% rise in revenue spending.*
- *While the fiscal deficit for Q1 FY2020 stood at a significant 61.4% of the revised budget estimate (RBE) for the full year, this marks an improvement relative to the situation in Q1 FY2019 (66.5% of the FY2019 provisional accounts or Prov.).*
- *Gross tax revenues rose by a muted 1.4% in Q1 FY2020, considerably undershooting the 18.3% growth included in FY2020 RBE, with a moderate rise in direct taxes and a contraction in indirect tax collections. The net tax revenues have grown by a faster 6.0%, since the taxes devolved to the states contracted by 5.6% in Q1 FY2020 to Rs. 1.5 trillion from Rs. 1.6 trillion in Q1 FY2019.*
- *In Q1 FY2020, direct tax collections rose by 9.7%, undershooting the growth of 18.6% included in the FY2020 RBE. In our view, the budgeted growth for direct tax collections remains optimistic, despite the hike in the super rich surcharge, given the lowering of corporate tax rate for most entities, and the modest outlook for earnings growth in certain sectors.*
- *Indirect tax collections recorded a disconcerting year-on-year (YoY) contraction of 4.9% in Q1 FY2020, in sharp contrast to the 20.4% expansion included in FY2020 RBE. However, the proposed hike in special excise duty, road and infrastructure cess, as well as customs duty on gold and precious metals, would support indirect tax revenues the remainder of FY2020.*
- *Net of a sharp 30% rise in subsidy outgo led by fertilisers and fuel, the GoI's revenue expenditure has remained similar to the year-ago levels in Q1 FY2020.*
- *The election related slowdown in capital spending has led to a sharp 26.2% contraction in capital outlay in Q1 FY2020, which should see a reversal in the post-budget months.*
- *The realisation of the target for direct taxes and GST collections, dividends and surplus from the RBI and disinvestment proceeds will be crucial to prevent a revenue slippage in FY2020. At present, we can't rule out that expenditure cuts may be required to prevent a fiscal slippage, if the revenue targets are missed.*

OVERVIEW

Revenue Trends in Q1 FY2020: Provisional data released by the Controller General of Accounts (CGA) indicates that the GoI's revenue receipts rose by 6.4% in YoY terms to Rs. 2.8 trillion in Q1 FY2020 from Rs. 2.7 trillion in Q1 FY2019. Notably, the pace of growth of revenue receipts was substantially lower than the 25.6% expansion included in FY2020 RBE. Moreover, revenue receipts during Q1 FY2020 stood at 14.5% of FY2020 RBE, lower than the same in Q1 FY2019 (17.1% of FY2019 Prov.). Net tax revenues rose by a modest 6.0% to Rs. 2.5 trillion (15.2% of FY2020 RBE), while non-tax revenues expanded by 9.4% to Rs. 0.3 trillion (10.7% of FY2020 RBE) in Q1 FY2020.

Tax Revenue: Net of refunds (gross of devolution to States), the GoI's tax revenues rose by a muted 1.4% in Q1 FY2020 to Rs. 4.0 trillion (refer Exhibit 1 and 2), sharply lower than the 18.3% growth included in FY2020 RBE. The net tax revenues (net of devolution to States) expanded by a faster 6.0%, since the taxes devolved to the states contracted by 5.6% in Q1 FY2020 to Rs. 1.5 trillion from Rs. 1.6 trillion in Q1 FY2019. In particular, the tax devolution to the states declined to Rs. 495.4 billion, each in April 2019 and May 2019, compared to the devolution of Rs. 557.9 billion, each in April 2018 and May 2018, respectively. Subsequently, the tax devolution to states in June 2019 exceeded the same in June 2018 (Rs. 495.4 billion vs. Rs. 459.5 billion).

Direct tax collections recorded a growth of 9.7% in Q1 FY2020, lower than the budgeted expansion of 18.6%, reflecting the trend for corporate tax collections (+6.3% vs. +15.4%), as well as income tax (+12.3% vs. +23.3%). Notably, income tax and corporate tax collections during Q1 FY2020 stood at 9.2% and 17.0%, respectively, of the RBE for the full year (10.0% and 18.7%, respectively, of FY2019 Prov. in Q1 FY2019). The GoI has introduced higher surcharges on individuals with incomes above Rs. 20 million per annum in the Union Budget for 2019-20. While this is likely to boost the revenues from income tax to some extent, the GoI's targeted growth of 23.3% in FY2020 may prove to be optimistic. Moreover, the GoI proposed to reduce corporate tax to 25% on companies with turnover below Rs. 4 billion in the budget, which will dampen the revenues from corporation tax to some degree in the ongoing fiscal. ***Overall, the 18.6% growth target for direct taxes included in the RBE appears optimistic, despite the hike in the super rich surcharge, given the lowering of corporate tax rate for most entities, and the modest outlook for earnings growth in certain sectors.***

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 de-growth of 4.9% to Rs. 2.1 trillion in Q1 FY2020, in sharp contrast to the 20.4% expansion included in FY2020 RBE. Indirect taxes accounted for 20.2% of the FY2020 RBE, lower than the same in Q1 FY2019 (25.5% of FY2019 Prov.). The combined CGST and IGST collections contracted by 7.8% in Q1 FY2020 and stood at 23.0% of the FY2020 RBE, which is lower than the level in Q1 FY2019 (Rs. 1.4 trillion; 28.4% of FY2019 Prov.). The combined revenue from customs, excise and service tax remained stagnant at Rs. 0.8 trillion in Q1 FY2020 (16.9% of FY2020 RBE), in line with the Q1 FY2019 levels (21.7% of FY2019 Prov.). ***Going forward, the GoI's tax***

proposal to increase special additional excise duty as well as road and infrastructure cess by Rs 1/litre each on petrol and diesel, would boost the indirect tax revenues in FY2020. Moreover, the Union Budget 2019-20 also proposed to increase custom duty on gold and other precious metals to 12.5% from 10%, which would further boost indirect tax collections.

The inflows from GST compensation cess amounted to Rs. 246.1 billion in Q1 FY2020, which provided an additional boost to the tax revenues in that period.

Exhibit 1: Trends in Tax Revenue Receipts in FY2019 and Q1 FY2020

	FY2019 Prov.	FY2020 RBE		Q1 FY2020 (Prov.)		
	Rs. billion	Rs. billion	Growth	Rs. billion	% of BE	Growth#
Gross Tax Revenues^	**20,802.0**	**24611.95**	**18.3%**	**4,004.2**	**16.3%**	**1.4%**
Direct Taxes	11,252.3	13,350	18.6%	1,675.7	12.6%	9.7%
Corporation Tax	*6,635.7*	*7660*	*15.4%*	*706.4*	*9.2%*	*6.3%*
Income Tax	*4,616.5*	*5690*	*23.3%*	*969.3*	*17.0%*	*12.3%*
Indirect Taxes	8,447.0	10,168.5	20.4%	2,050.7	20.2%	-4.9%
Central GST (CGST)	*4,575.4*	*5260*	*15.0%*	*1,168.1*	*22.2%*	*28.2%*
Union Territory GST (UTGST)	*24.1*	*69.48*	*188.7%*	*5.1*	*7.4%*	*149.0%*
IGST	*289.5*	*280*	*-3.3%*	*106.7*	*38.1%*	*-77.4%*
Customs Duty	*1,179.3*	*1559.04*	*32.2%*	*394.8*	*25.3%*	*16.9%*
Excise Duty	*2,310.0*	*3000*	*29.9%*	*369.5*	*12.3%*	*-7.7%*
Service Tax	*68.8*	*0*	*-100.0%*	*6.5*	*-*	*-79.8%*
GST Compensation Cess	950.8	1093.43	15.0%	246.1	22.5%	3.8%

^ Net of Refunds, Gross of States' share in Central Taxes; # As compared to the corresponding period of FY2019 Prov.
Source: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA research

Non-Tax Revenue and Disinvestment Proceeds: The GoI's non-tax revenues expanded by 9.4% in Q1 FY2020 to Rs. 334.8 billion, undershooting the 27.2% expansion in FY2020 RBE. Moreover, the inflows during Q1 FY2020 were equivalent to 10.7% of the RBE for FY2020, lower than the level in Q1 FY2019 (12.4% of FY2019 Prov.).

Within non-tax revenues, interest receipts of the GoI stood at Rs. 32.6 billion during April-June 2019, which was equivalent to 23.8% of FY2020 RBE. Dividends and profits stood at Rs. 2.8 billion, accounting for a muted 0.2% of FY2020 RBE, in line with seasonal trends. The receipts from dividends and surplus from the Reserve Bank of India (RBI), nationalised banks and financial institutions were set at Rs. 1.1 trillion in FY2020 RBE from Rs. 0.7 trillion in FY2019 RE. ***The awaited recommendations of the Jalan Committee, which was appointed to review the economic capital framework for the Central Bank, with respect to the transfer of the RBI's surplus to the GoI, may crucially influence the government's collections from this source in the ongoing fiscal.***

The GoI budgeted Rs. 505.2 billion for Other Communication Services in FY2020 RBE. ***This is in line with ICRA's estimates of revenues from communication services based on the deferred payments pertaining to earlier auctions and normal fees such as spectrum usage charges and license fees.***

The RBE set a significant target of Rs. 1.05 trillion for disinvestment proceeds in FY2020 RBE, against which the total disinvestment proceeds stood at a muted Rs. 23.6 billion in Q1 FY2020 (2.2% of FY2020 RBE). This included the receipts from the sale of the GoI's stake in Rail Vikas Nigam Ltd and the sale of enemy shares. Subsequently, in July 2019, the cumulative disinvestment proceeds increased to Rs. 123.6 billion following the inflows of Rs. 100 billion from the FFO of CPSE-ETF. Nevertheless, the realisation of disinvestment proceeds in the first four months of FY2020 remains limited at 11.8% of FY2020 RBE. ***The speed with which the disinvestment programme kicks off, as well as the interest shown by potential buyers in the PSUs being offered for strategic disinvestment, will be critical to achieve this target.***

Exhibit 2: Trends in Quarterly Tax Collections (Net of Refunds, Gross of States)

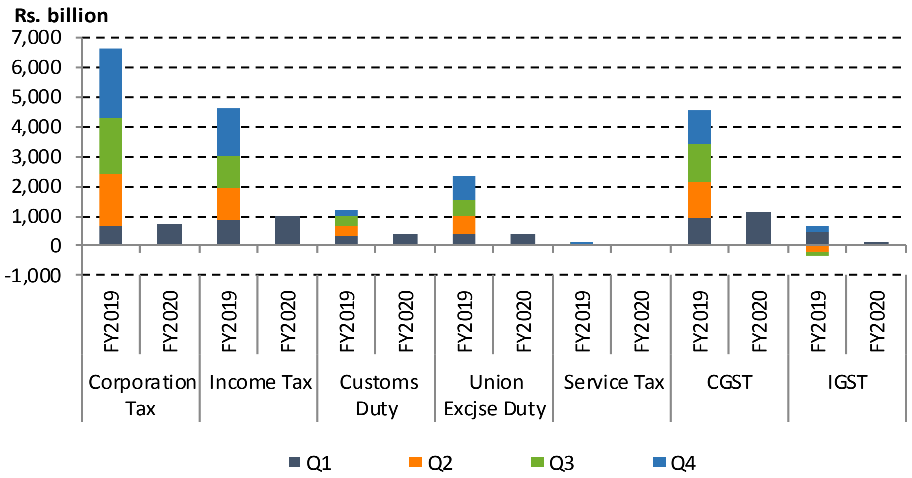
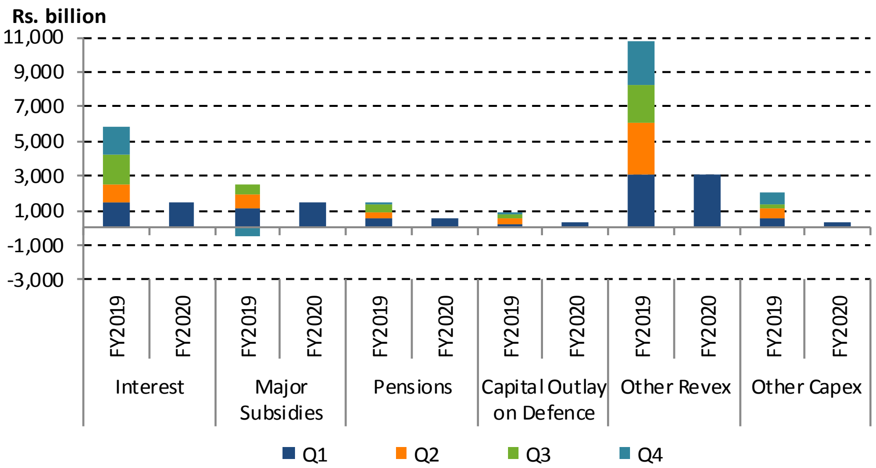


Exhibit 3: Trends in Quarterly Expenditure (ICRA's estimates)



Source: CGA, Ministry of Finance, GoI; ICRA research

Expenditure Trends for Q1 FY2020: In Q1 FY2020, the GoI's revenue spending rose by a modest 6.1% to Rs. 6.6 trillion (26.9% of FY2020 RBE) while its capital expenditure and net lending contracted sharply by 28.6% to Rs. 605.9 billion (18.7% of FY2020 RBE; refer Exhibit 3).

The GoI's revenue expenditure growth of 6.1% in Q1 FY2020 was significantly lower than the 21.9% expansion budgeted for FY2020. Moreover, interest expenditure contracted by 2.2% in Q1 FY2020, in contrast to the37.4% expansion included in FY2020 RBE.

However, the total outlay for major subsidies increased by a considerable 30.0% to Rs. 1.5 trillion in Q1 FY2020 (50.3% of FY2020 RBE) from Rs. 1.2 trillion in Q1 FY2019 (59.3% of FY2019 Prov.), led by fuel (141.6% growth) and fertiliser subsidies (72.8% growth). The subsidy outlay for the Ministry of Petroleum and Natural Gas, Department of Fertilisers and Department of Food and Public Distribution stood at Rs. 283.3 billion, Rs. 290.9 billion and Rs. 944.1 billion, respectively, in Q1 FY2020, equivalent to 75.6%, 36.4% and 51.2% of the respective FY2020 RBE.

In contrast to the 11.8% rise targeted in the RBE for FY2020, capital expenditure and gross lending declined by a considerable 27.6% in Q1 FY2020. Capital outlay contracted sharply to Rs. 569.7 billion in Q1 FY2020 from Rs. 770.4 billion in Q1 FY2019 and was equivalent to 18.3% of FY2020 RBE. The slowdown in capital outlay is likely to reverse in the post-budget months. In addition, gross lending posted a YoY decline of 39.4% in Q1 FY2020, and stood at 21.7% of the RBE for FY2020.

Fiscal Balances in Q1 FY2019: The GoI's fiscal deficit printed at Rs. 4.32 trillion in Q1 FY2020, a mild 0.7% higher than Q1 FY2019 (Rs. 4.29 trillion; refer Exhibit 4 and 5). However, the GoI's revenue and fiscal deficits in Q1 FY2020 stood at 77.1% and 61.4% of the RBE for FY2020, respectively, lower than the prints of 79.2% and 66.5% of FY2019 Prov., respectively, in Q1 FY2019 (refer Exhibit 6).

While the GoI's revenues are typically disproportionately higher in the later quarters of each fiscal, expenditure growth is also expected to pickup in FY2020 in the post budget months. The realisation of the target for direct taxes and GST collections, and dividends and surplus from the RBI will be crucial to prevent a revenue slippage in FY2020. Moreover, the speed with which the disinvestment programme kicks off, as well as the interest shown by potential buyers in the PSUs being offered for strategic disinvestment, will be critical. At present, we can't rule out that expenditure cuts may be required to prevent a fiscal slippage, if the revenue targets are missed.

While the market will continue to monitor the evolving fiscal trends, the size and timing of the sovereign bond issuance would impart a disproportionate effect on G-sec yields in the remainder of 2019. ICRA expects the 10-year G-sec yield to trade in a range of 6.2%-6.6% in Q2 FY2020, presuming a repo rate cut in August 2019.

Exhibit 4: Fiscal trends in FY2019 and Q1 FY2020

	FY2019 Prov.	FY2020 RBE		Q1 FY2020 (Prov.)		
	Rs. billion	Rs. billion	Growth	Rs. billion	% of BE	Growth#
Revenue Receipts	15,631.7	19,627.6	25.6%	2,848.9	14.5%	6.4%
Tax Revenues$	*13,169.5*	*16,495.8*	*25.3%*	*2,514.1*	*15.2%*	*6.0%*
Non-Tax Revenues	*2,462.2*	*3,131.8*	*27.2%*	*334.8*	*10.7%*	*9.4%*
Revenue Expenditure	20,084.6	24,477.8	21.9%	6,587.1	26.9%	6.1%
Revenue Deficit	**4,452.9**	**4,850.2**		**3,738.2**	**77.1%**	
Capital Receipts	850.5	1,050.0	23.5%	23.6	2.2%	-73.1%
Capital Expenditure, Net Lending	2,851.2	3,237.4	13.5%	605.9	18.7%	-28.6%
Fiscal Deficit	**6,453.7**	**7,037.6**		**4,320.6**	**61.4%**	

$ Net of Refunds, Net of States' share in Central Taxes

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

Exhibit 5: Trends in Revenues and Expenditure of the GoI

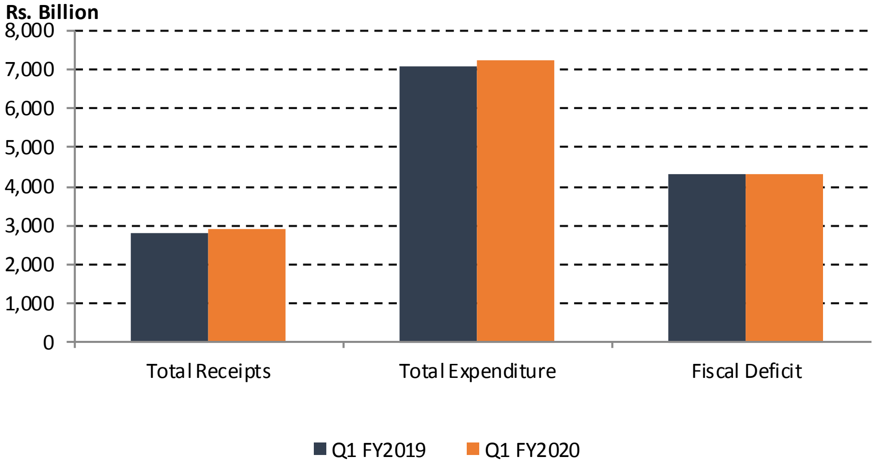
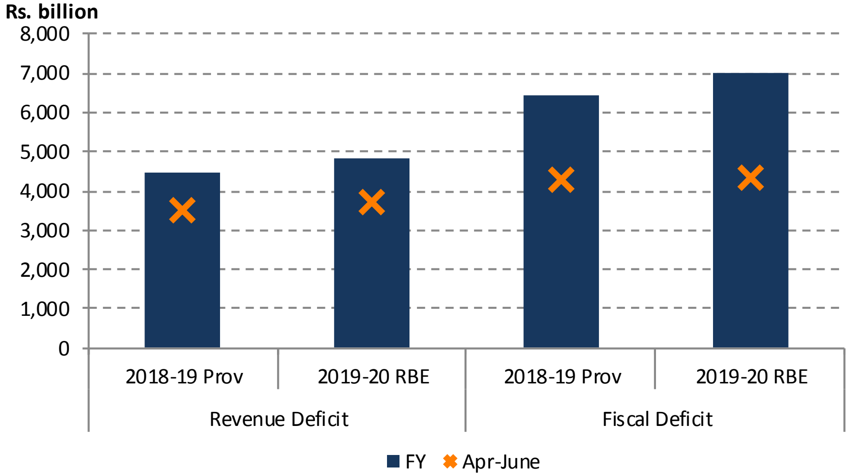


Exhibit 6: Revenue and Fiscal Deficits



Source: CGA, Ministry of Finance, GoI; CEIC; ICRA Research

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ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:
1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:
Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad
1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1
'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2
2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai
5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1
No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2
4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata
A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai
3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune
5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in