ICRA

A MOODY'S INVESTORS SERVICE COMPANY

UNION BUDGET 2021-22: EXPECTATIONS

GoI's fiscal deficit expected at 5% of GDP in FY2022

January 2021

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FISCAL ASSESSMENT: HIGHLIGHTS

ICRA projects the fiscal deficit of the GoI and the state governments at 7.5% of GDP and 4.7% of GSDP, respectively, in FY2021

In ICRA's view, sharp fiscal tightening should be avoided in FY2022

Normalising revenues would anyway reduce the fiscal strain in the coming year

ICRA foresees the General Government fiscal deficit at 8.5% of GDP in FY2022: 5.0% of GDP for the GoI and 3.5% of GSDP for the states

Net and gross market borrowings for FY2022 are forecast at Rs. 16.0 trillion and Rs. 20.5 trillion, respectively

Total liabilities of the GoI are projected to worsen from 49.3% of GDP at end-March 2020 to ~59% of GDP at end-March 2021, before easing mildly to ~57% of GDP at end-March 2022.

- Given the revenue shock engendered by the Covid-19 pandemic, ICRA expects the Government of India's (GoI's) fiscal deficit to widen to Rs. 14.5 trillion or 7.5% of GDP in FY2021. Based on a sample of 12 states, we project the state governments' fiscal deficit at 4.7% of gross state domestic product (GSDP) in FY2021, indicating a General Government fiscal deficit of ~12.2% of GDP.
- In our view, sharp fiscal tightening should be avoided by both the Centre and the state governments, as it would temper the awaited economic recovery. Moreover, revenue normalisation would anyway ease the fiscal strain in FY2022.
- In FY2022, a revenue deficit of 3.5% of GDP and a fiscal deficit of around 5% of GDP for the GoI may allow enough space for prioritising health expenditure, vaccine rollout as well as capital spending, based on the revenue rebound that is widely expected. Given the continuing uncertainty, tax changes should be avoided at this juncture, in our view, and the focus should instead be on maximising disinvestment proceeds.
- In terms of absolute numbers, we have pegged net tax revenues at Rs. 15.5 trillion, non-tax revenues at Rs. 2.5 trillion and disinvestment proceeds at Rs. 1.5 trillion in FY2022. Assuming a revenue deficit of 3.5% of GDP (~Rs. 7.8 trillion, based on our estimate of nominal GDP) and a fiscal deficit of around 5% of GDP (~Rs. 11.1 trillion), implies space for revenue expenditure and capital expenditure of Rs. 25.8 trillion and Rs. 4.8 trillion, respectively, in the coming fiscal.
- The Fifteenth Finance Commission's (15th FC's) recommendations on revenue sharing and fiscal deficit targets, the borrowing permission to be granted by the GoI, and the extent of improvement that can be realised in their own tax revenues, will guide state fiscal trends in FY2022. A fiscal deficit target of 3.5% of gross state domestic product (GSDP) for the state governments for FY2022, may allow them to prioritise a portion of the capital expenditure that had to be deferred during the pandemic, and provide some funds towards projects under the National Infrastructure Pipeline (NIP).
- Taken together, this would mean a General Government fiscal deficit of around 8.5% of GDP in FY2022, appreciably lower than the 12.2% of GDP being expected in the current year.
- With the GoI's fiscal deficit pegged at Rs. 11.1 trillion in FY2022, we expect net G-sec issuance to be placed at Rs. 9.0 trillion. Assuming that 90% of the states' estimated fiscal deficit of Rs. 7.8 trillion is funded by SDL, suggests a net issuance of Rs. 7.0 trillion, resulting in a total dated market borrowing of Rs. 16.0 trillion for FY2022. Adding the redemption of G-sec and SDL indicates substantial gross borrowings of Rs. 20.5 trillion in FY2022, which would continue to exert upward pressure on yields.
- The total liabilities of the GoI are projected to worsen from 49.3% of GDP at end-March 2020 (as per the revised estimates or RE) to ~59% of GDP at end-March 2021, before easing modestly to ~57% of GDP at end-March 2022.

OVERVIEW

The GoI had invoked the 'escape clause' provided for in the amended Fiscal Responsibility and Budget Management Act, to allow its fiscal deficit to rise to 3.8% of the GDP in the RE for FY2020 from the 3.3% of the GDP that had been budgeted for that year. Subsequently, it had expected its fiscal deficit to decline to 3.5% of GDP in the budget estimates (BE) for FY2021, and 3.3% of GDP in the rolling target for FY2022.

However, the Covid-19 pandemic has wreaked havoc on Government finances the world over in 2020. Our calculations suggest that the revenue shock engendered by the pandemic will widen the GoI's fiscal deficit to Rs. 14.5 trillion in FY2021 from the budgeted level of Rs. 8.0 trillion, and Rs. 9.4 trillion in FY2020 (Prov.). Our current projection of India's FY2021 nominal GDP suggests that the GoI's fiscal deficit in the current fiscal will be an unpleasant 7.5% of GDP.

Additionally, state governments were permitted to raise additional borrowings to tide over the revenue crunch in FY2021. The size of their individual fiscal deficits will partly be guided by the number of prescribed reforms they can complete in a timely manner. Based on a sample of 12 states (Karnataka, Kerala, Tamil Nadu, Gujarat, Maharashtra, Punjab, Haryana, Rajasthan, West Bengal, Telangana, Andhra Pradesh and Uttar Pradesh), we project the state governments' fiscal deficit at 4.7% of GSDP in FY2021, indicating a General Government fiscal deficit of ~12.2% of GDP.

When the budgets for FY2022 are being finalised during this quarter, the Union and state governments may not have full visibility of the end of the crisis, and the revenues likely to be realised in the coming fiscal. On one hand, the rollout of Covid-19 vaccines has commenced in various countries, imbuing optimism regarding the pace of post-vaccine recovery. However, the new contagious strain that has been discovered in the UK has sparked restrictions in many countries, heightening uncertainty regarding the level of economic activity that is realistic until the vaccine rollout reaches a critical mass.

In our view, targeting a revenue deficit of 3.5% of GDP and a fiscal deficit of around 5% of GDP for the GoI in FY2022 may allow enough space for prioritising health expenditure, vaccine rollout as well as capital spending, given the revenue rebound that is widely expected, albeit difficult to quantify

In terms of expenditure, in ICRA's view, the Union Budget FY2022 would prioritise capital expenditure and infrastructure spending, especially projects that had already been identified in the NIP, and where the plans are at an advanced stage. This will help create a multiplier effect and boost the tentative economic revival. An urban equivalent of the Mahatma Gandhi National Rural Employment Guarantee Program (MGNREGP) would offer social security to a significant section of the working population, boost consumption demand, restart remittances, and also enhance the pool of labour available in the urban areas for the private sector. Moreover, an adequate allocation for MGNREGP would aid in sustained rural consumption demand, which would further support the growth prospects of the economy. Further, some new schemes to support the agricultural and rural economy and the MSMEs and to support job creation, may also be announced in the Budget.

The 15th FC's recommendations on revenue sharing and fiscal deficit targets, the borrowing permission to be granted by the GoI, and the extent of improvement that can be realised in their own tax revenues, will guide state fiscal trends in FY2022. A fiscal deficit target of 3.5% of GSDP for the state governments for FY2022, may allow them to prioritise a portion of the capital expenditure that had to be deferred during the pandemic, in our view. Taken together, this would mean a General Government fiscal deficit of around 8.5% of GDP in FY2022, appreciably lower than the 12.2% of GDP being expected in the current year.

Fiscal Performance Of The Government Of India

The GoI had forecast a fiscal deficit of Rs. 8.0 trillion in its BE for FY2021 (refer Exhibit 1), lower than the provisional (Prov.) figure of Rs. 9.4 trillion for the previous fiscal. During April-November FY2021, the fiscal deficit of the GoI stood at Rs. 10.8 trillion, 33.1% higher (refer Exhibit 2) than the level recorded in April-November FY2020 (Rs. 8.1 trillion), and equivalent to 135.1% of the BE. This was led by the 17.3% decline in revenue receipts, coupled with subdued disinvestment receipts during the first eight months of FY2021. On a monthly basis, expenditure growth has been volatile during FY2021; cumulatively during April-November FY2021, capex growth stood at a reasonably encouraging 12.8%, while revenue expenditure growth was curtailed to a low 3.7%, as the expenditure management measures absorbed a portion of the cost of the fiscal support programmes announced by the GoI. Overall, the share of the revenue deficit in the total fiscal deficit of the GoI rose somewhat to 79.3% in April-November FY2021 from 77.1% in April-November FY2020.

Revenue and Capital Receipts: Net of refunds (gross of devolution to states), the GoI's tax revenues contracted by 12.6% to Rs. 10.3 trillion in April-November FY2021 from Rs. 11.7 trillion in April-November FY2020 (refer Exhibit 3). With a sharper 20.7% YoY decline in taxes devolved to the states in April-November FY2021 (led by the adjustments required for FY2020), the net tax revenues (net of devolution to states) contracted by milder 8.3% to Rs. 6.9 trillion in April-November FY2021 from Rs. 7.5 trillion in April-November FY2020.

The contraction in the GoI's gross tax revenues had narrowed appreciably to 13.1% in Q2 FY2021 from 32.6% in Q1 FY2021, benefitting from the unlocking of the economy, and the excise duty hike on fuels (refer Exhibit 4 and 5). The latter, in conjunction with the upswing in economic activity, has contributed to a healthy ~20% expansion in the GoI's gross tax revenues in October-November FY2021 on a moderate base. An expected sustenance of this trend augurs well for the tax collections during the rest of this year, in our view.

The GoI's major direct tax collections (corporation tax and income tax) declined by 24.4% to Rs. 4.2 trillion in April-November FY2021 from Rs. 5.6 trillion in April-November FY2020. The corporation tax inflows fell by a considerable 35.7% in April-November FY2021, the worst performance among the major taxes, led by the impact of the pandemic and the cut in

Exhibit 1: Fiscal Balances for GoI for FY2020 RE, FY2020 Prov. and FY2021

	FY2020 RE		FY2020 Prov.		FY2021 BE	
	Rs. trillion	% GDP	Rs. trillion	% GDP	Rs. trillion	% GDP
Revenue Receipts	18.5	9.1%	16.8	8.3%	20.2	10.4%
Tax Revenues$	15.0	7.4%	13.6	6.7%	16.4	8.4%
Revenue Expend.	23.5	11.5%	23.5	11.6%	26.3	13.5%
Revenue Balance	**-5.0**	**2.4%**	**-6.7**	**3.3%**	**-6.1**	**3.1%**
Capital Receipts^	0.7	0.3%	0.5	0.2%	2.1	1.1%
Capital Exp., Net Lending	3.3	1.6%	3.2	1.6%	4.0	2.0%
Fiscal Balance	**-7.7**	**3.8%**	**-9.4**	**4.6%**	**-8.0**	**4.1%**

GDP estimates for FY2021 as per Advance Estimates released by NSO on January 7, 2021
^Miscellaneous Capital Receipts
$ Net of Refunds, Net of States' share in Central Taxes
***Source**: GoI Budget Documents; Controller General of Accounts (CGA); NSO; ICRA research*

Exhibit 2: GoI's Fiscal Balances in April–November in FY2020 and FY2021

	April-November FY2020		April– November FY2021		
	Rs. trillion	% of Prov.	Rs. trillion	% of BE	Growth
Revenue Receipts	9.8	58.5%	8.1	40.2%	-17.3%
Tax Revenues$	7.5	55.4%	6.9	42.1%	-8.3%
Non-Tax Revenues	2.3	71.3%	1.2	32.3%	-46.6%
Revenue Expenditure	16.1	68.4%	16.7	63.3%	3.7%
Revenue Balance	-6.2	93.3%	-8.5	139.9%	
Miscellaneous Capital Receipts	0.2	36.0%	0.1	2.9%	-65.9%
Capital Exp., Net Lending	2.0	63.7%	2.3	57.7%	12.9%
Fiscal Balance	-8.1	86.3%	-10.8	135.1%	

$ Net of Refunds, Net of States' share in Central Taxes
***Source**: GoI Budget Documents; CGA; Ministry of Finance, GoI; ICRA research*

rates in mid-FY2020. However, the income tax collections recorded a milder YoY contraction of 12.3% during the same period. Moreover, after the 31.4% YoY decline in direct taxes in H1 FY2021, the performance improved with a 10.2% growth in October-November FY2021.

The recovery in economic activity and a favourable base effect would support direct tax collections in the remainder of FY2021. We project personal income tax collections in the last four months of this fiscal at the year-ago level. However, we expect corporate tax collections to grow by around 15% on a YoY basis in the remainder of this fiscal, given the low base; following the cut in tax rates, firms had sharply reduced their tax payments in H2 FY2020. This would limit the contraction in FY2021 relative to FY2020 Prov. to 11.3% and 6.8%, respectively, for the corporation tax and personal income tax collections. The shortfall in direct taxes, relative to the budgeted level, would nevertheless be large, at around Rs. 3.8 trillion in FY2021.

The major indirect taxes (customs duty, excise duty, service tax, CGST, IGST and UTGST) recorded a marginal YoY decline of 0.5% to Rs. 5.4 trillion in April-November FY2021 from Rs. 5.5 trillion in April-November FY2020. The CGST and IGST collections contracted by 16.0% to Rs. 2.8 trillion from Rs. 3.3 trillion, respectively; notably, the CGST and IGST collections contracted by 10.0% in October-November FY2021. Subsequently, the Ministry of Finance indicated vide a press release that the GST collections rose by a healthy 12.0% to Rs. 1.2 trillion during December 2020, of which CGST stood at Rs. 213.7 billion, SGST at Rs. 278.0 billion, IGST at Rs. 574.3 billion, and compensation cess at Rs. 85.8 billion. After the settlement of IGST, between the Centre and the states, the CGST inflows aggregated to Rs. 446.4 billion in December 2020. **We project the CGST and IGST collections to grow by 10% in the last four months of FY2021. With this, we estimate the CGST and IGST collections to contract by 13.5% relative to FY2020 prov. and fall short of the FY2021 BE by around Rs. 1.5 trillion.**

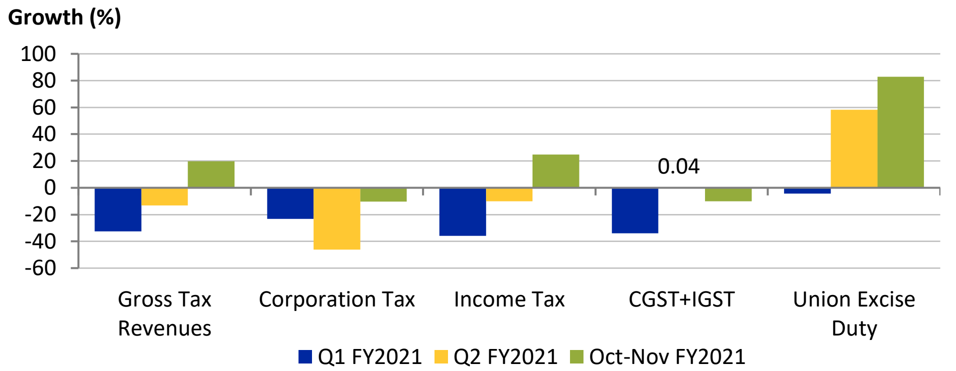
In contrast, the customs duty, excise duty and service tax collections expanded by 24.4% to Rs. 2.6 trillion in April-November FY2021 from Rs. 2.1 trillion in April-November FY2020. This was driven by the excise duty collections, which increased by a considerable 47.7% in April-November FY2021, led by the hikes of Rs. 13/litre and Rs. 16/litre, respectively, on petrol and diesel undertaken in March 2020. Fuel consumption has improved over the course of

Exhibit 3: Tax Collections (Net of Refunds, Gross of States' share in Central Taxes)

	FY2021 BE		April–November FY2021		
	Rs. trillion	Growth#	Rs. trillion	% of BE	Growth
Gross Tax Revenues^	**24.3**	**20.6%**	**10.3**	**42.3%**	**-12.6%**
Direct Taxes	13.2	27.2%	4.2	31.9%	-24.4%
Corporation Tax	6.8	22.3%	1.9	27.3%	-35.7%
Income Tax	6.4	32.8%	2.4	36.8%	-12.3%
Indirect Taxes	9.9	15.4%	5.4	54.6%	-0.5%
CGST	5.8	17.4%	2.5	42.3%	-25.3%
UT- GST	0.1	185.3%	0.0	16.3%	-28.0%
IGST	--	-	0.4	-	496.6%
Customs Duty	1.4	26.4%	0.6	45.7%	-17.0%
Union Excise Duty	2.7	11.4%	2.0	73.5%	47.7%
Service Tax	0.01	-83.1%	0.01	103.8%	99.1%
GST Compensation cess	1.1	15.6%	0.5	46.0%	-18.8%

#As compared to FY2020 Prov. ^Net of Refunds, Gross of States' share in Central Taxes ***Source****: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA research*

Exhibit 4: Trends in Tax Revenues in Q1 FY2021, Q2 FY2021 and Oct-Nov FY2021



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

FY2021, with the broader economic recovery, as well as higher preference for social distancing in personal mobility. Following the high 82.8% expansion seen in October-November FY2021, **we project a ~72% YoY expansion in excise duties in the last four months of this fiscal. This implies a YoY growth of 58.5% in FY2021, and a windfall relative to the FY2021 BE of Rs. 1.1 trillion (ICRA's previous exp: Rs. 1.0 trillion).**

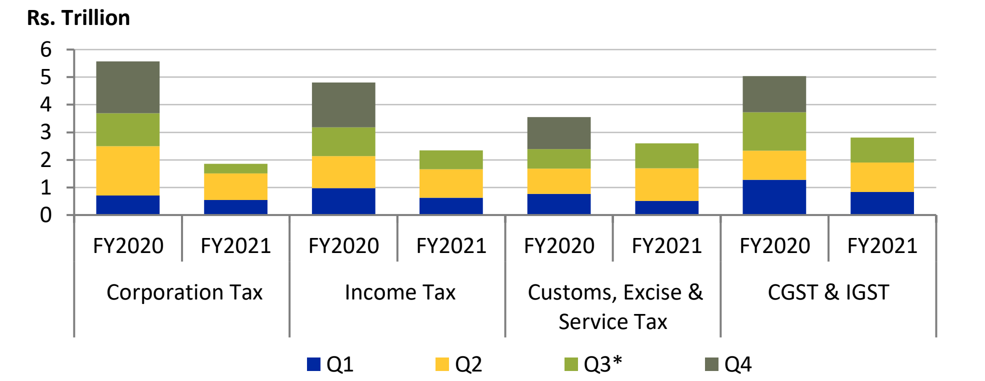
Overall, the revenue from customs duties recorded a YoY contraction of 17.0% in April-November FY2021, with the prolonged impact of the global pandemic on trade. However, following the 43.8% contraction in H1 FY2021, the performance has improved in the recent months on a low base. **We estimate the customs duty collections to record a YoY growth of 10% in December-March FY2021, limiting the YoY contraction for FY2021 to ~9%. ICRA estimates the shortfall in customs duty relative to the budgeted level at ~Rs. 385 billion.**

Data released by the CGA indicates that inflows of GST compensation cess totalled Rs. 508.3 billion during April-November FY2021, 18.8% lower than the level in April-November FY2020**. We expect such inflows to aggregate to ~Rs. 340 billion in the remainder of this fiscal, modestly higher than the year-ago level. Overall, the GST compensation cess inflows are likely to trail the budgeted level by around Rs. 260 billion.**

Following the recent upturn in economic activity, we expect the GoI's gross tax revenues to rise by 11% on a YoY basis in December 2020-March 2021. We now project the FY2021 gross tax collections at Rs. 19.4 trillion, a contraction of just 3.3% relative to FY2020 prov. (refer Exhibit 6), benefitting from the rise in excise inflows. Nevertheless, our estimate represents a shortfall of 20% or Rs. 4.8 trillion relative to the FY2021 BE of Rs. 24.2 trillion.

In line with this, we forecast the GoI's shareable taxes at Rs. 15.3 trillion in FY2021, 20% lower than the budgeted Rs. 19.1 trillion (ICRA's estimate). Accordingly, we estimate the Central tax devolution to the state governments for FY2021 at Rs. 6.3 trillion (41% of the projected shareable taxes of Rs. 15.3 trillion). With the FY2020 prov. indicating that the gross tax revenues of the GoI were Rs. 1.5 trillion lower than the FY2020 RE, we estimate that the Central tax devolution released to the state governments that year, was around Rs. 484 billion higher-than-warranted, which would need to be adjusted in FY2021. Subtracting this, we estimate the Central tax devolution to the state governments in FY2021 at ~Rs. 5.8

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



**Q3 FY2021 refers to data for October-November 2020*
***Source**: CGA, Ministry of Finance, GoI; ICRA research*

Exhibit 6: Gross Tax Revenues in FY2020 Prov., FY2021 BE, and ICRA's FY2021 Proj.

Rs. Trillion	FY2020 Prov. (A)	FY2021 BE (B)	FY2021 ICRA Est. (C)	Shortfall from BE (C-B)	Growth (C/A)
Gross tax revenues	**20.1**	**24.2**	**19.4**	**-4.8**	**-3.3%**
Direct taxes	10.4	13.2	9.4	-3.8	-9.2%
Corporation tax	5.6	6.8	4.9	-1.9	-11.3%
Income tax	4.8	6.4	4.5	-1.9	-6.8%
Indirect taxes	8.6	9.9	9.2	-0.8	6.5%
CGST + IGST	5.0	5.8	4.3	-1.5	-15.1%
Customs Duty	1.1	1.4	1.0	-0.4	-8.8%
Union Excise Duty	**2.4**	**2.7**	**3.8**	**1.1**	**58.5%**
Compensation cess for GST	0.1	1.1	0.8	-0.3	-11.2%

***Source**: GoI Budget Documents; CGA; ICRA research* trillion, significantly lower than the FY2021 BE of Rs. 7.8 trillion, but higher than our earlier estimate (Rs. 5.0 trillion). **Based on the above, we project the net tax revenues of the GoI at Rs. 13.6 trillion (previous estimate Rs. 13.0 trillion) in FY2021, Rs. 2.7 trillion lower than the FY2021 BE, and similar to the FY2020 prov. (refer Exhibit 7).**

The GoI's non-tax revenues posted a sharp contraction of 46.6% on a YoY basis to Rs. 1.2 trillion in April-November FY2021, and stood at a modest 32.3% of the FY2021 BE of Rs. 3.9 trillion. Within this, the GoI had budgeted Rs. 1.33 trillion as inflows from Other Communication Services in FY2021 BE. According to a recent notice issued by the Department of Telecommunications (DoT), spectrum auctions worth Rs. 3.92 trillion would be conducted from March 1, 2021. In addition to the bid amount, successful bidders will also have to pay 3% of the adjusted gross revenue (AGR), as spectrum usage charges for the spectrum won through this auction. **Regardless, the receipts from the telecom sector would be limited to around Rs. 0.5-0.6 trillion in FY2021, as per ICRA's estimates.**

Dividends and profits more-than-halved to Rs. 0.7 trillion in April-November FY2021 (refer Exhibit 8) from the level recorded in April-November FY2020, which largely reflects the lower surplus transferred by the RBI (to Rs. 0.6 trillion from Rs. 1.48 trillion). Moreover, dividends and profits during April-November FY2021 accounted for a moderate 45.4% of the Rs. 1.6 trillion included in FY2021 BE. Under this category, ~Rs. 657.5 billion or 42% of the FY2021 BE was indicated as dividends from public sector enterprises and other investments. However, such collections have been subdued so far, and may trail the FY2021 BE.

In contrast, the interest receipts of the GoI increased to Rs. 95.7 billion in April-November FY2021 from Rs. 75.4 billion in April-November FY2020. Moreover, interest receipts of the GoI during April-November FY2021 accounted for a significant 86.7% of the Rs. 110.4 billion included in FY2021 BE. We expect the interest receipts of the GoI in FY2021 to be in line with the budgeted level for the year (Rs. 110.4 billion).

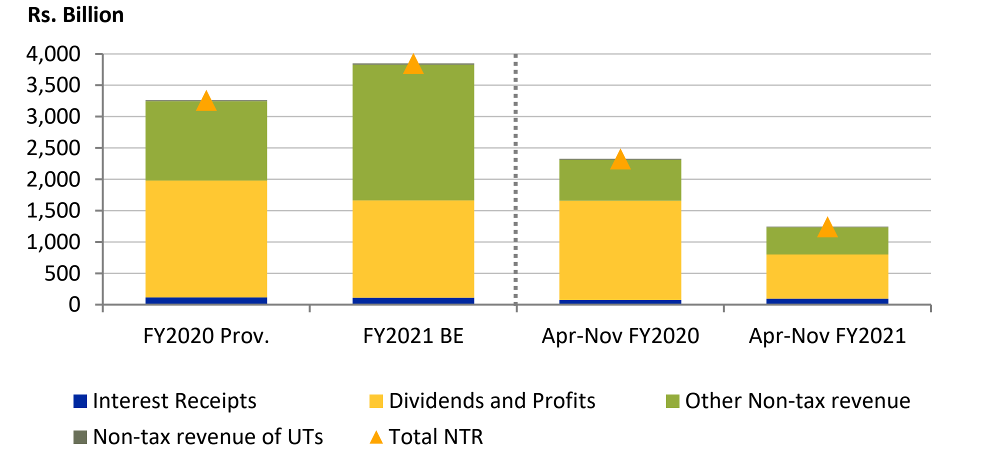
Excluding the receipts expected from the telecom sector (Rs. 0.5-0.6 trillion) and the surplus transferred by the RBI (Rs. 0.6 trillion), ICRA estimates the balance non-tax revenues at ~Rs. 1.0 trillion in FY2021. Hence, ICRA expects the total inflows from non-tax revenues in FY2021 to be limited to ~Rs. 2.2 trillion, well below the BE of Rs. 3.9 trillion.

Exhibit 7: Gross and Net Tax Revenues of the GoI and Central Tax Devolution in FY2020 Prov., FY2021 BE, and ICRA's FY2021 Proj

Rs. Trillion	FY2020 Prov. (A)	FY2021 BE (B)	FY2021 ICRA Est. (C)	Shortfall from BE (C-B)	Growth (C/A)
Gross tax revenues	20.1	24.2	19.4	-4.8	-3.3%
Central tax devolution	6.6	7.8	5.8	-2.0	-11.8%
Net tax revenues	13.6	16.4	13.6	-2.7	0.5%

***Source**: GoI Budget Documents; CGA; ICRA research*

Exhibit 8: Break-up of Total Non-Tax Revenues of the GoI in FY2020 Prov., FY2021 BE, Apr-Nov FY2020 and Apr-Nov FY2021



***Source**: GoI Budget Documents; CGA; ICRA research*

The GoI had set a significant target of Rs. 2.1 trillion for disinvestment proceeds in its FY2021 BE. Against this, the inflows were low at Rs. 61.8 billion in April-November FY2021, according to the CGA data (2.9% of the FY2021 BE), as the pace of the disinvestment process has been affected by the prolonged duration of the pandemic. As on January 20, 2021, the total receipts from disinvestment of GoI's equity holdings had risen but remained modest at ~Rs. 152.2 billion as per DIPAM data; this includes the sale of the GoI's stake in Hindustan Aeronautics Ltd. (75.15% share; Rs. 49.2 billion), and Bharat Dynamics Ltd. (74.93% share; Rs. 7.7 billion) through the OFS route, as well as the Mazagon Department of Investment and Public Asset Management, which includes the receipts from Dock Shipbuilders Ltd.'s IPO (Rs. 4.4 billion). The GoI has recently initiated plans to divest an additional 26% stake in BEML Limited. Moreover, it is pursuing the privatisation of state-run companies such as BPCL, Container Corporation of India, Shipping Corporation of India, Air India and LIC etc. However, it appears unlikely that the reported disinvestment in most of the above entities would be achievable within this fiscal. **With less than three months left in this fiscal, the disinvestment inflows are unlikely to cross Rs. 0.4 trillion in FY2021 in our view.**

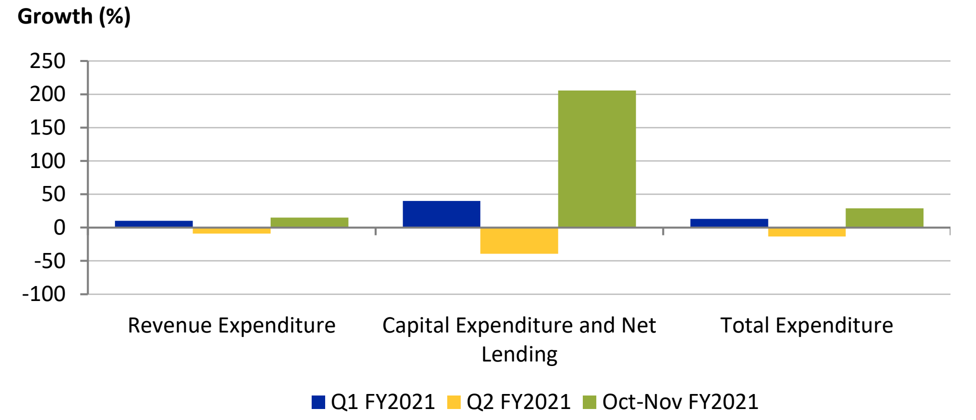
ICRA projects the GoI's non-tax revenues and disinvestment proceeds in FY2021 at a sharp Rs. 3.4 trillion below the budgeted level of around Rs. 6.0 trillion. In aggregate, ICRA expects the net tax revenues of the GoI, non-tax revenues and disinvestment proceeds to trail the FY2021 BE by Rs. 6.1 trillion.

Revenue and Capital Expenditure: To alleviate the economic fallout of the crisis, the GoI and the RBI have announced a wide variety of fiscal and monetary measures, estimated at Rs. 29.9 trillion. We assess the aggregate fiscal outgo related to the measures announced by the GoI so far under the Aatma Nirbhar Bharat Abhiyan 1.0-3.0, and the Pradhan Mantri Garib Kalyan Yojana (PMGKY), at around Rs. 3.5 trillion.

After the growth of 13.1% in Q1 FY2021 (refer Exhibit 9), the Government spending lost steam in Q2 FY2021, with a contraction of 13.5%, suggesting that the expenditure management restrictions outweighed the fiscal support measures that were announced.

The Ministry of Finance had indicated vide an Office Memorandum that the quarterly expenditure plan for Q3 FY2021 may be considered as relaxed to the extent of expenditure

Exhibit 9: Trends in Revenue Expenditure, Capital Expenditure and Net Lending, and Total Expenditure in Q1 FY2021, Q2 FY2021 and Oct-Nov FY2021



***Source**: GoI Budget Documents; CGA; ICRA research*

Exhibit 10: Trends in Interest Payments, Subsidies, Transfers to States, and Balance Revenue Expenditure

	April-November FY2020		April– November FY2021		
	Rs. billion	% of Prov.	Rs. billion	% of BE	Growth
Interest payments	3,418.1	55.9%	3,834.3	54.1%	12.2%
Aggregate Subsidy	2,350.2	105.3%	2,021.2	88.7%	-14.0%
-Food	1,321.8	121.6%	1,162.6	100.6%	-12.0%
-Fertilizer	732.8	90.3%	657.3	92.2%	-10.3%
-Fuel	295.6	88.5%	201.3	49.2%	-31.9%
Transfers to states	1,070.9	74.4%	1,173.8	61.5%	9.6%
Balance revex*	9,222.9	67.3%	9,622.7	64.0%	4.3%

**Total revex minus interest payments, aggregate subsidy outgo, and transfers to states (revenue);*
***Source:** GoI Budget Documents; CGA; ICRA research*

ceiling finalised for FY2021 RE. Perhaps benefitting from this, as well as the improved revenues, the GoI's total expenditure expanded by a high 28.8% in October-November FY2021.

In aggregate, the GoI's revenue expenditure rose by a modest 3.7% to Rs. 16.7 trillion during April-November FY2021 from Rs. 16.1 trillion in April-November FY2020, with substantial volatility in the YoY trend over the course of the year. The outgo towards transfers to states and major subsidies contracted by 9.6% and 14.0%, respectively, in April-November FY2021, to Rs. 1.2 trillion and Rs. 2.0 trillion, respectively (refer Exhibit 10). However, the outgo towards interest payments rose by 12.2% to Rs. 3.8 trillion in April-November FY2021. Moreover, the balance revenue expenditure rose modestly by 4.3% to Rs. 9.6 trillion during April-November FY2021 from Rs. 9.2 trillion in April-November FY2020.

The food subsidy amount budgeted for FY2021 (Rs. 1.2 trillion) had already been exhausted in April-November of this fiscal. The amount released towards the food subsidy during this period (Rs. 1.2 trillion) was 12.0% lower than the year-ago level (Rs. 1.3 trillion; 121.6% of FY2020 Prov., with a write-back in Q4 FY2020 following loans taken from the NSSF). However, the total cost of the provision of free food grains under the Pradhan Mantri Garib Kalyan Ann Yojana until November 2020, had been pegged by the GoI at Rs. 1.48 trillion, of which, only Rs. 0.3 trillion had been earlier included for three months' provision in the Pradhan Mantri Garib Kalyan Package announced in March 2020. The amount of further funds that the GoI is likely to release towards food subsidy in FY2021 remains unclear.

In FY2021 BE, the GoI had pegged the fertiliser subsidy at Rs. 713.1 billion, 12.1% lower than the level in FY2020 Prov. In April-November FY2021, the outgo eased by 10.3% on a YoY basis to Rs. 657.3 billion (92.2% of the FY2021 BE) from Rs. 732.8 billion in April-November FY2020 (90.3% of FY2020 Prov.). Under the Aatma Nirbhar Bharat Abhiyaan 3.0 package, an additional allocation of Rs. 650 billion was announced in November 2020 for the fertiliser subsidy. Based on the increased allocation, a headroom of Rs. 0.7 trillion is available for additional outgo towards fertiliser subsidies, which we expect will be back-ended in the last four months of this fiscal.

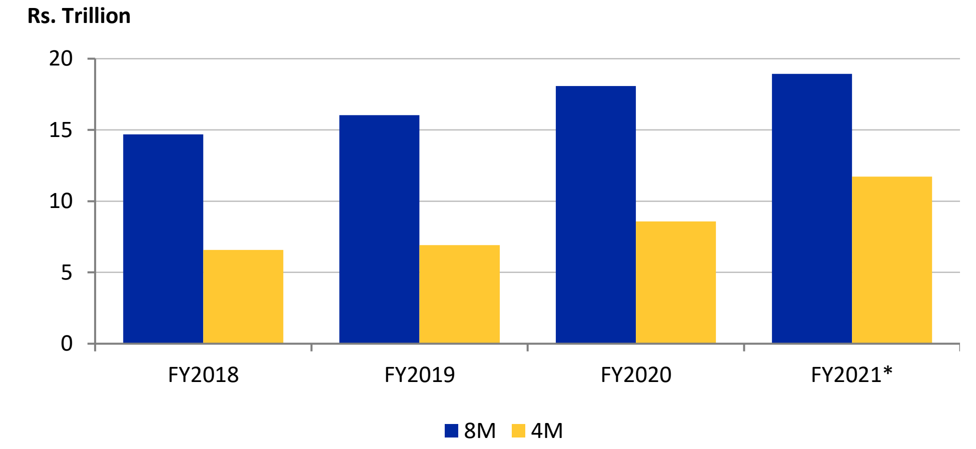
The subsidy outgo under Ministry of Petroleum and Natural Gas eased by 31.9% to Rs. 201.3 billion (49.2% of FY2021 BE) in April-November FY2021 from Rs. 295.6 billion in April-

Exhibit 11: ICRA's estimates for the GoI's Expenditure (adjusted for recovery of loans in FY2021

Expenditure Items	FY2021 BE	Apr-Nov FY2021	ICRA's FY2021 Estimates	Headroom for Dec-Mar FY2021 needed to meet our exp.	
(Rs. Trillion)		(A)	(B)	(B-A)	YoY Growth
Total Expenditure (adjusted for recovery of loans)	30.3	18.9	30.7	11.7	36.5%

***Source**: GoI Budget Documents; CGA; ICRA research*

Exhibit 12: Trends in Total Expenditure^ in April-November and December-March since FY2018



*^Adjusted for recovery of loans; *4M FY2021 refers to ICRA's projections*
***Source**: CGA, Ministry of Finance, GoI; ICRA research*

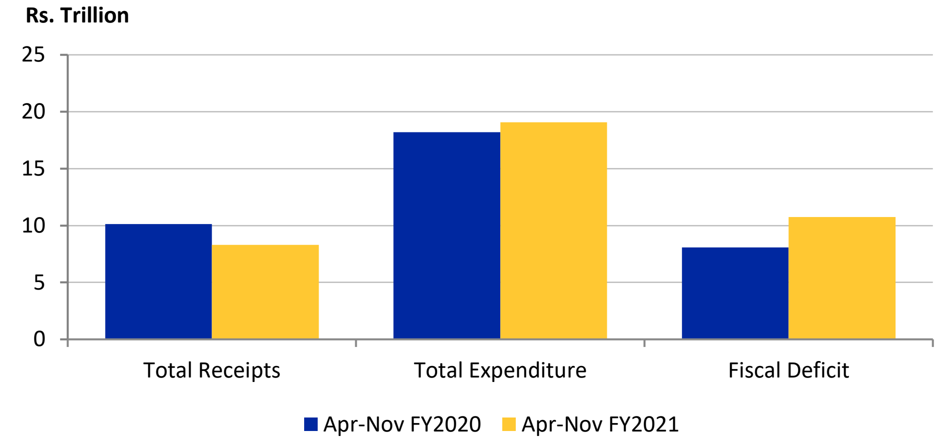
November FY2020. The gross under-recovery (GUR) for domestic LPG had plunged to Rs. 11.3 billion in H1 FY2021 from Rs. 126.5 billion in H1 FY2020, following the YoY decline in global crude oil prices in light of the demand-supply shock caused by the Covid-19 pandemic. Additionally, the GoI has not extended the subsidy to customers under DBTL for domestic LPG after May 1, 2020, and similarly for PDS kerosene with effect from March 1, 2020. **ICRA estimates the GURs to be nil (at average Indian basket crude price of up to $45/bbl and exchange rate of Rs. 75/US$) in H2 FY2021. Accordingly, the fuel subsidy requirement would trail the budgeted amount of Rs. 409.2 billion (which includes some outlay for LPG connections). This would result in some savings to the GoI relative to its FY2021 BE, which may absorb a modest part of the higher outgo likely towards food and fertiliser subsidies.**

The capital expenditure and net lending rose by 12.9% to Rs. 2.3 trillion in April-November FY2021 from Rs. 2.0 trillion in April-November FY2020. After the high growth of 39.8% in Q1 FY2021, capex and net lending had contracted by 39.1% in Q2 FY2021. Subsequently, capital expenditure expanded by a sharp 205.6% in October-November FY2021; we anticipate this ramp up in capital spending to be sustained in the rest of this fiscal.

We expect the GoI's total expenditure to rise by 15.0% on a YoY basis to Rs. 30.7 trillion in FY2021 (refer Exhibit 11). This entails spending of Rs. 11.7 trillion in December 2020-March 2021 (refer Exhibit 12), 36.5% higher than the year-ago level, which could be led by a back-ended release of subsidies and sustained capital spending. Despite the fiscal support packages, we expect the total spending in FY2021 to be only mildly higher than the budgeted level of Rs. 30.3 trillion, dampened by the expenditure management measures.

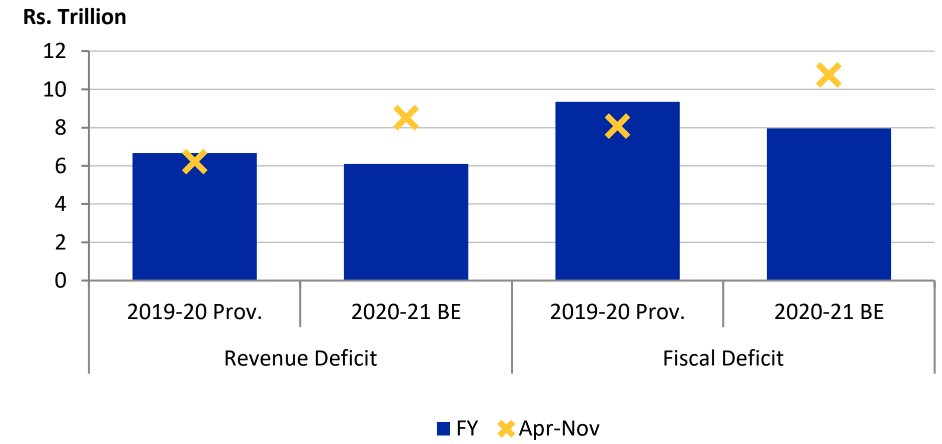
Fiscal Balances: While we now expect net tax revenues to exceed our earlier forecast, we have also revised our projection of expenditure upwards, and reduced that of disinvestment. Accordingly, we continue to expect **the GoI's fiscal deficit to widen to Rs. 14.5 trillion in FY2021 from the budgeted Rs. 8.0 trillion, and the Rs. 10.8 trillion recorded in April-November FY2021 (refer Exhibits 13 and 14). Assuming a nominal GDP contraction of 4.5% to Rs. 194.2 trillion (slightly lower than the NSO's Advance Estimate of Rs. 194.8 trillion), we project the GoI's fiscal deficit at 7.5% of GDP for FY2021. We do not foresee an upward revision in the GoI's planned market borrowings for Q4 FY2021, with any balance funding requirements to be met through green-shoe options or treasury bills.**

Exhibit 13: Trends in GoI's Receipts, Expenditures and Fiscal Deficit (Rs. trillion)



***Source**: CGA; ICRA research*

Exhibit 14: Revenue and Fiscal Deficits in FY2020 and FY2021 (Rs. trillion)



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

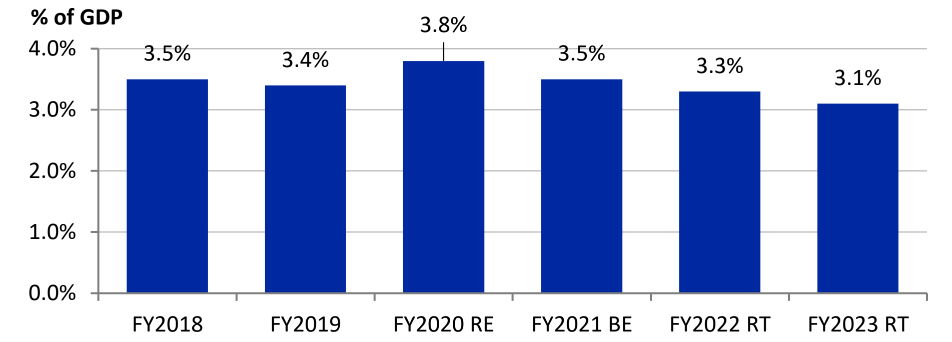
Key expectations for FY2022: The rolling target included in the Union Budget for 2020-21, had placed the fiscal deficit at 3.3% of GDP for FY2022 (refer Exhibit 15). **Revenue normalisation would anyway help to contain the size of the fiscal deficit in FY2022, relative to the considerable expansion engendered by the pandemic in the current year. In our view, sharp fiscal tightening should be avoided by both the Centre, as well as the state governments, as it would temper the awaited economic recovery.**

ICRA expects GDP to witness a turnaround in FY2022, with ~10.1% growth in real terms, in contrast to the 7.8% contraction expected in FY2021 (refer Exhibit 16). We expect the Union Budget for FY2022 to assume a nominal GDP growth of 14-15% in FY2022, higher than the 10% assumption that was made in the Budget for FY2021. In this note, we are using our projections for nominal GDP of Rs. 194.2 trillion for FY2021 and Rs. 221.4 trillion for FY2022.

In terms of revenues, the split of Central tax collections that the 15th FC has suggested for its award period of FY2022 to FY2026, is not available in the public domain as of now (refer Exhibit 17); in this note, we have assumed a broad status quo on the devolution share. Moreover, assessing potential revenues for a turnaround year like FY2022 is challenging. However, the assumptions made in the Union and state budgets must be realistic to ensure credibility of the overall budgeting exercise.

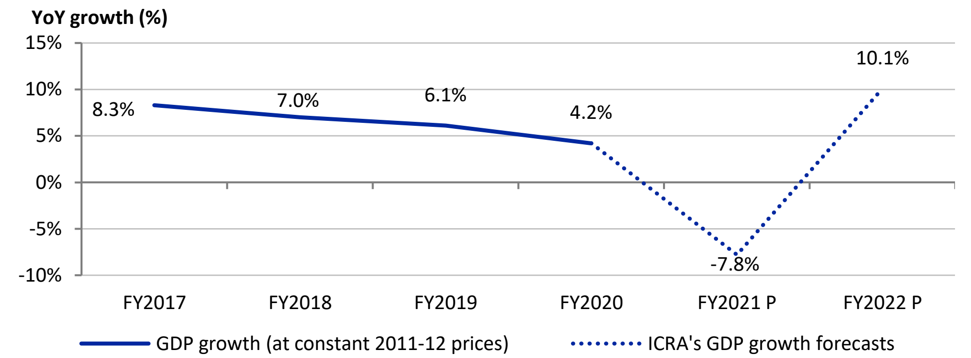
ICRA believes that major changes in tax rates should not be undertaken in the upcoming Budget. At this stage, when the revenue visibility remains somewhat clouded, the timing may not be appropriate to consider lowering the direct tax rates, to avoid having to impose curbs on spending later if the expected revenue buoyancy does not end up being realised. Moreover, any modifications to the GST rates are in the domain of the GST Council. From the sharp hit during the lockdown, GST collections have recovered and displayed a healthy growth in the recent months. However, innovative borrowing options had developed to fund the spike in GST compensation that was inevitable in FY2021[1]. Subsequently, the size

Exhibit 15: GoI's Fiscal Deficit (as % of Nominal GDP): actual up to FY2019 and GoI's estimates up to FY2023



*RE: Revised Estimate, BE: Budget Estimate, RT: Rolling Target (as per the Medium Term Fiscal Policy or MTFP statement); **Source:** Union Budget, CGA, ICRA research*

Exhibit 16: Growth of GDP (at constant 2011-12 prices)



*P: Projected; **Source**: NSO; CEIC; ICRA research*

[1] In the GST Council meeting held on August 27, 2020, the Ministry of Finance of the GoI had pegged the GST compensation requirement of the state governments at Rs. 3.0 trillion for FY2021 and the expected GST cess collections at Rs. 0.65 trillion, implying a gap of Rs. 2.35 trillion. The GoI had offered two options to the state governments for bridging this gap of Rs. 2.35 trillion, which vary in terms of the amount that can be borrowed, the source of borrowing, rate of interest on borrowings, interest payment, etc. Out of Rs. 2.35 trillion, an amount of Rs. 970 billion had been estimated as a shortfall on account of the GST implementation, and the remaining amount was projected as revenue losses due to the Covid-19 pandemic. Subsequently, the GST implementation shortfall was revised to Rs. 1.1 trillion, and the equivalent amount is being borrowed by the GoI in appropriate tranches through a special window under Option-I, and is being passed on to states as a back-to-back loan.

of the GST compensation that will be required in FY2022, and whether the specified cess collections will be anywhere close to being adequate to fund the same, remains unclear. Therefore, GST rates may be left unchanged until there is greater stability in the collections, and a clearer understanding of the compensation requirement for FY2022.

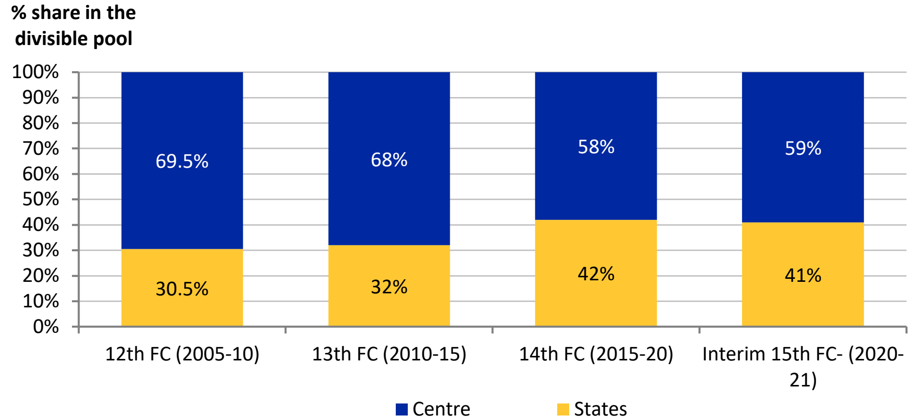
Non-tax revenues would record a muted rise in FY2022. For instance, after the spectrum auctions that are planned to be conducted in Q4 FY2021, the inflows of the GoI from the telecom sector are expected to be subdued in FY2022.

Additionally, the surplus transferred by the RBI is unlikely to rise sharply in FY2022. The RBI's interest earned on holdings of rupee securities would have benefitted from the interest receipts of the OMO purchases of Rs. 2.4 trillion in FY2021 (excluding the Twist OMO operation). Moreover, its interest income from foreign securities would rise, commensurate with the increase in the foreign currency assets held by the Central Bank. However, the significant reverse repo operations conducted in FY2021 to absorb the surplus systemic liquidity, would dampen the RBI's surplus. Moreover, the surplus would be impacted by the shift in the financial year, as the RBI's accounting year in FY2022 will have only nine months from July to March. Overall, the magnitude of the RBI's surplus transfer in FY2022 may end up being similar to the Rs. 0.6 trillion surplus transferred in FY2021.

While the pandemic will result in a large miss relative to the disinvestment target set by the GoI for FY2021, the pipeline for FY2022 is healthy. In our view, the PSU disinvestment offers a viable avenue to raise revenues and create fiscal space to boost spending. We expect the disinvestment and strategic divestment programme to be pursued actively in FY2022, for entities such as LIC, and a few other entities, particularly if the market conditions are appropriate. Moreover, a medium-term plan for disinvestment, outlining the entities in the pipeline, what steps need to be taken before the disinvestment can actually take place, as well as indicative timelines, would add to the credibility of the revenue forecasts.

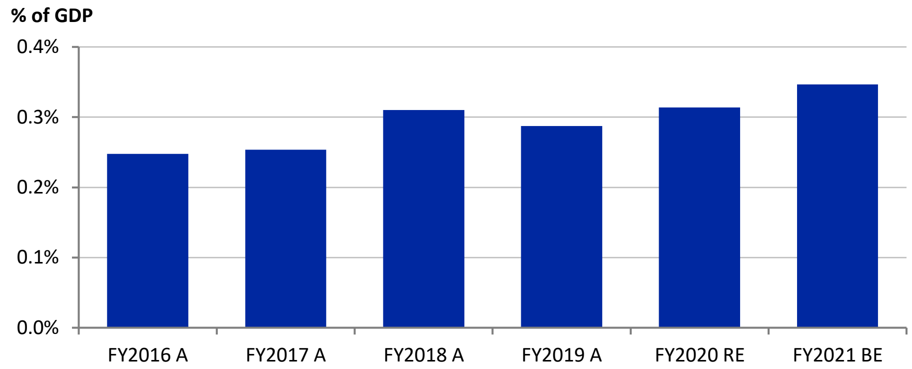
In terms of expenditure, in ICRA's view, the Union Budget FY2022 would prioritise capital expenditure and infrastructure spending, especially projects that had already been identified in the NIP, and where the plans are at an advanced stage. This will help create a multiplier effect and boost the tentative economic revival. Moreover, higher capital spending, especially on core infrastructure projects, would help create new jobs in the economy.

Exhibit 17: Share of Divisible Pool between Centre and States since 12th FC's award period



Source: *Finance Commission of India, GoI; ICRA research*

Exhibit 18: Centre's expenditure* on Health (as % of Nominal GDP)



Includes expenditure from own account and transfer to states for Centrally Sponsored Schemes (CSS)- National Health Mission (NHM); Rashtriya Swasthya Bima Yojna (RSBY); and Pradhan Mantri Jan Arogya Yojana (PMJAY); A: Actuals; RE: Revised Estimate; BE: Budget Estimate;* ***Source**: Union Budget; RBI; ICRA research*

An adequate budgetary provision for the vaccine rollout will boost confidence of the economic agents, and aid in their decision-making regarding both consumption and investment. In addition to the specific outlay for the Covid-19 vaccination drive, the allocations towards the health sector should be enhanced appreciably, in our view, relative to the recent trend (refer Exhibit 18).

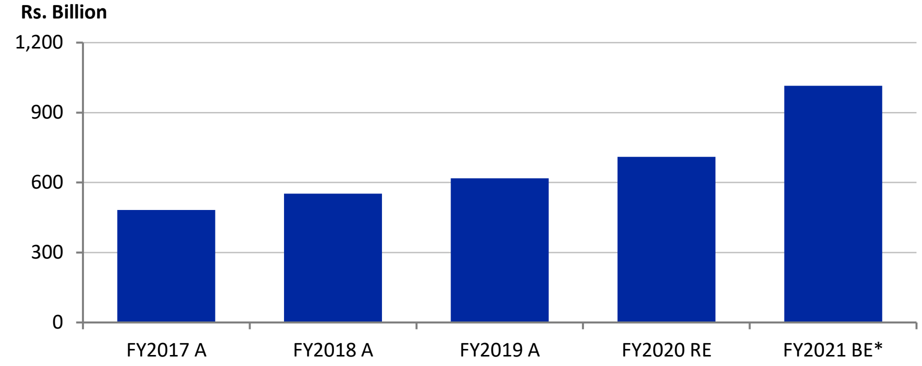
Moreover, adequate allocations for various subsidies, to ensure that no amount needs to be carried forward to the subsequent year, would aid in the transparency of expenditure. Additionally, clearance of any arrears, pending dues to contractors and vendors, as well as expediting any tax refunds will help boost liquidity as well as sentiment in the economy.

The pandemic has exerted a disproportionately adverse impact on the self-employed, informal sectors, smaller enterprises and contact-intensive jobs. A widespread vaccine rollout will anyways help these segments to get back to some semblance of their pre-Covid situation. Additionally, an urban equivalent of the MGNREGP may help to persuade the migrant labourers who are lingering in the hinterland, fearing the unavailability of jobs, to return to the urban areas. This would offer social security to a significant section of the working population, boost consumption demand, restart remittances, and also enhance the pool of labour available in the urban areas for the private sector.

Moreover, an adequate allocation for MGNREGP would aid in sustained rural consumption demand, which would further support the growth prospects of the economy (refer Exhibit 19). Further, some new schemes to support the agricultural and rural economy and the MSMEs and to support job creation, may also be announced in the Budget.

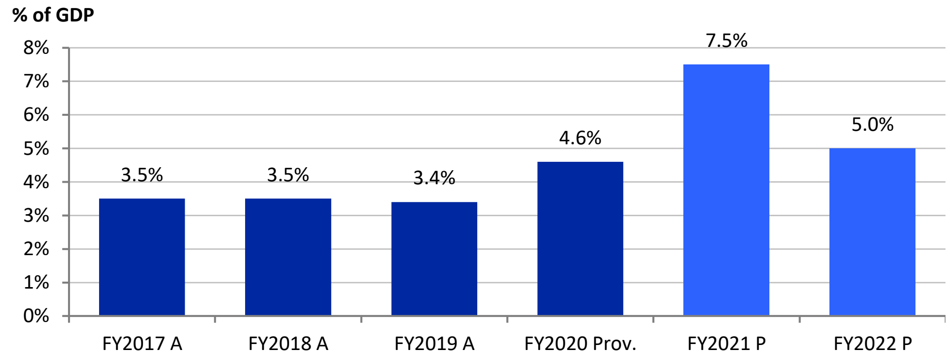
For FY2022, ICRA expects the public banks to break even, in a worst-case scenario as well, with the possibility of a return on equity (RoE) of ~5% in a favourable scenario, which means that their capital requirements will be lower because of the reduced losses. However, capital requirements would arise on account of the estimated Rs. 23,000-crore Additional Tier I (AT-I) bonds, where a call option would fall due next year. Hence, public banks will require capital not only for growth, but also to replace these bonds to maintain their capital profiles.

Exhibit 19: Budgetary allocation towards MGNREGP by the GoI



*A: Actuals; RE: Revised Estimate; BE: Budget Estimate; *Includes additional allocation of Rs. 400 billion in FY2021 which was announced later in the Aatma Nirbhar Bharat Abhiyaan 5.0 package*
***Source**: Union Budget; GoI; CEIC; ICRA research*

Exhibit 20: GoI's fiscal deficit (as a % of nominal GDP): actual up to FY2019, FY2020 Prov. and ICRA's Proj. for FY2021 and FY2022



A: Actuals; Prov.: Provisional Estimate; P: Projected;
***Source:** Union Budget; Controller General of Accounts; Ministry of Finance; GoI; ICRA research*

Factoring in the above two requirements, ICRA estimates the capital requirements for public banks to be negligible in a favourable scenario (RoE of 5%), but up to Rs. 430 billion in a worst-case scenario.

In FY2022, a revenue deficit of 3.5% of GDP and a fiscal deficit of around 5% of GDP (refer Exhibit 20) for the GoI may allow enough space for prioritising health expenditure, vaccine rollout as well as capital spending, given the revenue rebound that is widely expected. While the economic, and by extension, revenue outlook remains uncertain, the fiscal deficit target should be realistic, be it in the form of a point estimate or a range.

In terms of absolute numbers, we have assumed net tax revenues at Rs. 15.5 trillion (+14% relative to ICRA's FY2021 exp), non-tax revenues at Rs. 2.5 trillion (+17%) and disinvestment proceeds at Rs. 1.5 trillion (+275%). Assuming a revenue deficit of 3.5% of GDP (approximately Rs. 7.8 trillion, based on our aforementioned estimate of nominal GDP) and a fiscal deficit of around 5% of GDP (approximately Rs. 11.1 trillion) would mean space for revenue expenditure and capital expenditure of Rs. 25.8 trillion (-5%, which appears reasonable given the cessation of some portions of the fiscal support packages) and Rs. 4.8 trillion (+30%), respectively (refer Exhibit 21).

General Government Fiscal Deficit and Market Borrowings: The 15th FC's recommendations on revenue sharing and fiscal deficit targets, the borrowing permission to be granted by the GoI, and the extent of improvement that can be realised in their own tax revenues, will guide state fiscal trends in FY2022. **A fiscal deficit target of 3.5% of GSDP for the state governments for FY2022 (refer Exhibit 22), roughly equivalent to Rs. 7.8 trillion, may allow them to prioritise a portion of the capital expenditure that had to be deferred during the pandemic, and provide some funds towards projects under the NIP. Taken together, this entails a General Government fiscal deficit of 8.5% of GDP in FY2022 (Rs. 18.8 trillion), appreciably lower than the 12.2% of GDP being expected in the current year.**

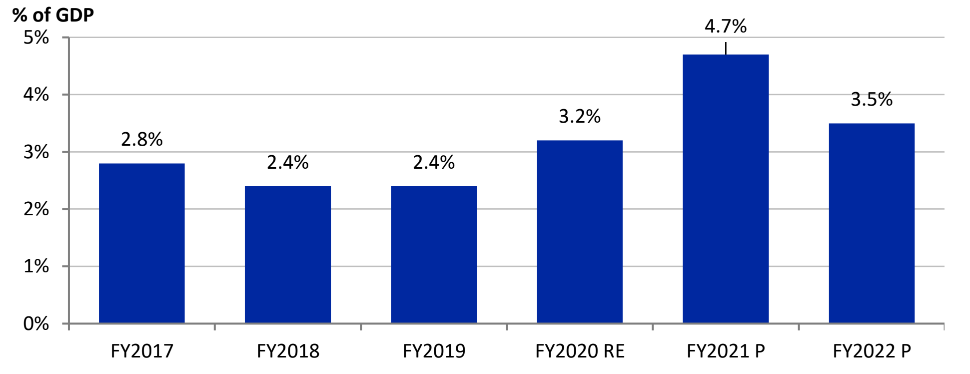
With the GoI's fiscal deficit pegged at Rs. 11.1 trillion in FY2022, we expect net G-sec issuance to be placed at Rs. 9.0 trillion. Assuming that 90% of the states' estimated fiscal

Exhibit 21: ICRA's Projections for Key Fiscal Metrics for FY2021 and FY2022

Rs. Trillion	ICRA's FY2021 Projections	ICRA's FY2022 Projections	Growth (%)
Net Tax Revenues	13.6	15.5	14%
Non-tax Revenues	2.1	2.5	17%
Revenue Expenditure	27.0	25.8	-5%
Revenue Balance	**-11.2**	**-7.8**	
Disinvestment Proceeds	0.4	1.5	275%
Capital Expenditure	3.7	4.8	30%
Fiscal Balance	**-14.5**	**-11.1**	

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

Exhibit 22: Gross Fiscal Deficit (as a percentage of Nominal GSDP) of all State Governments and Union Territories



**FY2021 P based on sample of 12 state governments- Karnataka, Kerala, Tamil Nadu, Gujarat, Maharashtra, Punjab, Haryana, Rajasthan, West Bengal, Telangana, Andhra Pradesh and Uttar Pradesh; RE: Revised Estimates; P: Projected*

Source: *Budget Documents of state governments; CAG; ICRA research*

deficit of Rs. 7.8 trillion is funded by SDL, suggests a net issuance of Rs. 7.0 trillion, resulting in a total dated market borrowing of Rs. 16.0 trillion for FY2022. Adding the redemption of G-sec and SDL of Rs. 2.7 trillion and Rs. 1.9 trillion, respectively, indicates substantial gross borrowings of Rs. 20.5 trillion in FY2022 (refer Exhibit 23), which would continue to exert upward pressure on yields.

We estimate the total liabilities of the GoI to worsen from 49.3% of GDP at end-March 2020 (as per the RE) to ~59% of GDP at end-March 2021, before easing modestly to ~57% of GDP at end-March 2022.

Medium-term path: That brings us to a medium-term question as to what level of fiscal deficit should be targeted by the GoI after the pandemic and the recovery are behind us?

For the GoI, a fiscal deficit of 3% of GDP has anyway proved to be rather elusive. Moreover, it may be neither achievable in a sustained manner and nor appropriate, as the only way to get there may be to continuously defer much-needed capex.

In our view, it may be time to bring back a focus on the revenue deficit target. The GoI's revenue deficit ranged from 2.1%-2.6% of GDP between FY2016 and FY2019, before widening to 3.3% of GDP in FY2020 (Rs. 6.7 trillion) according to the provisional data (refer Exhibit 24). We expect it to bloat to Rs. 11.2 trillion (budgeted Rs. 6.1 trillion) or 5.8% of GDP in FY2021, driven by the ongoing revenue shock. The GoI could curtail the revenue deficit back to 3.5% of GDP in FY2022 (Rs. 7.8 trillion as per our estimates) and bring it down by 0.25-0.3% of GDP each over the next few years to 2% of GDP.

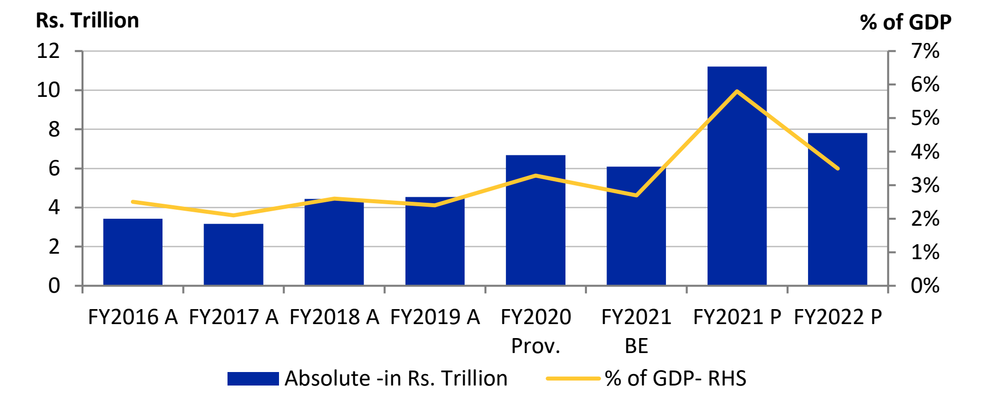
Subsequently, the target could be set to ensure that the revenue deficit averages 2% of GDP over each Finance Commission period. Simultaneously, capital spending as well as disinvestment proceeds should be aimed to be maximised in each year. Assuming that capital spending net of disinvestment stabilises at 2% of GDP, this would mean a fiscal deficit of 4% of GDP for the GoI over the medium term.

Exhibit 23: ICRA's expectations for the General Government (GoI and States) Fiscal Deficit and Long-term Market Borrowing in FY2022

Rs. Trillion	ICRA's FY2022 Estimates		
	G-Sec	SDL	Total
Fiscal Deficit	11.1	7.8	18.8
Net Borrowings	9.0	7.0	16.0
Redemptions	2.7	1.9	4.6
Gross borrowings	11.7	8.9	20.6

Source: *RBI; ICRA research*

Exhibit 24: GoI's Revenue Deficit (Absolute and % of GDP) and ICRA's projections for FY2021 and FY2022



A: Actuals; Prov.: Provisional Estimate; BE: Budget Estimate; P: Projected;
Source: *Union Budgets; CGA; ICRA research*

UNION BUDGET 2021-22: SECTORSPEAK

AUTOMOBILES

- Budget is expected to reinforce Government's focus on rural ecosystem & agri infrastructure
- Government expected to maintain its focus on infrastructure spend
- Focus on local manufacturing as part of 'Atmanirbhar Bharat'
- Any boost to consumer disposable income through tax reliefs would be welcome

ICRA expects the Government to maintain its focus on the rural economy and infrastructure investments in the upcoming Budget. This apart some roadmap for the recently announced production-linked incentive (PLI), can be expected. Another long pending auto-specific policy, relating to the scrappage of Commercial Vehicles (CV) may also find a mention in the Budget.

The automotive industry faced strong demand headwinds during FY2020 with the slowdown in economy during H2 FY2020, exacerbated by the NBFC crisis. The industry also had to grapple with challenges of investments and cost increases, following the tightening of emission & safety norms, especially the BS-IV to BS-VI transitions. On the back of these challenges, came the Covid-19 related lockdown, which disrupted manufacturing activities, supply chain and most importantly affected consumer demand during the first six months of the current fiscal. The automotive demand, however, has been on a mend since then, with strong sequential recoveries across most segments. The rural sector has withstood the Covid-19 challenges better – which is manifested into relatively robust demand in rural-focused product categories, especially tractors. The rural sentiment had been positive with healthy crop cycles of kharif and rabi in 2019 and healthy water reservoir levels, helped further by a normal monsoon and Government support in the form of increased procurement of key crops, higher MNREGA allocations, the MSME guarantee loans etc.

The domestic CV industry has faced significant demand drawdown with 85% and 55% contraction in CV retail volumes witnessed in Q1 and Q2 FY2021 respectively. This has come on the back of a steep volume contraction of 29% in FY2020. Challenges such as release of capacity in the trucking system (due to revised axle load norms and GST implementation), a weak macroeconomic environment, cost increases due to new emission norms (BS-VI), financing constraints, and stress on the cash flows of fleet operators, have all exacerbated with the onset of the pandemic.

ICRA's recent survey of CV dealers across 11 states, indicated muted sentiments, despite sequential improvements in the demand. The industry would be keenly watching for initiatives to kickstart infrastructure and capital spend.

The PLI scheme announced by the Government has the potential to kick-start significant investments in the automotive industry. Furthermore, the Government's focus on supporting local manufacturing through continuation of import duty in the auto component segment continues to support investments by ancillaries in India. The automobile OEMs too are focusing on reducing reliance on imports and building supply chains with vendors in India in segments, particularly in the electronics and allied product segments, where our ecosystem has had limited capabilities. The Budget document may provide some clarity on these issues.

Last year the Government had provided some boost to the consumer sentiments through tax reliefs. While rural demand has largely sustained the pandemic, the urban consumer sentiments have been significantly impacted. Considering the current challenging demand environment, any steps to boost consumer confidence and domestic consumption would be a positive for the industry.

AVIATION

- Focus on improving regional connectivity through regional connectivity scheme (RCS) or Ude Desh ka Aam Nagrik (UDAN)
- Possible reduction in taxes on aviation turbine fuel (ATF)
- Continued thrust on airport infrastructure creation and development
- Focus on tourism development by developing more iconic tourist destinations and expansion of e-visa scheme to additional countries

The Indian aviation industry expects financial aid and reduction in levies and taxes in the immediate near term to revitalise operations and boost passenger traffic, which include among others, lowering taxes on ATF and reducing other levies like airport charges, parking and landing and navigation charges. Furthermore, since airlines has to currently follow a fare band as per the directives of the Ministry of Civil Aviation (MoCA), which is constraining their ability to charge higher fares, these entities want relaxations in terms of the fares they can charge.

Budget 2021 is expected to reiterate focus on improving regional connectivity through RCS or UDAN. The Budget is also likely to focus on setting up new airports and expanding the existing airport capacities at some key airports to help address the current airport infrastructure constraints faced by the airlines and to improve connectivity with the underserved/unserved airports to boost tourism. The Government is also expected to undertake other measures to boost tourism like developing more iconic tourist destinations and expanding the e-visa scheme to additional countries.

In line with the Government's increasing thrust on Atmanirbhar or Make in India, the Budget could focus on incentivising the maintenance repair overhaul (MRO) sector to retain the MRO activities in the country. The Budget is also expected to prioritise the privatisation of Air India Limited, which has been facing roadblocks over the last several months.

BANKING AND FINANCE

- Capital requirements of PSBs is expected to be lower in FY2022 because of losses, however, capital requirements could arise because of ~Rs 23,000 crore of Additional Tier I bonds where the call option would fall due next year. This, coupled with growth capital requirement, ICRA estimates that PSBs could require up to Rs 43,000 crore of capital during FY2022
- Extension of GoI/RBI-directed funding in the near term and a well-defined medium-term support framework would be the key for sustainable revival
- Targeted incentives for MSME and housing sectors

ICRA expects the public banks to break even in a worst-case scenario as well with the possibility of a return on equity (RoE) of ~5% in a favourable scenario during FY2022, which means that their capital requirements will be lower because of the losses. The capital requirements would, however, arise on account of the estimated Rs. 23,000-crore Additional Tier I (AT-I) bonds where a call option would fall due next year. Hence, public banks will require capital not only for growth but also to replace these bonds to maintain their capital profiles. Factoring in the above two requirements, ICRA estimates the capital requirements for public banks to be negligible in a favourable scenario (RoE of 5%), but up to Rs. 43,000 crore in a worst-case scenario.

The appetite of investors towards the AT-I bonds of public banks has improved recently with more public banks issuing AT-I bonds in FY2021 compared to FY2020. If the banks can raise a part of the Rs. 43,000-crore capital through AT-Is and market sources, it could reduce the GoI's recapitalisation burden for the coming fiscal. Though clarity is likely to emerge on this front only in H2 FY2022, ICRA expects the GoI to allocate some quantum to the PSBs in the Budget itself (unlike last year when they made the announcement later) to provide some additional comfort to the markets.

For the NBFCs (non-infra), extension of the RBI and GoI-backed funding and guarantee schemes, which were rolled-out in the current fiscal, are likely to be the keys for the sector's near-term liquidity. Considering the moderate growth expectation of 7-9% in FY2022, it would also be critical to provide guidance on the medium-term support framework for the sector to boost investor confidence and for sustainable growth revival. The expected boost to infrastructure spending would kindle demand for infra-focussed NBFCs, however, most of these are PSUs. Establishment of institutions, which can extend long-term funding to these infra-NFBCs and also banks for infrastructure development would ensure adequate sectoral liquidity. Benefits and additional incentives for micro, small & medium enterprises (MSMEs) and tax-breaks to homebuyers and builders in the housing sector, especially affordable housing, would also augur well for the sector, which is expected to be faced with asset quality headwinds.

CEMENT

- Focus on rural economy, housing and infrastructure sectors expected to support cement demand
- Significant budgetary allocation for the agriculture sector
- Spending on affordable housing likely to be enhanced to improve the access to housing in the low-to-mid income segments of the population
- A major part under the National Infrastructure Pipeline (NIP) budgeted towards transportation infrastructure

The demand from the rural markets was the major driver for cement in the current fiscal year. In the Budget, the Government is expected to remain focused on the rural economy and is likely to make significant budgetary allocation for the agriculture sector, besides increasing allocations towards rural employment, housing as well as infrastructure development. In the housing sector, the Budget could consider steps to improve affordability, including expansion of the current income tax benefits available for homeowners, especially the first-time buyers. Further, the spending on affordable housing under Housing for All is expected to be enhanced to improve the access to housing in the low-to-mid income segments of the population. These expected measures in the Budget would boost the cement demand.

As per the NIP, infrastructure investment in FY2022 is projected at Rs. 21.3 lakh crore, of which the Centre's share is estimated at ~39% and the focus is expected to be mainly towards transportation infrastructure, i.e. roads, railways, etc. With respect to infrastructure project financing, the National Investment and Infrastructure Fund (NIIF) could play a major role in channelising long-term funds and hence, higher allocation is expected towards NIIF in the upcoming Budget.

FERTILISER

- Clarity on timelines for release of additional allocation of Rs. 65,000 crore towards fertiliser subsidy under Atmanirbhar Bharat 3.0
- Budgetary allocation for fertiliser subsidy for FY2022 to be in line with subsidy requirement of Rs. 85,000-90,000 for the sector
- Roadmap on rollout of further reforms for the fertiliser industry like implementation of Direct Benefit transfer (DBT), Nutrient-based Subsidy Scheme (NBS) for urea sector among others
- Rationalisation of import duty on phosphoric acid, ammonia and natural gas to improve competitiveness of the domestic fertiliser industry

The Union Budget for FY2022 is expected to be pivotal for the fertiliser industry. ICRA expects clarity on the release of the additional allocation of Rs. 65,000 crore announced under the Atmanirbhar Bharat 3.0 scheme and announcement of further reforms like a roadmap on the rollout of the true form of Direct Benefit Transfer (DBT) for the fertiliser sector. Timely release of the additional allocation for the fertiliser sector will enable clearance of the subsidy backlog, which has been having an adverse impact on the performance of the sector for nearly a decade now.

While the additional allocation for the fertiliser sector has come as a pleasant surprise for the industry, continued adequate budgeting going forward for the fertiliser subsidy will remain critical for ensuring adequate fertiliser availability for the agri sector. ICRA expects the subsidy requirement for FY2022 to be in the range of Rs. 85,000-90,000 crore, driven by volume growth. The subsidy allocation is expected to increase for the urea sector following the commissioning of four new urea plants, which will result in nearly 11% YoY increase in subsidy requirement for the sector. While implementation of the true form of DBT for the sector would be a major positive, ICRA believes the possibility of the implementation of the same remains low in the upcoming budget in the light of the ongoing farmer agitations related to the Farm Bills.

Lowering of import duties on raw materials like phosphoric acid and ammonia to improve the competitiveness of the domestic phosphatic fertiliser manufacturers has been a long-pending industry demand along with the reduction of import duty on LNG for the urea industry, as the consumption of the latter is on a steady rise.

HEALTHCARE

- With the global pandemic significantly affecting the country, the need to have an adequate healthcare infrastructure has come to the forefront
- India currently has seven beds per 10,000 population, against the global average of 27 beds per 10,000. Further, India spends 3% of its GDP on healthcare, against the global average of 8% and the spend is below many developing countries

ICRA expects a sharp jump in the allocation towards the Healthcare sector in the forthcoming budget, to provide for the cost of Covid-19 vaccination. At a negotiated price and even if 50% of the population is to be provided vaccination by the Government, the cost will be Rs. 27,000 crore, which will in itself lead to 40% jump in allocation.

Higher allocation is necessitated, also to enable the Government to achieve its target spend of 2.5% of GDP on healthcare by 2025, from the current ~1.3%.

To boost investments in the sector, in addition to the VGF already announced, tax incentives for private sector investments in modernising medical facilities and developing greenfield hospitals will be a welcome step.

A rise in budgetary support to the Rashtriya Swastha Bima Yojna scheme will help expand the network and the coverage, while providing affordable healthcare facilities to beneficiaries; the same is also expected to boost performance of the service providers.

HOSPITALITY

- Infrastructure status for the industry
- Standardise/rationalise the multiple GST slabs
- Tourism to be moved to the concurrent list, from the current state list

While the industry has annually come out with a laundry list of requirements, the previous several Budgets have largely ignored any direct benefits to the industry. Measures have been rolled out outside the Budget periodically, targeted at rationalising indirect taxes in recent years.

This financial year, the industry has witnessed one of its worst turmoil, with demand hitting an all-time low. Unlike several other sectors which have started the recovery journey, supported by pent-up demand and governmental support/liquidity, high-contact, discretionary spends like travel & tourism will face a challenging climb uphill on muted consumer confidence.

The industry, facing a 2-3 year-long recovery cycle, requires support from the Government. An Infrastructure status will provide the industry with right-tenured & structured debt, matching asset life to liability. It will help bring down costs of several utilities for the industry. Similarly, rationalisation of the GST rates from the currently high 12-18% and re-introduction of input tax credit for restaurants would help reduce costs and customer bills, attracting footfalls. During the past 10 months, while several states have stepped in to support the local travel and tourism operators, a cohesive approach by the state and the Centre in formalising policy support and marketing of the country would be a positive. Moving the industry to the concurrent list will enable this.

INFRASTRUCTURE

- To increase the pace of infrastructure investment as envisaged under the National Infrastructure Pipeline (NIP), the budgetary allocation towards various infrastructure sectors, including key implementing agencies like the NHAI, needs to be further increased
- Measures to improve availability of long-term funds to the sector are expected. Announcement is also expected on the structure, size, and funding of the new Development Finance Institution (DFI) proposed in the last Union Budget. Furthermore, measures to strengthen the corporate bond market, and higher allocation towards the National Investment and Infrastructure Fund (NIIF) are also expected in the budget
- Further, given the crucial role, which the private sector is expected to play in the NIP, measures to attract private sector investments by way of easing regulatory environment, speedier resolution of claims/disputes etc need to be taken to improve private sector sentiments
- Select infrastructure companies/finance companies can be allowed to raise long-term funds in the form of Infrastructure Bonds / Tax-free Bonds. More clarity on the NHAI's plans of raising funds through InvITs is also expected in the Budget

INFRASTRUCTURE/CONSTRUCTION

The infrastructure sector expects the Government to take steps towards achieving a Rs. 111-trillion infrastructure investment as per the NIP. Hence, increased allocations towards the infrastructure sector are expected with the focus on roads, railways and urban infrastructure segments. Dedicated allocations for specified large infrastructure projects announced such as Bullet Trains, Bharatmala, Sagarmala, Smart Cities, inland waterways development, etc can help expedite these projects. Further, the budgetary allocation towards the NHAI can be increased, keeping in view the increased capital outlay on National Highway development. The infrastructure sector is also looking at steps to improve long-term funding availability for the sector. To bridge the funding gap, a new DFI for infrastructure was proposed in the last Budget and the industry expects more clarity on the structure, size, and timelines for the same. Also, a higher allocation towards the National Investment and Infrastructure Fund (NIIF) and steps towards strengthening the corporate bond market are likely. Permitting some reputed public-sector enterprises to raise long-term funds by way of Infrastructure Bonds or Tax-free Bonds, may also support funding availability for the infrastructure sector. To revive private sector interest in taking up new projects, measures towards the resolution of bottlenecks and further improvement in the regulatory environment, including the resolution of stuck claims, are expected.

OIL & GAS

- Provision of a floor for domestic gas prices governed by the modified Rangarajan formula
- Rationalisation of cess, which currently stands at an ad-valorem rate of 20%
- Exemption of royalty, cost petroleum and profit petroleum from service tax
- Exemption of exploration and development activity from the levy of GST
- Crude oil, natural gas and petroleum products be brought under GST
- Reduction in custom 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
- Reconsider the proposal to deny full MAT credit on opting for Section 115BAA of the Income-Tax Act

Domestic gas prices, as governed by the modified Rangarajan formula, have remained below the cost of production for many years and are currently at $1.79/mmbtu for H2 FY2021. At such low prices, gas production remains a loss-making proposition from even benign geologies. Accordingly, the upstream industry has been demanding the provision of a floor for gas prices. Additionally, crude oil prices have increased to the levels of ~$55/bbl as of mid-January 2021, from $14-15/bbl in April. At higher crude oil prices, the ad-valorem cess of 20% limits the realisations and cash accruals of upstream companies compared to the earlier fixed cess per MT. Accordingly, the upstream industry has been demanding a downward revision in cess on crude oil production to improve earnings in a high crude oil price regime. Further, the levy of NCCD of Rs. 50/MT on import of crude oil was introduced in 2003 for one year, however, it has remained in force since then. Additionally, one of the key demands of the upstream industry has been the exemption of exploration and development activities from the levy of GST. Also, the industry wants the levy of service tax removed from cost petroleum, profit petroleum and royalty as the same are not payments against any service and, therefore, should not be subject to service tax. The GoI should also clarify the eligibility to avail a tax holiday under Section 80-IB of the Act and enumerate the definition of 'mineral oil' to include natural gas retrospectively, which has been a long-running demand of the industry.

Additionally, in September 2019 the Finance Minister had announced cuts in the corporate tax rates. However, domestic companies opting for Section 115BAA will not be able to claim MAT credits for taxes paid under MAT during the tax-holiday period. Accordingly, companies would not be able to reduce their tax liabilities under Section 115BAA by claiming MAT credits. The industry wants the GoI to reconsider the proposal to deny full MAT credit.

Further, the industry has been demanding that crude oil, natural gas and 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 while LNG attracts 2.5% duty.

With the production cuts undertaken by OPEC+ and sanctions of various countries, the supply of heavy crude has declined, leading to an increase in the cost of heavy crude and lowering of light heavy differentials. To reduce costs, refiners opt to reduce heavy crude purchase and use vacuum gas oil, fuel oil etc for feeding secondary processing units. However, these products attract basic customs duty and GST, making them significantly more expensive than crude oil. Accordingly, the downstream industry demands that the GST and customs duty on such products be reduced to zero to enable the efficient use of alternate hydrocarbon streams for refinery optimisation. Additionally, the downstream industry wants the GoI to introduce a specific rate of excise duty on aviation turbine fuel from an ad-valorem rate of 11% at present, which would eliminate difficulties in re-determination of duty on stock transfers.

PHARMACEUTICALS

- Reducing dependence on API supplies from China
- Providing impetus to R&D through higher tax deductions
- Reducing GST rates for life saving and essential drugs

The pharmaceutical industry has shown resilience in the wake of the pandemic owing to the inelastic demand for drugs and resumption of manufacturing to pre-Covid levels, leading to 7.0-9.0% growth for FY2021e. With over 60% of the API/KSM (key starting material) being imported from China, reduced dependence on these items is critically important. The Covid-19 pandemic, leading to supply chain disruptions, coupled with geo-political issues, has brought to the forefront the risk of such high import dependence. As a measure to address the problem, the GoI has introduced a Rs. 10,000-crore bulk drug park and production-linked incentives (PLI) for the API manufacturers. The incentive scheme covers 53 APIs, which are critical from the point of view of import dependence on China, with a few of them being entirely imported. This augurs well in the long term as it will not only lead to reduced dependence for the domestic formulators but also help manage long-run supply disruptions. The Government will do well to extend similar incentives through the Budget for other import-dependent APIs, which will boost local manufacturing and further reduce import dependence.

Being research intensive, the pharma sector spends a significant amount on R&D efforts. Providing higher tax deductions for R&D expenses will support higher investments in developing new drugs. Investments in novel and specialty drugs are subject to higher risk of failure, leading to risk averseness. Higher tax incentives for R&D spends will incentivise Indian players to spend more, thereby providing the impetus for further R&D activities. Currently R&D investments are 100% tax deductible, which can be increased to 150%-200%, especially for novel drug discovery.

Currently, drugs are taxed under four categories – Nil, 5%, 12% and 18%. While a few life-saving drugs are taxed at Nil rates, some are taxed at 5.0% while a majority fall under the 12.0% GST slab. Lowering the GST rates for all life-saving drugs and moving them under the Nil slab, while moving other drugs to the 5.0% slab is likely to increase affordability and thereby lead to higher demand and consumption.

POWER

Renewables & strengthening of power distribution segment to remain focus areas in Budget FY2022: ICRA

- Higher budgetary allocation to strengthen the power distribution infrastructure and improve the financial viability of the distribution segment, including the implementation of amendments to the Electricity Act
- Measures to augment fund availability and ease land acquisition challenges remain important to achieve the renewable capacity targets
- Support measures to promote investments in the roof-top solar segment
- Long-term policy measures to promote domestic module manufacturing
- Promote investments in transmission infrastructure for evacuating power from renewable projects

Measures for supporting renewable energy (RE), strengthening transmission & distribution (T&D) network, and improving the viability of distribution segment are likely to continue in the coming budget, given the importance of the power sector to the country's economic growth and the strong policy focus on renewables.

Better tariff competitiveness and policy thrust are likely to drive capacity addition in the RE (particularly, solar, wind and hybrid) segment, which is evident from the strong project pipeline of about 50 GW, which comprises projects awarded through both the Central nodal and state agencies. ICRA expects a capacity addition of about 70 GW in RE till March 2025, necessitating an investment outlay of about Rs.3.5-4.0 lakh crore. Hence, ICRA expects supportive policy measures in the Budget to ensure long-tenure financing avenues for such projects. Further, a significant push is required from both the Central and state governments to promote investments in the roof-top solar segment by providing incentives, ensuring a favourable regulatory framework and creating a single window to ensure procedural approvals.

While Atmanirbhar Bharat is likely to encourage domestic manufacturing of solar cells and modules, clarity on the specific policy measures towards tariff (such as basic customs duty) and non-tariff concessions is still awaited. Given that the implementation of various Government schemes to encourage module sourcing from domestic players is slow, other measures must be enacted to support the domestic players till their scale and cost competitiveness improves against imports, particularly from that of China

Policy measures are also required to revive stranded gas-based projects as they can be used to meet peak power demand and balance the power source as the share of intermittent renewable generation in the overall energy mix is expected to increase.

The weak financial profile of state-owned discoms continues to be of concern for the power sector, given the limited improvement in the operating and financial performance of these utilities. While a liquidity relief scheme was announced in May 2020 for state discoms through state government guarantee backed loans, it remains a short-term measure. So far, this scheme has been only partially implemented. ICRA expects higher budgetary allocation towards strengthening of the distribution infrastructure, which will enable discoms to improve their operational efficiencies, and clarity on the implementation of reforms, such as the proposed amendments to the Electricity Act.

Given that wind and solar power projects are likely to be concentrated in a few resource-rich regions, while the entire India consumes the power produced, the inter-state transmission network must be augmented in a timely manner. Thus, ICRA expects the budget to accelerate the execution of transmission network strengthening projects (both at intra-state and inter-state level) through higher budgetary allocation and faster approval from Central/state nodal agencies, as well as regulatory bodies.

RETAIL

- Incentives or measures to boost disposable income
- Clarity on implementation of the National Retail Policy and e-Commerce Policy
- Continued focus and push towards a cashless economy with greater impetus for digital payments like unified payment interface (UPI), credit cards and debit card payments
- Relaxations in foreign direct investment (FDI) policy, including
  - Cautious relaxations in inventory-based model of e-commerce
  - Raising the cap on FDI in multi-brand retail trade (MBRT) from the current level of 51% (under the approval route)

The Indian retail industry has been facing demand pressure following the Covid-19 pandemic. While some recovery in demand was witnessed during the festive season, the industry is looking forward to Budget announcements to boost consumption and spur spending, which will help sustain demand in the coming quarters. Reduction in the Goods and Services Tax (GST) rate on readymade garments that belong to the range of Rs. 1,000-2,000 per piece to 5% from 12% has also been a long-pending expectation of the industry.

The industry is also expecting greater clarity on the implementation of key policies, including the National Retail Policy and the e-Commerce policy. While the former focuses on ease of doing business by rationalising the licensing processes and improving infrastructure access, the latter addresses issues involving regulation, data protection and privacy, anti-competitive practices, among others, in the e-commerce sector. A concrete step towards these would help boost confidence in the sector and attract investments. The Budget 2021 is also expected to reiterate its focus on improving infrastructure to incentivise retailers to penetrate further in tier II, III and IV cities. Continued digital push to move towards a cashless economy with greater impetus for digital payments like UPI, credit cards and debit card payments, is also expected.

The Government could also relook at the existing FDI policy to improve capital access for the retail industry. There is a strong case to raise the cap on FDI from the current level of 51% (under the approval route) for the MBRT segment, with relaxations in inter-segment restrictions and conditions such as mandatory investments in back-end infrastructure. Easing of FDI rules for the inventory model of e-commerce could also be considered.

ROADS

- ICRA expects capital outlay for the sector to be increased by at least 15%, supported by increase in budgetary allocation to the sector by at least 20% to around Rs. 0.98 lakh crore
- Given the limited fiscal headroom, fiscal deficit targets are expected to be relaxed to meet the huge funding requirements for productive asset creation
- Fund allocation towards equity for setting up a new development finance institution (DFI)

The ambitious National Infrastructure Pipeline (NIP) involves an outlay of around Rs. 20.3 lakh crore in the road sector over the next five years. However, in the past, budgetary allocations have not kept pace with these plans. Consequently, the sector's dependence on debt funding remained elevated. The total debt for the NHAI increased by more than three times to Rs. 2.49 lakh crore as on March 31, 2020 from Rs. 75,385 crore as on March 31, 2017. The borrowings are expected to surpass Rs. 3.5 lakh crore by FY2023 to fund the Bharatmala Pariyojana programme (subset of NIP). ICRA, in its earlier observation on the subject, had already highlighted the importance of speeding up the TOT awards and other fund-raising initiatives (viz., InvITs) to meet the large funding requirements of the ambitious programme.

FY2022 remains a crucial year for two reasons—a) the importance of Government spending on infrastructure to revive the economy; and b) the significant catch up required in the ongoing Bharatmala and allied programmes. As a result, the capital outlay has to be increased by at least 15%, supported by increase in budgetary allocation to the sector by at least 20% to around Rs. 0.98 lakh crore to make up for the shortfall in the last three years and slow progress on asset monetisation. Investors also expect a funding roadmap for the ambitious NIP. Given the limited fiscal headroom, the Government could consider relaxing fiscal deficit targets to meet the huge funding requirements for productive asset creation; failing which both the Bharatmala and the NIP could get jeopardized.

Much of infrastructure financing in the country is currently supported by the banking sector. Availability of long-term infrastructure financing continues to remain a challenge, given the twin problems faced by commercial banks: (a) asset-liability mismatch and (b) increasing share of stressed assets. To address this, ICRA expects fund allocation towards equity for setting up a new DFI (2-3% of overall NIP is envisaged to be funded by a new DFI). At the same time, there is a need to shift operational road assets towards capital markets by promoting investments in A category rated bonds. There is a need to deepen bond markets for the infrastructure sector.

STEEL

- Announcement of measures that could accelerate the recovery of the real estate sector and higher budgetary allocation to infrastructure projects
- Decisions to increase rake availability, and a higher budgetary allocation to strengthen logistics infrastructure in mineral rich belts
- Removal of the 2.5% import duty on heavy metal ferrous scrap
- Budgetary provision for incentivising the domestic steel industry to set up state-of-the-art R&D facilities

The steel industry witnessed a V-shaped turnaround, following Unlock 1.0, supported by a combination of external and internal drivers, which includes a resilient Chinese demand, a healthy domestic rural demand following favourable agri-outlook, and a pick-up in the automobile and consumer durable sectors. Unlike the previous upcycle, which briefly lasted for only three quarters (Q4 FY2018 to Q2 FY2019), the 2021 Union Budget could lay the foundation for a more durable recovery of the steel industry, supported by a long-term funding visibility for infrastructure and construction projects in the country. In this context, a higher budgetary allocation for projects identified in the Rs. 111 lakh crore National Infrastructure Pipeline, and announcement of measures that could accelerate the recovery of the real estate sector would be welcomed by the steel industry. On looking at structural issues, India significantly lags other leading steel-producing countries on the quality of its logistics infrastructure. Therefore, decisions to increase rake availability, and a higher budgetary allocation to strengthen logistics infrastructure in the mineral-rich belts can address concerns regarding bottlenecks in the movement of bulk-commodities.

Following many iron ore lease expiries post March 31, 2020, the domestic steel industry is staring at a 55-60 mt of iron ore supply shortage in FY2021, which has led to iron ore prices in Odisha reaching an all-time high. With this shortage likely to persist for the next 6-9 months, removal of the 2.5% import duty on heavy metal ferrous scrap could help secondary steel producers bring down the cost of input materials by increasing the sourcing of ferrous scrap over sponge iron in the steel-making process. Despite India emerging as the second largest global steel producer in CY2018, tipping Japan, it continues to rely on imports for special grades, especially high-grade alloy steel products for which the technology is not available in India. Therefore, budgetary provision for incentivising the domestic steel industry to set up state-of-the-art R&D facilities is the need of the hour. This can enable domestic steel companies gain technological knowhow in developing some of the specialised steel grades in India, helping not only substitute imports, but also supply to the global markets, and make the country truly Atmanirbhar in the steel sector.

TELECOM

- Steps to boost infrastructure in rural and remote areas and stimulus for broadband penetration
- Focus on improving connectivity through public WiFi expansion via PM WANI project
- Emphasis on domestic production of telecom equipment

The Indian telecom industry has been facing turbulent times, given the elevated debt levels amid low tariffs and the need for consistent capex. This was exacerbated by the adjusted gross revenue (AGR) verdict, which added to the payment liabilities of the telcos. This, along with the proposed spectrum auctions, places the industry debt at Rs. 4.9 lakh crore as on March 31, 2021 as per ICRA's estimates.

As a result, the industry has been seeking financial incentives from the Government time and again, which can lower the cost of equipment or services. The first and foremost demand of the industry is a reduction in the levies (mainly licence fee and spectrum usage charges) to ease the financial burden on the already stressed sector.

Fiscal incentive schemes for driving domestic innovations and indigenous manufacturing as well as promoting the development of the ecosystem around new technologies like artificial intelligence, machine learning, etc, should be looked at. The production-linked incentive (PLI) scheme to boost the domestic manufacturing of telecom gear is also likely to receive more attention to attract investments. Further, steps to boost the infrastructure in rural and remote areas should remain in focus, with stimulus for increasing broadband penetration. Moreover, in line with the strengthening of the Digital India mission, focus is expected to be on the Prime Minister Wi-Fi Access Network Interface (PM WANI) project to promote public WiFi expansion.

TEXTILE

- Adequate provisions for the Production-Linked Incentive (PLI) Scheme
- Adequate provisions for procurement of cotton by the Cotton Corporation of India Limited (CCI) under the Price Support Scheme
- Increased provisions for Amended Technology Upgradation Fund Scheme (ATUFS) subsidy
- Better clarity and adequate provisions for export incentive schemes
- Provisions for investments in textile parks

1. **Adequate provisions for PLI Scheme** – In November 2020, the Union Cabinet approved the introduction of the PLI Scheme for 10 key sectors, including textiles, for enhancing India's manufacturing capabilities and exports. The scheme's focus in the textile sector is on man-made fibre (MMF) and technical textiles, with an approved financial outlay of Rs. 10,683 crore over a five-year period. While India drives ~5% of the global apparel trade market, its share in the MMF segment is low. Considering the sizeable opportunities available in global apparel markets with an increasing focus on diversifying one's vendor base beyond China, the timely launch of the scheme with adequate budgetary provisions can provide a boost to the domestic sector.
2. **Adequate provisions for CCI to procure cotton under the Price Support Scheme** – Given the nodal role played by CCI in carrying out the Government of India's (GoI's) mandate of cotton MSP operations, the GoI extends regular funding support to it to reimburse losses incurred in executing such operations. Provisions for such reimbursements are made in the Union Budget every year. It was noted that no provisions had been made for this in the Union Budget 2020-21. Adequate provisions support CCI's financial flexibility and, hence, the efficacy of price support operations on a sustainable basis.
3. **Increased provisions for ATUFS subsidy** – There has been a considerable reduction in budgetary allocation towards ATUFS (with an implementation period till March 2022), from Rs. 2,600 crore for 2016-17 and Rs. 1,900 crore for 2017-18 to an annual average of around Rs. 600 crore for the past three fiscal years. This scheme primarily aims at incentivising capital investments in the downstream segments of the textile sector. Continued access to these incentives remains crucial for encouraging investments in India's downstream textile segments.

4. **Better clarity and adequate provisions for export incentive schemes** – The export segment of India's domestic textile sector has been facing multiple challenges in recent years, including intense competition heightened by preferential duty access available to certain peer nations, subdued demand from some of its key markets and continued uncertainty on the export incentive structure. On December 31, 2020, the GoI announced that the benefit of the Scheme for Remission of Duties and Taxes on Exported Products (RoDTEP) was to be extended to all export goods with effect from January 1, 2021. However, the rates under the scheme are yet to be notified. In the absence of any clarity on such rates, it is challenging for exporters to formulate their pricing strategies. Accordingly, clarity on rates and procedures as well as adequate provisioning for the export incentive schemes in the Budget remains crucial for the liquidity and, hence, performance of India's textile exporters.

5. **Fund allocation for investments in textile parks** – Healthy funds should be allocated for the development of textile parks in the country, for addressing prevailing constraints (such as infrastructure bottlenecks and a dispersed value chain) and assisting small and medium entrepreneurs in the industry by providing them financial support (in the form of equity/ grants).

ICRA
A MOODY'S INVESTORS SERVICE COMPANY

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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+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 7940-50

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,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

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

4th Floor, 'Shoban'
6-3-927/A&B. Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

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

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 1194

Email: Info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.Icraresearch.in