MACROECONOMICS UPDATE

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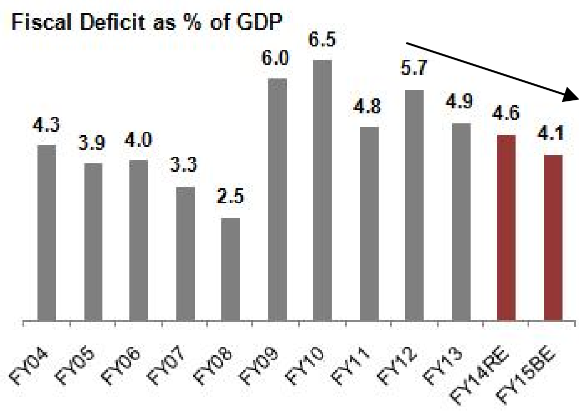
FY 2015 Interim Budget: Is the fiscal consolidation achievable?

Finance Minister tabled the interim budget – achieved better than budgeted fiscal consolidation

The finance minister presented the interim budget in the parliament on 17th February, 2014. The full budget will be presented in June-July after the general election.



Source: Central Statistics Office (CSO)

The good news was that the Fiscal deficit for FY14 was better than expected....

The Finance minister ostensibly kept his promise and remained on the path of fiscal consolidation. The revised estimate for the FY14 fiscal deficit is at 4.6% of GDP vs. budgeted 4.8% despite significant shortfall on the revenue front.

In FY15, the government has pencilled in a fiscal deficit target of 4.1% of GDP, marginally better than expected (4.2%). About 87% of this deficit will be financed by market borrowing (net borrowing: Rs 4.57 lakh crore). Both net and gross market borrowings (Rs 5.97 lakh crore) in FY15 are better than market expectation.

...however details disappoint as fiscal consolidation was achieved by sharp cut in Plan expenditure....

The total revenue receipts in FY 14 was lower by Rs 56,904 crore from the budgeted estimate as gross tax revenue was sharply down (by Rs 76,964 crore) due to slowing growth. Disinvestment receipts were also lower by about Rs 35,000 crore. Part of the tax revenue shortfall was met by higher dividends from PSUs. These totalled Rs 43,075 crore which is much higher than in past years (Rs 13,354 crore in FY 13) and also higher than the budgeted amount of Rs 29,870 crore. Hopefully, this will not compromise on investment activity of these PSUs in the coming years.

The non-Plan expenditure went up by only about Rs 5,000 crore as higher subsidy of Rs 24,416 crore (mostly higher oil subsidy) was offset through cut in non-Plan capital expenditure by Rs 29,853 crore.

The fiscal deficit target was primarily met through sharp cut in the Plan expenditure. Total Plan expenditure was cut by a whopping Rs 79,790 crore in the revised estimate.

Despite these measures, it might still be difficult to achieve this revised fiscal deficit target of 4.6% of GDP

The actual net tax revenues collected during the first nine months (April to December 2013) of this fiscal came in at Rs 5,17,661 crore. To achieve the revised target of Rs 8,36,026 crore for the full year, the net tax revenues need to grow at 24% in the last quarter of 2013-14. Similarly, based on the actual number for the period of April to December, the expenditures for the last quarter of this fiscal need to grow at mere 2% to stay within the revised estimate for the full year. These assumptions are a bit aggressive, in our view and may result in the fiscal deficit being higher than not only 4.6% but even 4.8% for this year.

FY 15 fiscal deficit target, budgeted at 4.1% of GDP, will be tough to achieve

Finance minister expects that fiscal deficit for next year (2014-15) will be slightly better than the earlier roadmap of 4.2% of GDP. We feel, there might be fiscal slippage because:

- **Nominal GDP growth assumption is optimistic:** The nominal GDP growth assumed in FY 15 at 13.4% is higher than our expectation. If inflation, measured by WPI, is assumed to average 6.5% in FY 2014-15, this implies a real GDP growth rate of 7.0% next year, which is much higher than our expectation of GDP growth being between 5.5-6% in 2014-15. If we assume a higher inflation rate, it will not be compatible with the inflation target set by the RBI. The confusion arises because the RBI has now set itself the inflation target in CPI at 7.5-8.5% by the end of March 15. It will therefore be useful for the government came out with an explicit GDP estimate for 2014-15 and clarify if it is using retail of wholesale inflation rate for estimating the growth in nominal GDP.
- **Tax Revenue receipts unrealistic:** The tax revenue growth assumptions in FY 15 are on the higher side. Net tax revenues are expected to grow at 18% yoy against a nominal GDP growth of 13.4% yoy. The tax revenues elasticity to growth averaged at around 0.9 for last five years. It is assumed at 1.3 for FY 15. Based on past trend, the net tax revenue growth for next fiscal might be around 14 to 15% yoy. If nominal GDP growth disappoints in line with our expectation, it might be more difficult to achieve the budgeted tax revenue target.
- **Disinvestment target ambitious:** The budget aims to garner about Rs 52,000 crore in FY 15 through divestments and stake sale in non-government companies, which are dependent on market conditions. This assumption is very optimistic.
- **Expenditure assumptions low:** The oil subsidy of Rs 63,427 crore includes a roll-over of about 35,000 crore from this fiscal. This leaves only Rs 28,400 crore for the three quarters of next fiscal. So, unless government continues with diesel price deregulation or global crude oil prices remain range-bound or rupee stabilises, the oil subsidy might be higher. Food subsidy will also be higher if Food security bill is implemented in full. Overall, expenditure growth is assumed at only 11% yoy, even lower than this year’s 13% growth after the sharp cut in expenditure during this year. There might be some space to cut Plan expenditure to offset any shortfall but this space is limited considering Plan expenditure has already been pushed back for two consecutive years.

Bottomline:

The fiscal deficit for the current year (2013-14) was brought down to 4.6% of GDP below the red line indicated by the finance minister. However, it was achieved by pushing back Plan expenditure, and bringing forward dividend receipts, both of which could adversely affect future growth. The bigger worry is that assumptions made for fiscal flows in the last quarter to achieve this target look to be unreal as derived from actual fiscal number for nine months (April to December 2013) and there is a strong possibility that the fiscal deficit target even for 2013-14 will be missed.

The FY 15 budgeted numbers have optimistic revenue growth assumptions along with subdued expenditure growth estimates. Therefore, it is unlikely that these fiscal targets will be achieved. However, the final fiscal picture for 2014-15 will be known only when the actual budget is presented. The next government will do well to keep a very sharp eye on all the assumptions and disguised cuts while preparing the budget for FY 15. It will have to find some innovative measures for bringing the fisc back into balance while preventing any further deterioration in the conditions for generating much needed growth and employment.

APPENDIX

How FY14 fiscal deficit target of 4.6% of GDP was achieved?

The revised estimate of FY14 shows that fiscal deficit is expected to be 4.6% of GDP, lower than budgeted 4.8% despite sharply lower tax revenues on slowing growth and higher oil subsidies. This is achieved by drastically cutting the Plan expenditure, some cut in Non-Plan Capital expenditure and higher dividend receipts (as shown in the table below).

Rs Crore	FY13 Actual	FY14 BE	FY14 RE	Change in FY14 RE from BE (Rs cr)	Annual change (% YoY) FY14BE over FY13	Annual change (% YoY) FY14RE over FY13
a. Gross Tax Revenue	10,36,235	12,35,870	11,58,906	-76,964	19%	12%
Corporation tax	3,56,326	4,19,520	3,93,677	-25,343	18%	10%
Income tax	2,01,487	2,47,639	2,41,691	-5,948	23%	20%
Wealth tax	846	950	950			
Excise duty	1,76,535	1,97,554	1,79,538	-18,016	12%	2%
Import duty	1,65,346	1,87,308	1,75,056	-12,252	13%	6%
Service tax	1,32,601	1,80,141	1,64,927	-15,214	36%	24%
Other Tax	3,094	2,758	3,067	309	-11%	-1%
(-) Devolvement to States & UTs	2,95,979	3,51,792	3,22,000	-20,912	19%	9%
b. Net tax revenues (a-b)	7,40,256	8,84,078	8,36,026	-48,052	19%	13%
c. Non Tax Revenues	1,37,357	1,72,252	1,93,226	20,974	25%	41%
Interest Receipts	20,763	17,764	21,018	3,254	-14%	1%
Dividends and Profits	53,761	73,866	88,188	14,322	37%	64%
From PSUs	13,354	29,870	43,075	13,204	124%	223%
From RBI and SCBs	40,406	43,996	45,114	1,117	9%	12%
Other non-Tax Revenues	59,405	78,000	79,788	1,788	31%	34%
e. Net revenue receipts (c+d)	8,77,613	10,56,331	10,29,252	-27,079	20%	17%
f. Non-debt capital receipts	42,157	66,468	36,643	-29,825	58%	-13%
Recoveries of Loans and advances	16,267	10,654	10,802	148	-35%	-34%
Disinvestments	25,890	40,000	16,027	-23,973	55%	-38%
Divestment of stake		14,000	3,000	-11,000		
Others		1,814	6,814	5,000		
TOTAL REVENUES (e+f)	9,19,770	11,22,799	10,65,895	-56,904	22%	16%
Total Revenue expenditure	12,43,509	14,36,169	13,99,540	-36,629	15%	13%
Total Capital expenditure	1,66,858	2,29,129	1,90,895	38,234	37%	14%
Non-Plan Capital expenditure	82,441	1,17,067	87,214	-29,853	42%	6%
Non-Plan Revenue Expenditure	9,14,301	9,92,908	10,27,689	34,781	9%	12%
Subsidies	2,57,079	2,31,100	2,55,516	24,416	-10%	-1%
Food	85,000	90,000	92,000	2,000	6%	8%
Fertiliser	65,613	65,972	67,972	2,000	1%	4%
Petroleum	96,880	65,000	85,480	20,480	-33%	-12%
Others	9,585	10,129	10,065	-64	6%	5%
Plan Revenue expenditure	3,29,200	4,43,260	3,71,051	-71,409	35%	13%
Plan Capital expenditure	84,417	1,12,062	1,03,681	-8,381	33%	23%
Plan exp on rev & cap a/c	4,13,625	5,55,322	4,75,532	-79,790	34%	15%
Non Plan expen on rev & cap a/c	9,96,712	11,09,975	11,14,902	4,927	11%	12%
TOTAL EXPENDITURE	14,10,367	16,65,297	15,90,434	-74,863	18%	13%

Gross tax revenues down by about Rs 77,000 crore with corporate tax lower by Rs 25,843 crore and Excise and Customs down by Rs 30,000 crore.

Higher dividends push up Non-Tax revenues.

Lower Disinvestments receipts

Subsidy payment went up by Rs 24,416 crore due to higher oil subsidy.

Plan expenditure was drastically cut by Rs 79,790 crore.

Deficit trends			
Fiscal deficit (Rs Bn)	4,90,597	5,42,499	5,24,539
% to GDP	4.9%	4.8%	4.6%
Revenue deficit (Rs Bn)	3,65,896	3,79,838	3,70,288
% to GDP	3.6%	3.3%	3.3%
Effective Revenue Deficit (Rs Bn)	2,50,383	2,05,182	2,49,005
% of GDP	2.5%	1.8%	2.2%
Primary deficit (Rs Bn)	1,77,428	1,71,814	1,44,473
% to GDP	1.8%	1.5%	1.3%

Source: Budget documents, CPR research

- **The fiscal deficit of 4.6% was achieved by pruning the Plan expenditure and through higher dividend receipts.**
- **However, based on actual fiscal numbers available for nine months till December, the tax revenues are expected to grow by about 24% and expenditure by mere 2% in 4Q FY14. These assumptions are too optimistic in our view.**

APPENDIX

FY 15 fiscal deficit at 4.1% of GDP through lower spending and higher disinvestment

Rs Crore	FY13 Actual	FY14 RE	FY15 BE	Annual change (% YoY) FY14RE over FY13	Annual change (% YoY) FY15BE over FY14RE
a. Gross Tax Revenue	10,36,235	11,58,906	13,79,199	12%	19%
Corporation tax	3,56,326	3,93,677	4,51,005	10%	15%
Income tax	2,01,487	2,41,691	3,06,466	20%	27%
Wealth tax	846	950	950		0%
Excise duty	1,76,535	1,79,538	2,00,585	2%	12%
Import duty	1,65,346	1,75,056	2,01,314	6%	15%
Service tax	1,32,601	1,64,927	2,15,478	24%	31%
Other Tax	3,094	3,067	3,401	-1%	11%
(-) Devolvement to States & UTs	2,95,979	3,22,880	3,92,782	9%	22%
b. Net tax revenues (a-b)	7,40,256	8,36,026	9,86,417	13%	18%
c. Non Tax Revenues	1,37,357	1,93,226	1,80,714	41%	-6%
Interest Receipts	20,763	21,018	19,729	1%	-6%
Dividends and Profits	53,761	88,188	77,229	64%	-12%
From PSUs	13,354	43,075	27,815	223%	-35%
From RBI and SCBs	40,406	45,114	49,414	12%	10%
Other non-Tax Revenues	59,405	79,788	80,240	34%	1%
e. Net revenue receipts (c+d)	8,77,613	10,29,252	11,67,131	17%	13%
f. Non-debt capital receipts	42,157	36,643	67,452	-13%	84%
Recoveries of Loans and advances	16,267	10,802	10,527	-34%	-3%
Disinvestments	25,890	16,027	36,925	-38%	130%
Divestment of stake		3,000	15,000		400%
Others		6,814	5,000		
TOTAL REVENUES (e+f)	9,19,770	10,65,895	12,34,583	16%	16%
Total Revenue expenditure	12,43,509	13,99,540	15,50,054	13%	11%
Total Capital expenditure	1,66,858	1,90,895	2,13,160	14%	12%
Non-Plan Capital expenditure	82,441	87,214	1,00,111	6%	15%
Non-Plan Revenue Expenditure	9,14,301	10,27,689	11,07,781	12%	8%
Subsidies	2,57,079	2,55,516	2,55,708	-1%	0.1%
Food	85,000	92,000	1,15,000	8%	25%
Fertiliser	65,613	67,972	67,970	4%	0%
Petroleum	96,880	85,480	63,427	-12%	-26%
Others	9,585	10,065	9,310	5%	-7%
Plan Revenue expenditure	3,29,208	3,71,851	4,42,273	13%	19%
Plan Capital expenditure	84,417	1,03,681	1,13,049	23%	9%
Plan exp on rev & cap a/c	4,13,625	4,75,532	5,55,322	15%	17%
Non Plan expen on rev & cap a/c	9,96,742	11,14,902	12,07,892	12%	8%
TOTAL EXPENDITURE	14,10,367	15,90,434	17,63,214	13%	11%

Sharp increase in tax revenue growth assumed at 19%. Assumption of Direct and Indirect tax growth optimistic.

Telecomm auction, Dividend receipts realistic.

Disinvestment and stake sale are market dependent

Oil subsidy might increase unless government continues with slow deregulation of prices. Food subsidy might be higher if food bill fully implemented.

Expenditure growth might be higher than budgeted but we will wait for the actual budget to be presented after the election.

Deficit trends			
Fiscal deficit (Rs Bn)	4,90,597	5,24,539	5,28,631
% to GDP	4.9%	4.6%	4.1%
Revenue deficit (Rs Bn)	3,65,896	3,70,288	3,82,923
% to GDP	3.6%	3.3%	3.0%
Effective Revenue Deficit (Rs Bn)	2,50,383	2,49,005	2,36,342
% of GDP	2.5%	2.2%	1.8%
Primary deficit (Rs Bn)	1,77,428	1,44,473	1,01,620
% to GDP	1.8%	1.3%	0.8%

Source: Budget documents, CPR research

The fiscal deficit for FY15 is budgeted at 4.1% of GDP. But the actual budget presented after election will give us a better idea about the path of fiscal consolidation.

The fiscal estimates for FY 15 are not very relevant as final budget will be announced after the election by the new government. .