Motilal Oswal

EcoScope
The Economy Observer

How big is growth push from the Budget 2021?

Not much. The devil is in the details

- **Union Budget 2021-22 is hailed as growth expansionary. With fiscal deficit of the central government (CG) pegged at all-time high of 9.5% of GDP in FY21 and budgeted at 6.8% of GDP for FY22 – both much higher than expectations, it is believed that the Budget will help push growth higher, especially with all-time high growth of 28.4% YoY in total spending in FY21RE. Further, the average growth of 28% YoY in capital expenditure (capex) in FY21RE and FY22BE is also expected to create better growth multiplier.**
- **In our recently published note, we explained that the adjusted capex growth is estimated at 6.6% in FY21RE and budgeted at 12.3% YoY in FY22BE, implying an average growth of just 9.5% in FY21 and FY22, much lower than the growth suggested in the Union Budget and similar to the growth seen in the pre-COVID years. If so, the expected growth multiplier is expected to be much lower than perceived.**
- **Further, while capex has a higher growth multiplier than current/revenue spending, and, thus, is more important from the long-term growth perspective, total spending is more important for economic impact in the short run. There are two important points to note:**
  - **A large part of fiscal stimulus is already over. Record-high spending growth in FY21RE is on account of higher food/fertilizer subsidies, which is a one-off expenditure on account of COVID-19. More importantly, majority of this spending is already incurred. In hindsight, it helps explain better-than-anticipated economic recovery in the past few months and also better performance of the rural vis-à-vis urban economy during COVID-19, and**
  - **Total spending growth is budgeted at record-low of just 1% YoY next year, with first-ever budgeted decline in revenue expenditure in the past half a century. A large part of this slower budgeted growth is on account of disappearance of one-off COVID-related expenditure such as subsidies and MGNREGA. In short, there was a fiscal stimulus in FY21, but definitely not in FY22.**
- **Lastly, the Government's proposal to bring down fiscal deficit to below 4.5% of GDP by FY26 is also seen as growth expansionary. This is also highly misleading. Assuming average nominal GDP growth of 10% and tax buoyancy of 1.2x (same as in pre-COVID period) between FY23 and FY26, a fiscal consolidation of 0.6 percentage point (pp) of GDP per annum till FY26 means average growth of just 6.2% (5.2%) in total (primary) spending, slower than 8.6% (8.3%) seen in the pre-COVID period.**
- **Overall, while the Budget has not done anything to disturb the economic growth momentum (which is the best part), it is definitely not a largely perceived "growth expansionary" Budget also.**

Union Budget 2021-22 is hailed as growth expansionary. With CG's fiscal deficit pegged at all-time high of 9.5% of GDP in FY21 and budgeted at 6.8% of GDP for FY22 – both much higher than expectations (~7% and ~5.5% respectively), it is broadly believed that the Budget will help push growth higher, especially with all-time high growth of 28.4% YoY in total spending in FY21RE *(Exhibits 1-2)*.

Adjusted capex is estimated to grow at an average of just 9.5% in FY21 and FY22, much lower than 28% suggested in the Union Budget

Further, the average growth of 28% YoY in capital expenditure (capex) in FY21RE and FY22BE is also expected to create better growth multiplier. However, as we have explained in our recently published note, the adjusted capex growth is estimated at 6.6% in FY21RE and budgeted at 12.3% YoY in FY22BE, implying an average growth of just 9.5% in FY21 and FY22, similar to the growth seen in the pre-COVID years. If so, the expected growth multiplier is expected to be much lower than perceived.

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Exhibit 1: FY21RE fiscal deficit at all-time high…

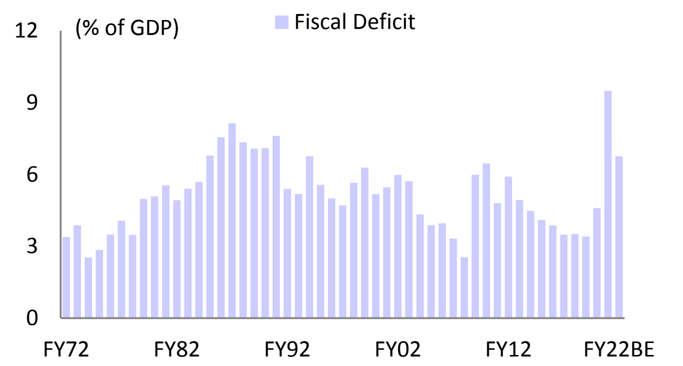
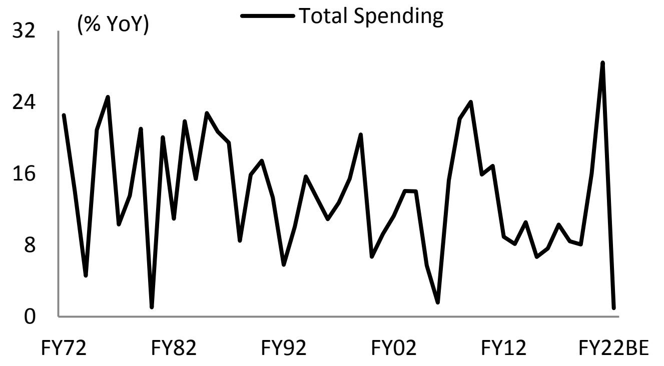


Exhibit 2: …when total spending grew at fastest-ever pace



Source: Budget documents, Ministry of Finance, CEIC, MoFSL

While capex has a higher growth multiplier than current/revenue spending, and, thus, is more important from long-term growth perspective, total spending is more important for economic growth in the short run. There are two important points to note *(Exhibit 3)*:

Record-high spending growth in FY21RE is on account of higher subsidies. More importantly, majority of this spending is already incurred

1.) A large part of fiscal stimulus is already over. Record-high spending growth in FY21RE is on account of higher food/fertilizer subsidies, which is a one-off expenditure on account of COVID-19. More importantly, majority of this spending is already incurred. According to Controller General of Accounts (CGA), almost four-fifth of total expenditure excluding subsidies has been incurred in the first nine months of FY21 (up to December 2020).

Exhibit 3: Details about total expenditure in FY21RE and FY22BE

INR trillion	FY20	FY21YTD	FY21RE		FY22BE	
	Annual	% of REs	Annual	Change	Annual	Change
Total expenditure	**26.9**	**66.1**	**34.5**	**7.6**	**34.8**	**0.3**
Total ex subsidies	**24.2**	**79.9**	**28.0**	**3.8**	**31.1**	**3.1**
Revenue expenditure	**23.5**	**65.5**	**30.1**	**6.6**	**29.3**	**(0.8)**
Interest payments	6.1	68.1	6.9	0.8	8.1	1.2
Defense	2.1	71.3	2.2	0.1	2.1	(0.1)
Subsidies	2.7	41.7	6.5	3.8	3.7	(2.8)
Grants to states/UTs	5.3	#	5.7	0.4	6.1	0.5
Rural sector*	2.3	78.2	3.4	1.0	3.1	(0.2)
Others	5.0	#	5.6	0.6	6.1	0.6
Capital expenditure	**3.4**	**70.4**	**4.4**	**1.0**	**5.5**	**1.2**
Defense	1.1	59.0	1.3	0.2	1.4	0.0
Roads & Highways	0.7	74.1	0.9	0.2	1.0	0.1
Railways	0.7	#	1.1	0.4	1.1	0.0
Loans to States/UTs	0.1	#	0.2	0.1	0.1	0.0
Others	0.8	#	0.9	0.1	2.0	1.0

* Department of Agriculture, Cooperation and Farmers' Welfare, Department of Drinking Water and Sanitation and Ministry of Rural Development

Details not available on monthly basis

Rounding-off discrepancies may be there

Source: Budget documents, CGA, MOFSL

Interestingly, while subsidies expenditure by the Government (included in fiscal math) up to Dec'20 is only about two-fifth of revised estimates (REs), it is very likely that this spending is being incurred off-budget. As a matter of fact, outstanding debt of the Food Corporation of India (FCI) has risen from INR3.3T in Mar'20 to INR4.1T as on Jan'21. Further, the Government has procured almost two-third of paddy in the ongoing Kharif Marketing Season (KMS) 2020-21, implying that such expenditure has been incurred but not yet reflected on the fiscal math.

If so, it suggests that most of fiscal stimulus has already happened and the related growth multiplier has already been into the economy. In hindsight, it helps explain better-than-anticipated economic recovery in the past few months and also better performance of the rural vis-à-vis urban economy during COVID-19.

After record-high spending growth in FY21RE, it is budgeted to grow at record-low of just 1% YoY next year, with first-ever budgeted decline in revenue expenditure in the past half a century

2.) Although there was a fiscal stimulus in FY21, it is definitely not there for FY22. After record-high spending growth in FY21RE, it is budgeted to grow at record-low of just 1% YoY next year, with first-ever budgeted decline in revenue expenditure in the past half a century. A large part of this slower budgeted growth is on account of disappearance of one-off COVID-related expenditure such as subsidies and MGNREGA. However, in any case, it suggests that the fiscal multiplier will fade off substantially in FY22, leaving the economic growth totally dependent on the private sector recovery.

What about the fiscal consolidation path up to FY26? Lastly, the Government's proposal to bring down fiscal deficit to below 4.5% of GDP by FY26 is also seen as growth expansionary. This is also highly misleading.

A fiscal consolidation of 0.6 pp of GDP per annum implies an average growth of just 6.2% in total spending, slower than 8.6% in pre-COVID years

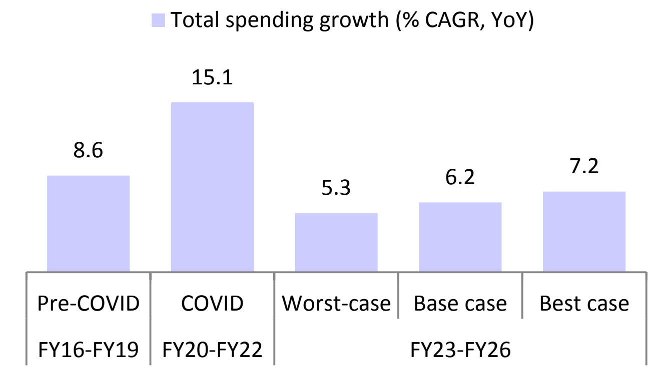
Assuming average nominal GDP growth of 10% and tax buoyancy of 1.2x (same as pre-COVID period) between FY23 and FY26, a fiscal consolidation of 0.6 percentage point (pp) of GDP per annum implies an average growth of just 6.2% (5.2%) in total (primary) spending, slower than 8.6% (8.3%) in pre-COVID years *(Exhibits 4-5)*.

Exhibit 4: Average spending growth between FY23-FY26 based on different assumptions…

Nominal GDP growth ↓	Receipts buoyancy*				
	0.9	1.0	1.1	1.2	1.3
9.0	4.6	5.3	5.9	6.6	7.2
10.0	4.9	5.6	6.2	6.9	7.5
11.0	5.3	5.9	6.5	7.2	7.8
12.0	5.6	6.2	6.9	7.5	8.2

Assuming gradual fiscal consolidation to 4.5% of GDP in FY26
* Including tax buoyancy (tax growth/GDP growth) of 1.2x

Exhibit 5: …implies that total spending could grow at an average of just 6.2% vis-à-vis 8.6% in pre-COVID years



Source: Budget documents, CEIC, MoFSL

Overall, while the Budget has not done anything to disturb the economic growth momentum (which was our demand), it is also not a largely perceived "growth expansionary" Budget beyond FY21.

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