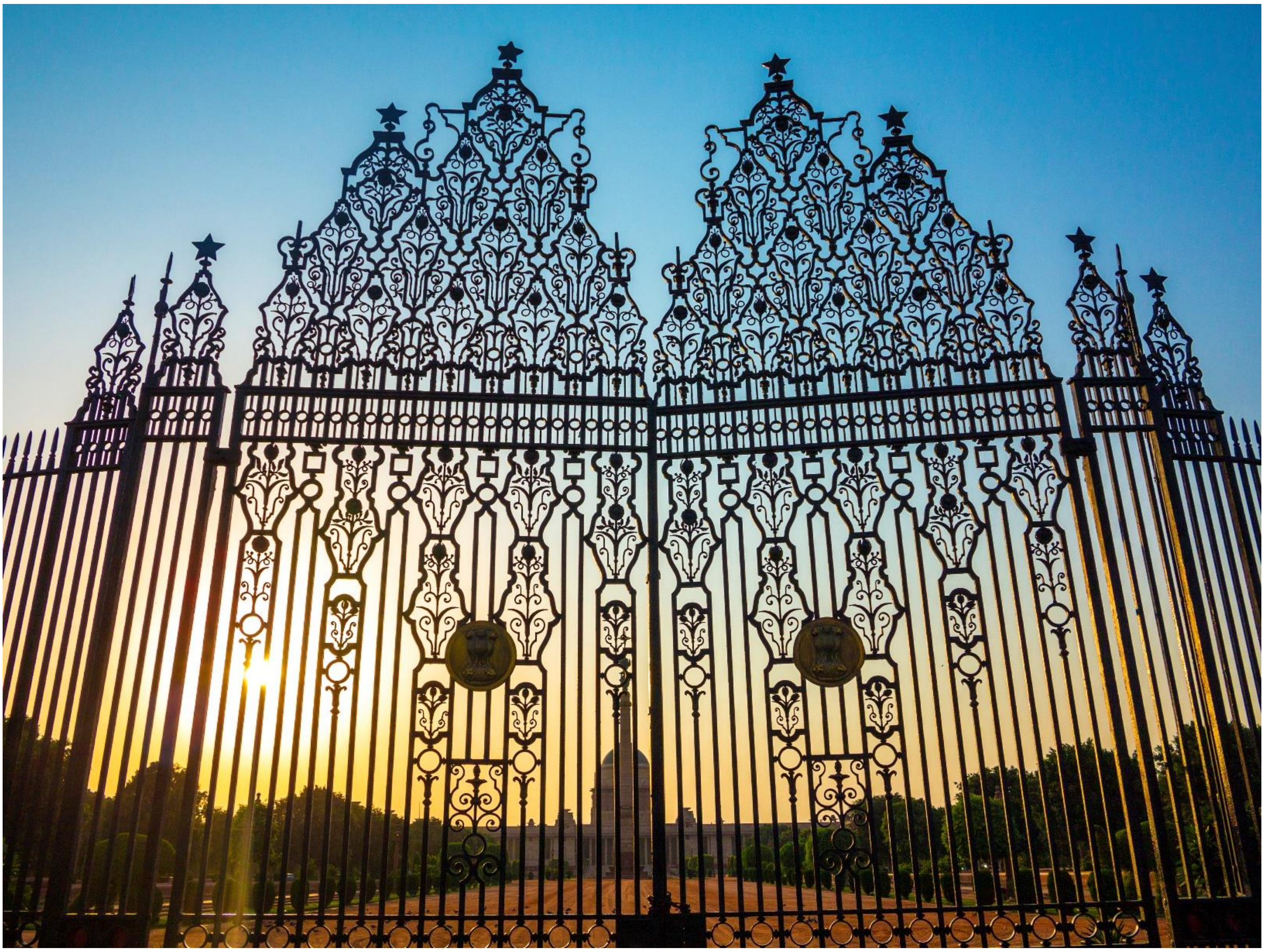
Research

CRISIL
An S&P Global Company

The capex gambit

Union Budget 2022-23

February 2022



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Spending to grow

The budget has bet big on an investment push to lift economic growth, two years and three waves into the pandemic.

The lift in the consumption cycle is now tied to a broad-based pick-up in economic activity — which the government is trying to engineer through a focus on investments.

Pursuing this path would enhance the growth potential and, it is hoped, will bring endurance to growth in the medium term, though refraining from giving a direct consumption support could curb the pace of economic recovery in the short term.

For the next fiscal, the government's revenue expenditure is budgeted to grow less than 1% after growing 2.7% in this fiscal. The total capex of the central government though (budgetary capex plus revenue grants for capital creation and capex by central public sector enterprises) is budgeted to rise 14.5% compared with only 3.1% in this fiscal.

So the budget essentially makes way for capex by tightening the belt around revenue expenditure. In general, the government has refrained from giving any direct consumption support in this budget. Yet, frontloading infrastructure spending could bring about faster growth.

The risks to India's near-term economic outlook are still tilted to the downside. Global growth looks uncertain and that will have a bearing on India's exports, one of the key demand drivers of domestic growth during the pandemic. International commodity prices, especially of crude, remains stubbornly high. And critical raw materials, such as chips, remain in short supply.

CRISIL projects fiscal 2023 real GDP growth at 7.8%, compared with the advance estimate of 9.2% for this fiscal.

Among the sectors, infrastructure continues to be a bright spot, with a 30% hike in budgetary support. Railways, water, and green energy have got particularly strong impetus. Railways, for one, benefits from a 14% rise in capex compared with fiscal 2022RE.

Notably, the government's direct spend (gross budgetary support) is budgeted at 62% of aggregate capex next fiscal, up from 55% in the current one. This reflects a shift in the financing pattern — an increase in reliance on direct budgetary support and a reduction in funding from central public sector enterprises — as visible in the IEBR component in roads being eliminated completely, reducing dependence on borrowings by the National Highways Authority of India.

The power sector also benefits from the thrust to green energy and the increase in outlay to Rs 24,000 crore from Rs 19,500 crore. Also, the basic customs duty of 40% and 25% on imported solar photovoltaic modules and cells will spur domestic manufacturing.

The signal for agriculture, however, is mixed. The reduction in food subsidy by a quarter for next fiscal implies a decline in government procurement for crops at minimum support price, which could impact farmer income and thereby sales of two-wheelers and tractors.

Electric vehicles, though, have impetus from moves to standardise battery swapping infrastructure, which will boost their adoption and commercial use.

Stoking an investment-led recovery

This budget has thrown all its weight behind government-led capital expenditure (capex), in the hope of setting off a virtuous investment cycle to lift growth.

What it misses though, is the bridge — short term, consumption-raising measures to address the unequal recovery so far, tilted against large sections of the population particularly in the informal sector, still under pandemic-led duress.

To be sure, the Indian economy is at plucking distance from a faster growth trajectory, two years and three waves into the pandemic.

In large part, it is sheer luck that the omicron variant that embodied the third wave was relatively mild. Though highly contagious, it necessitated fewer curbs[1]. More significantly, increasing vaccination coverage and the acquired ability to live with the virus, have lessened the severity of economic impact with each successive wave.

As of February 01, 2022, 71.4 crore people (~50% of the total Indian population) have been administered two doses of vaccines. In the past few days, the number of daily cases have slowed. At 2,38,614 cases currently, the 7-day moving average of daily new cases has come down for the sixth consecutive day, from 3,11,982 cases.

Growth outlook for fiscal 2023

We are looking at fewer supply disruptions and a fuller resumption of activity in the coming fiscal. As a result, contact-intensive services (such as hospitality, restaurants, theatres etc.), which still trail the pre-pandemic levels of fiscal 2020, could start contributing favourably to growth.

Bank credit growth — a broader indicator of economic activity — is flashing good news, too. It picked up to 8.0% on-year as of January 14, 2022 from 5.2% in March 2021.

But India is not out of the woods yet.

Given the fragile consumption recovery, the third wave's impact on contact-based services, and weak rural demand, fiscal support has become crucial, especially with monetary policy reaching its limits.

To this end, the budget has done right by loosening its purse strings (more on this in the expenditure section), especially boosting capital expenditure (capex), and going slow on fiscal consolidation.

Fiscal deficit for fiscal 2023 is budgeted at 6.4% of GDP and is slated to be brought down only gradually to 4.5% by fiscal 2026.

Broadly speaking, government capex should continue to juice up recovery. That, in turn, should help improve consumption demand and crowd in private investment.

[1] *Oxford Stringency index during the current third wave peaked at 71.76, much lower than 81.94 during the second wave*

Large private corporates, on their part, have been deleveraging. They are well-placed to undertake investments, but are cautious owing to continued demand uncertainty. They are also probably unwilling to repeat past mistakes, of over-investment in previous booms.

That said, private sector investment is also expected to benefit from the Production-Linked Incentive (PLI) scheme, which has the potential to generate Rs 2.5-3.0 lakh crore of capex spread across 14 sub-schemes between fiscals 2023 and 2025. Given that approvals for many companies were granted only in the third quarter of this fiscal, meaningful capex is likely during this period.

All said, risks to India's economic outlook are still skewed towards the downside.

Global growth is expected to slow this year, with the withdrawal of extraordinary fiscal and monetary policy support by major economies. Their economic recovery looks incomplete, even as risks from fresh Covid-19 variants cannot be ruled out.

S&P Global forecasts global gross domestic product (GDP) growth to narrow to 4.2% in calendar year 2022 from 5.7% in 2021.

This could have a direct bearing on India's exports,[2] which has been one of the key demand drivers of domestic growth during the pandemic.

As for international commodity prices, while non-energy prices are expected to somewhat come off[3] the multi-year highs seen last year, energy prices, especially that of crude oil, are likely to continue firming up, partly owing to geo-political issues.

CRISIL forecasts Brent crude price at $80-85 per barrel for 2022 vs an average of $70.44 per barrel in 2021. Sustained high crude prices could lead to curtailing growth, and raising current account deficit and inflation.

Moreover, even if global supply chain disruptions are expected to ease, critical raw material shortages such as those of chips could take time to tide over.

CRISIL projects fiscal 2023 real GDP growth at 7.8% over 9.2% in previous fiscal.

How can capex support near-term consumption? Simply, frontload it.

For yet another year, the budget steered clear from a definitive consumption push to support economic recovery.

Instead, it batted for investment spend, with an eye on the medium term.

What are the implications?

One the one hand, the lift in the consumption cycle is now tied to a broad-based pick-up in economic activity — which the government is trying to engineer through a focus on investments. Pursuing this path would enhance the growth potential and, it is hoped, will bring endurance to growth in the medium term.

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[2] Please refer to CRISIL Quickonomics, 'Envisioning new frontiers of trade', January 2022
[3] According to World Bank's 2022 global outlook, non-energy commodity prices are expected to decline 2% in 2022, after having risen 31.9% in 2021

On the other, refraining from giving a direct consumption support could keep the pace of economic recovery slow in the short term.

The latest National Statistical Office (NSO) estimates[4] for India's GDP for this fiscal indicate that household consumption demand is lagging fiscal 2020[5] levels by 2.2%. That makes it the worst performer among the demand components of GDP post-pandemic. To boot, private consumption was already slowing before the pandemic. It is a similar story with household incomes.

The current consumption slowdown also stems from the pandemic-induced income inequality. So, some direct support to consumption and incomes could have provided a faster lift to growth, besides providing people the means to survive.

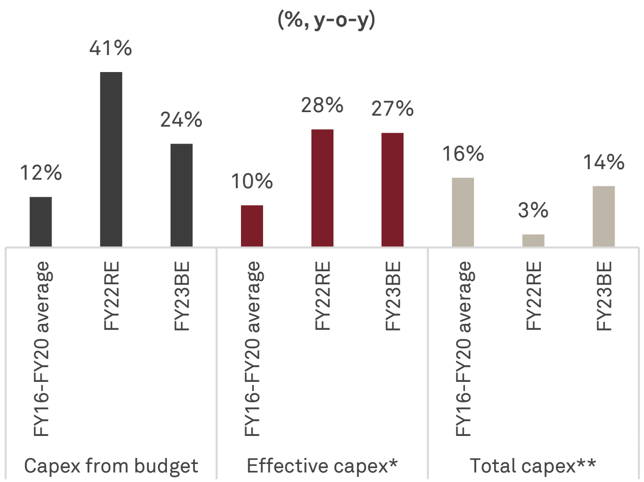
Moreover, consumer sentiment is an important cue for firms embarking on investment. Thus, policy support to ensure a sustained revival in consumption in this budget would also have incentivised manufacturers to invest in expanding capacities to meet what they perceive as rising demand.

The stage is otherwise set for an investment revival — large capex push by the government which would crowd in private investment, soft lending rates, other government policy measures such as the PLI scheme, and healthier corporate balance sheets.

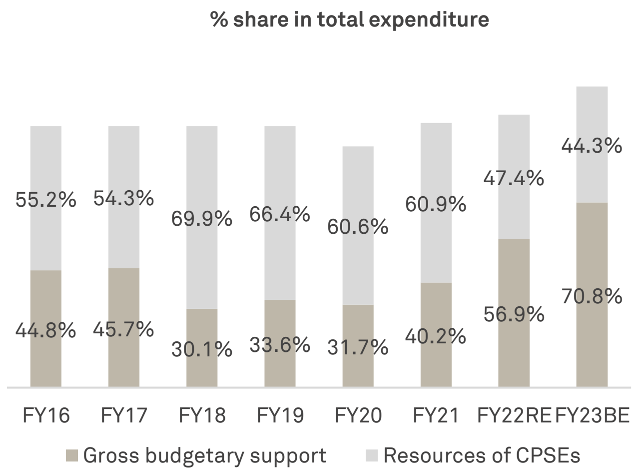
Increased allocation for labour-intensive schemes such as the PM Awas Yojana, PM Gram Sadak Yojana will support incomes/consumption.

From that perspective, the next fiscal should see the rural economy lead the recovery in consumption, with majority of these schemes benefitting the hinterland. Similarly, higher allocation for National Highways Authority of India (NHAI) also favours employment creation.

Capex push remains high on all counts...



...with higher reliance on budgetary resources



*Note: *Effective capex includes capex from budgetary allocation plus revenue grants for creation of capital assets.*
***Total capex is computed by adding capex by central public sector enterprises to effective capex*
Source: Budget documents, CRISIL

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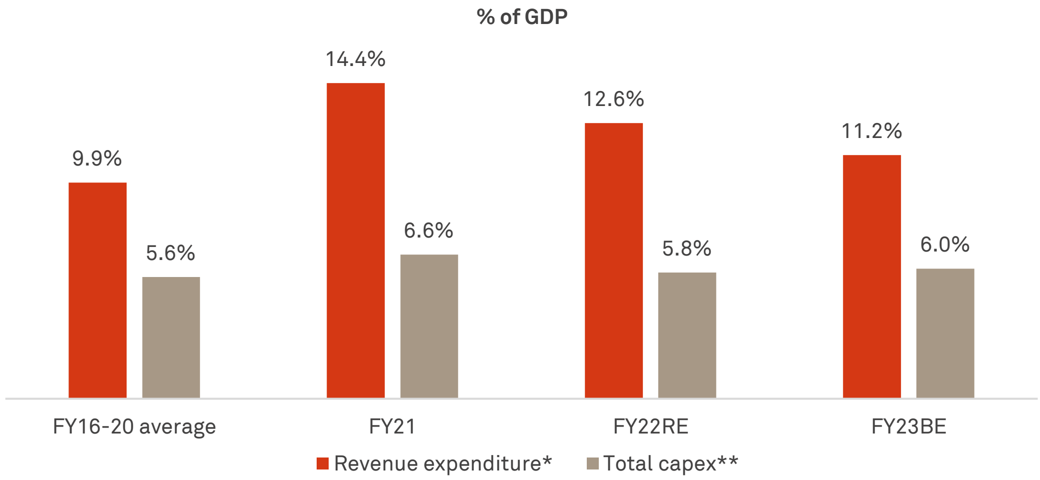
[4] *Advance estimates*
[5] *Second revised estimates*

Mild compression in revenue spending makes way for capex

Capex to swing above pre-pandemic average in FY23



Note: Revenue expenditure is revenue expenditure minus grants-in-aid for capital creation. Total capex is computed by adding capex by CPSEs and grants-in-aid for capital creation to budgetary capex*
Source: Budget documents, CRISIL

- Revenue spending: This has been crawling at a snail's pace in the past two years. The budget normalises some of the revenue spends incurred during the pandemic and also makes way for higher capex. For the next fiscal, it is budgeted to grow less than 1% after growing 2.7% in this fiscal. As a percentage of GDP, revenue spending is therefore budgeted to decline from 13.6% this fiscal to 12.4% in the next, but remain higher than the 11% average seen over fiscals 2016 to 2020. The chart above shows revenue spending after deducting the grants which go towards capital creation. This measure, capturing the actual revenue spends by the government, also reflects this trend
- Capex: Budgetary capex is projected to increase 24.5% for the next fiscal, after growing 41.4% this fiscal. Some of the higher capex this fiscal was on account of settlement dues (Rs 51, 971 crore) paid on behalf of Air India. Excluding this, government capex next fiscal would see a higher growth rate of 36.2%
- Grants for capital creation: Though included by the government in revenue expenditure, it is considered as another leg of capex. Next fiscal, this is expected to rise 33.6% vs only 3% this fiscal. Furthermore, capex is also incurred by CPSEs, which they finance through their own resources, or by way of borrowings. Capex through this route has been declining. It fell 22.2% this fiscal on-year (revised estimates) and is budgeted to decline 6.6% in the next.
- So, the total capex of the central government (budgetary capex plus revenue grants for capital creation and CPSE capex) is budgeted to rise 14.5% next fiscal compared to only 3.1% in this fiscal. Clearly, the reliance on budgetary support remains high.

Winners and losers in government spending

- On the infrastructure side, higher budgetary allocation to NHAI for expanding the highway network, continued support to construction of affordable housing through the PMAY and to rural roads construction through PMGSY, are clear positives. Not only will these improve physical infrastructure, they will also generate mass employment

- MGNREGA, another employment generating cum asset creation scheme, though, has seen a dip in allocation next fiscal, taking it only 1.8% above the pre-pandemic level. Extending this jobs guarantee scheme could have act as a bridge for boosting short-term incomes and consumption in the rural areas, before growth becomes broad-based and the investment cycle kicks off
- Spending has been curtailed towards food subsidies to the Food Corporation of India (FCI) and for procurement of wheat and paddy. Yet, they remain well above pre-pandemic levels, suggesting that the budget is normalising some of these spends

How does the budget spend on major schemes?

Budgetary outlay on select major schemes (Rs crore)	FY20	FY21	FY22RE	FY23BE
Food Subsidy to FCI	75,000	462,789	210,929	145,920
Investment in NHAI	31,691	46,062	65,060	134,015
MGNREGA	71,687	111,170	98,000	73,000
PM Kisan	48714	60990	67500	68,000
Food Subsidy for Decentralized Procurement of Foodgrains	33,508	78,338	75,290	60,561
Jal Jeevan Mission / National Rural Drinking Water Mission	10,030	10,998	45,011	60,000
Pradhan Mantri Awas Yojna (PMAY)	24,964	40,260	47,390	48,000
National Education Mission	33,654	28,088	30,796	39,553
National Health Mission	35,155	37,478	34,947	37,800
Pradhan Mantri Gram Sadak Yojna (PMGSY)	14,017	13,688	14,000	19,000

Higher allocation Lower allocation

Source: Budget documents, CRISIL

Making the room to spend

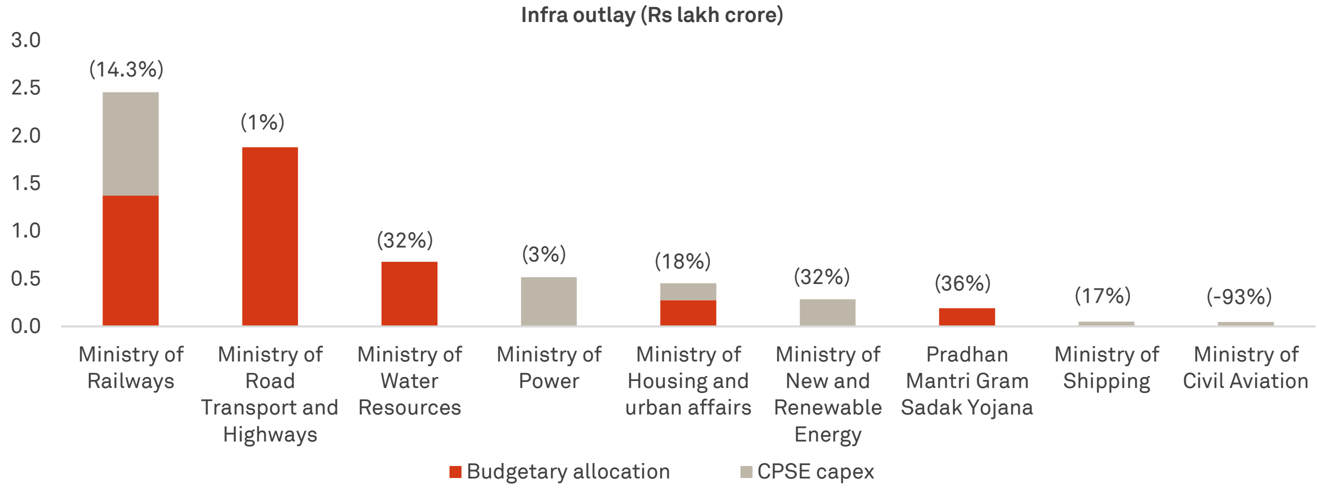
A higher revised fiscal deficit (of 6.9% of GDP compared to 6.8% budgeted for this fiscal), a small reduction (to 6.4%) in the next fiscal and thereafter a gradual reduction to 4.5% by fiscal 2026, creates some room for spending in the current fiscal as well as over the medium term.

The government plans to use this additional space to drive public investment in select infrastructure segments and alongside create employment.

Similar to the previous budget, this one has created incentives to nudge state governments to increase capex by allowing for higher fiscal deficits (at 4.0% of gross state domestic product instead of the FRBM mandated 3%) and also announced assistance by way of long-term interest-free loans to fund capex.

Studies have shown that, for the Indian economy, capex tends to have a much higher multiplier effect than revenue spending, as it crowds in private investments. Of the total fixed investment in the economy, private sector investment comprises ~35%. The rest ~65% comes from the centre and state governments, and public sector enterprises.

How is infrastructure capex being funded?



Source: Budget documents, CRISIL

The fiscal arithmetic

Assessing the GDP target

- The budget has targeted a reduction in fiscal deficit to 6.4% of GDP next fiscal, from 6.9% for fiscal 2022RE
- To arrive at this target, the government has assumed the nominal GDP to grow 11.1% on-year next fiscal. This is lower than the 17.6% growth expected in fiscal 2022[6], but slightly above the average of 10% seen in the five years preceding the pandemic (i.e., fiscals 2016-2020)
- We evaluate this as a conservative estimate. CRISIL expects real GDP growth at 7.8% next fiscal, factoring in a fading impact of the pandemic and broad-basing of economic recovery. At the same time, we expect inflation to remain elevated, driven by high commodity prices. We expect CPI inflation to average 5.2% next fiscal. Due to these factors, we also forecast nominal GDP growth to be higher at 12-13%

How FY23 targets compare with the past

	Average FY16-20	FY22RE	FY23BE
Fiscal deficit (% of GDP)	3.8	6.9	6.4
Nominal GDP growth (y-o-y %)	10.0	17.6	11.1
Revenue growth (y-o-y %)	8.9	27.2	6.0
Expenditure growth (y-o-y %)	10.1	7.4	4.6

Source: Budget documents, CEIC, CRISIL

Assessing revenue targets

- Gross tax revenue is budgeted to grow 9.6% next fiscal, compared with a revised estimate of 24.1% in the current fiscal
- Slower tax revenue growth is expected, given the likely moderation in nominal GDP growth. Nevertheless, we believe the revenue estimates are conservative. We expect nominal GDP and implied inflation to

[6] *First advance estimates, NSO*

materialise at a higher level than assumed by the government, which means an upside to revenue growth as well

- Relative to its own estimate of nominal GDP growth, the government has assumed taxes to grow slower next fiscal. In other words, tax buoyancy[7] is expected at 0.9 in fiscal 2023. While this is lower than 1.4 in fiscal 2022, it is same that seen between fiscals 2016 and 2020, on average
- The convergence of tax buoyancy to pre-pandemic rates appears realistic, in our view. Given this buoyancy, higher nominal GDP than currently assumed by the government would mean an upside to revenue estimates
- Corporate tax, income tax, GST collections and customs are budgeted to see slower growth next fiscal (see table below). Excise duty collections are expected to decline
- Tax buoyancy for corporate taxes, according to government estimates, is expected to be lower next fiscal relative to the current year, but higher than pre-pandemic average. In contrast, for income taxes, it is estimated to be lower, both than this year's and the average
- Robust corporate tax collections are likely, given that the increase in formalisation of the Indian economy during the pandemic has benefited the corporate sector. Recovery in domestic demand is also likely to benefit corporates, as it will enable them to pass through the cost pressures to consumers to a greater extent next fiscal
- As economic recovery strengthens and becomes more broad-based next fiscal, it would improve income tax revenues as well
- For Goods and Services Tax (GST), tax buoyancy is estimated to be higher than last year, but lower than the pre-pandemic average. This is expected, since the boost from improved tax compliance will fade out gradually
- We expect a decline in excise duty collection next, as duties on petrol and diesel will be lower than that seen in most of fiscal 2022. In November 2021, duties on petrol and diesel were reduced by 15.2% and 31.4%, respectively. In our base case of Brent crude prices averaging $80-85 per barrel in 2022, there is unlikely to be a further cut in excise duties next fiscal. However, further increase in prices could force the government to cut duties, which would create a downside on current estimates from these revenue

Composition of tax revenue by key sources

		Growth (y-o-y %)			Tax buoyancy		
		Average FY16-20	FY22RE	FY23BE	Average FY16-20	FY22RE	FY23BE
Total	Gross tax revenue	10.3	24.1	9.6	0.9	1.4	0.9
Direct tax	Corporate tax	6.1	38.7	13.4	0.3	2.2	1.2
	Income tax	14.0	26.2	13.8	1.3	1.5	1.2
Indirect tax	GST	17.2*	23.0	15.6	1.7*	1.3	1.4
	Excise duties	9.3	0.6	-15.0	0.9	0.0	-1.3
	Customs	-7.9	40.3	12.7	-0.8	2.3	1.1

*Note: *Average of FY19 and FY20; tax buoyancy numbers for FY23 are based on government's nominal GDP growth assumption of 11.1%*
Source: Budget documents, CEIC, CRISIL

[7] *Ratio of tax revenue growth to nominal GDP growth*

Disinvestment targets pared to realistic levels

The government has significantly reduced reliance on disinvestments for garnering revenue.

Disinvestment proceeds are budgeted to decline to Rs 65,000 lakh crore next fiscal. This follows a sharp downward revision to Rs 78,000 crore (RE), from Rs. 1.75 lakh crore (BE) for this fiscal. Going by the government's dismal disinvestment track record, it is just as well that it has brought down the fiscal 2023 target to more realistic levels. It is now similar to the average annual disinvestment of Rs 66,986 crore seen in the five years preceding the pandemic (i.e. fiscals 2016-2020).

The tightening of financial conditions amid monetary policy normalisation could further add challenges in raising capital by divestment in the coming fiscal.

Clean-up of government's balance sheet, a work in progress

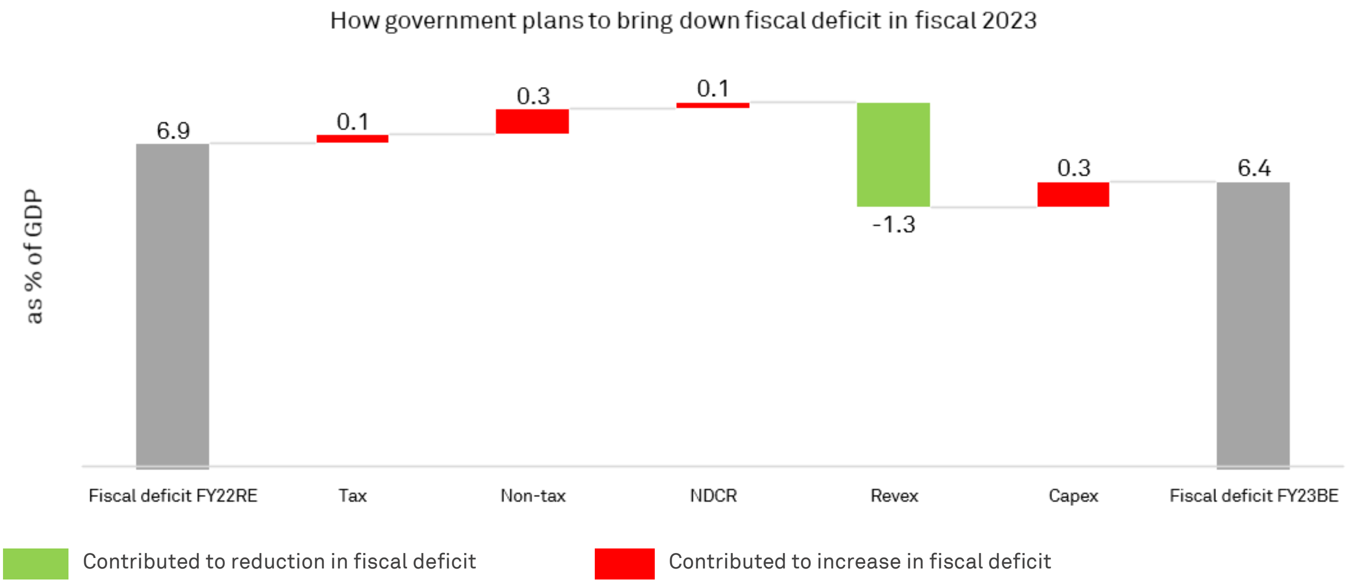
In efforts to improve transparency, the government has reduced its recourse to off-budget borrowings in the budget and is gradually paying back the public sector enterprises it has borrowed from. In the past, the government funded subsidies on items such as food, fertiliser, and oil by way of 'special' bonds raised through the FCI, fertiliser companies, and oil marketing companies (OMCs).

These debts are being paid down. According to its statement of liabilities, it reduced the outstanding debt on account of special securities to these entities to Rs 1.5 lakh crore in fiscal 2022 from Rs 1.6 lakh crore previous fiscal. This is further budgeted to decline to Rs 1.4 lakh crore next fiscal.

How the government plans to slowly consolidate the deficit next fiscal

The budget's lower estimate for fiscal deficit next fiscal by 50bps (from 6.9% to 6.4% of GDP) could be attributed to lower revenue expenditure, even as relatively lower receipts and higher capex contribute to increasing it:

- Normalisation of some of the revenue spends incurred during the pandemic (e.g. lower vaccination requirement) mean that the government has budgeted for a marginal growth in revenue expenditure (of less than 1% over fiscal 2022RE). As a percentage of GDP, this brings revenue expenditure down to 12.4% next fiscal, from 13.6%: contributing to a reduction in the deficit
- Lower receipts are budgeted to add to fiscal deficit due to slower tax revenue growth in fiscal 2023BE, both compared to fiscal 2022RE and the government's nominal GDP growth assumption. Non-tax and non-debt capital receipts too, are budgeted to slow down (as percentage of GDP) in the next fiscal
- Budgetary support to capex too, is projected to add to fiscal deficit, as it is expected to increase to 2.9% of GDP in fiscal 2023RE, from 2.6% in the current fiscal.



Note: NDCR= Non-debt capital receipts, Revex= Revenue expenditure, Capex= capital expenditure
Source: Union budget documents, CRISIL

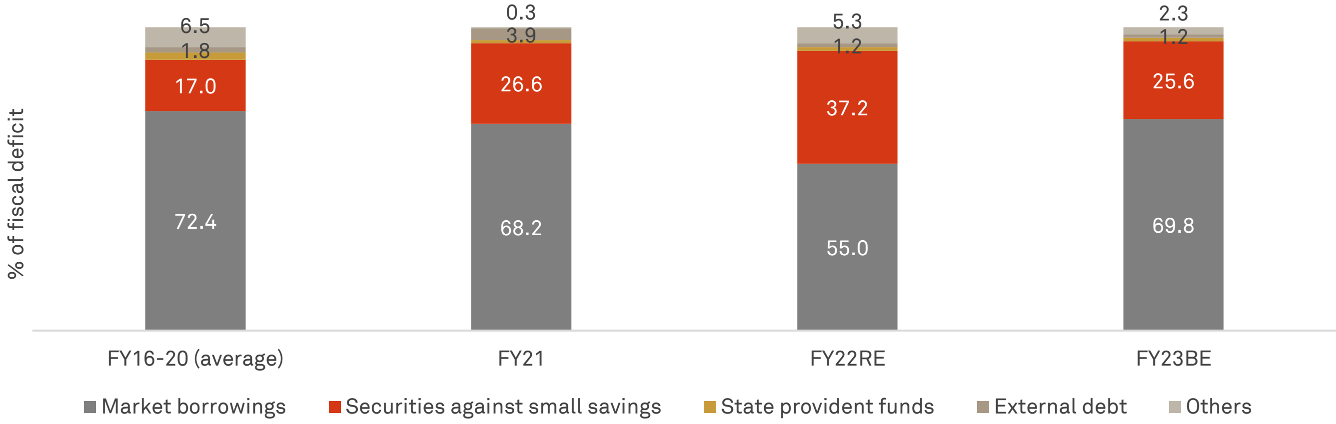
Financing next year's fiscal deficit

The central government's fiscal deficit is budgeted to narrow to 6.4% of GDP next fiscal, from an upwardly revised 6.9% in fiscal 2022RE. In absolute terms, though, fiscal deficit in fiscal 2023BE, at Rs 16.6 lakh crore, is 4.4% higher than the Rs 15.9 lakh crore deficit for fiscal 2022RE.

Along with the increase in fiscal deficit, we see some change in the sources of deficit financing, too, compared with fiscal 2022RE:

- **Market borrowings:** As much as 69.8% of fiscal 2023 deficit is expected to be financed through market borrowings. Net market borrowing is budgeted to increase a sharp 32.3% to Rs 11.6 lakh crore in fiscal 2023BE (from Rs 8.75 lakh crore in fiscal 2022RE). This is also much higher than the pre-pandemic levels (Rs 6.2 lakh crore in fiscal 2020), indicating that supply pressure on G-sec yields will continue for some time (*see Box: Yields under the pump*)
- **Borrowing from NSSF** is budgeted to come down by 28% in fiscal 2023BE, despite the rise in fiscal deficit in absolute terms. The reliance on small savings securities is expected to reduce to financing 25% of the deficit in fiscal 2023BE (from more than 37% share in fiscal 2022RE). This is, however, much higher compared with the pre-pandemic average of 17%.
- **External debt**, after moderating in fiscal 2022RE, is expected to further decline in fiscal 2023BE by 2.5%. It is budgeted to finance a small proportion of the deficit, at 1.2%.

Sources of deficit financing



Note: 'Others' include drawdown of cash balance and other receipts
Source: Union budget documents, CRISIL

Yields under the pump

The budget indicates that fresh supply of G-secs in the market — as evident in the gross market borrowing estimate — will increase to Rs 14.95 lakh crore next fiscal from Rs 10.47 lakh crore this fiscal. This will be much higher than the pre-pandemic level of Rs 7.1 lakh crore in fiscal 2020.

Higher borrowings will increase the pressure on bond yields, along with other macroeconomic factors, such as:

1. **Rate hikes:** We expect the Monetary Policy Committee of the RBI to hike the repo rate by 25 basis points (bps) during its April 2022 review meeting. By the end of fiscal 2023, we see at least two more rate hikes of 25 bps each, which will take the repo rate to 4.75% by March 2023.
2. **Lower RBI support to G-secs:** The RBI is likely to continue draining excess liquidity that it had provided in the two years of the pandemic. This would require a reduction of G-sec purchases, or even selling them via open market operations (OMOs).
3. **Monetary tightening by the US Federal Reserve:** The US Federal Reserve is scheduled to end its net asset purchases programme, or quantitative easing, by early March 2022. Following this, S&P Global expects the Fed to raise its policy rate at least thrice, by 25 bps each time, in 2022, starting March and take steps for balance sheet normalisation in 2023. That would mean the Fed's exit from its pandemic-era stimulus will be quicker than what was seen after the Global Financial Crisis. This will tighten global financial conditions, and affect capital flows to emerging markets such as India.
4. **High crude prices**: The price of crude has been among the key drivers of G-sec yields in India. Being the biggest import item, it impacts the current account deficit, exchange rate, inflation, and, at times, even the fiscal deficit. Our base-case assumption for average crude oil price in 2022 is $80-85 per barrel, significantly higher than $70.4 per barrel last year. This can put pressure on G-sec yields, especially as the RBI's support through OMOs reduces.

We expect yield on the benchmark 10-year G-sec to rise to 7% by March 2023 (with risks tilted to the upside), compared with an expected 6.8% in March 2022.

Rising repayment obligations keep gross borrowings high

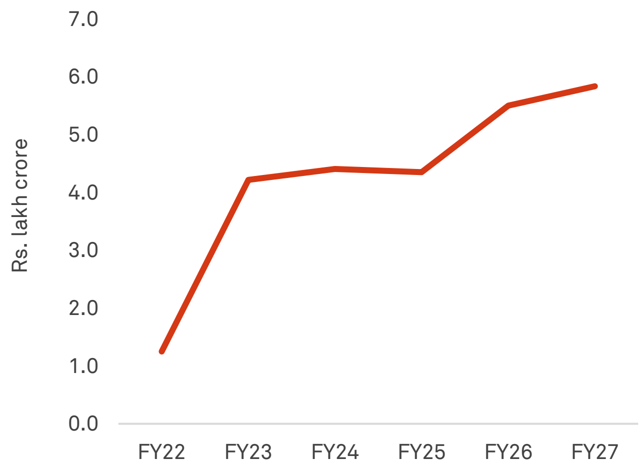
Even though fiscal deficit for next fiscal is projected to be lower than fiscal 2022RE, the central government's debt-to-GDP ratio is budgeted to be higher. With high deficits in the previous two fiscals — 9.2% of GDP in fiscal 2021, the first year of the pandemic, and 6.9% in this fiscal RE — the central government's debt to GDP ratio, too, has risen (from 59.9% this fiscal 2022RE to 60.2% in fiscal 2023BE). This includes all liabilities contracted by the Consolidated Fund of India (including external debt valued at current exchange rate), all outstanding liabilities on public account, and extra budgetary resources liabilities raised through fully serviced bonds.

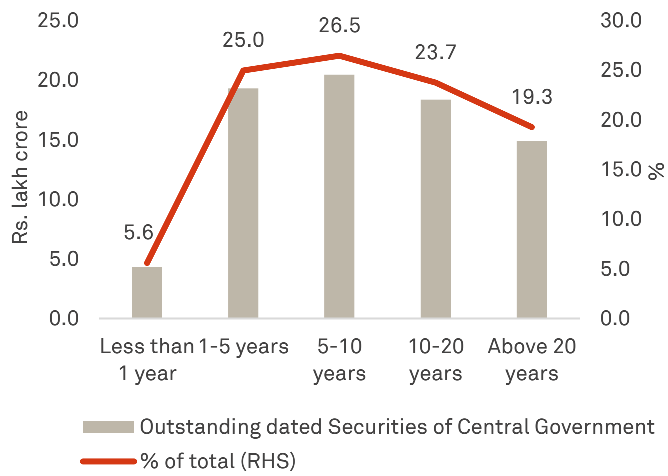
With the rise in debt stock, redemption pressure is also building. According to the FRBM statement made under the Budget, more than 30% of the central government's outstanding debt will mature in the next five fiscals, which will increase repayment obligations. The RBI's Financial Stability Report of December 2021 said given the rising obligations, 'gross borrowing is likely to remain elevated notwithstanding fiscal consolidation'. This is indeed the case: gross borrowings (= fresh issuances) are set to increase to Rs 14.95 lakh crore in fiscal 2023BE compared with Rs 10.46 lakh crore in fiscal 2022RE. As borrowings remains high to repay debt, associated interest cost could also rise. The weighted average yield of securities issued up to the December quarter of this fiscal rose to 6.22%, compared with 5.79% last fiscal *(see Box: The rising cost of government borrowings).*

That said, the central government did a conversion/switch operation with the RBI on January 28 for securities maturing in fiscal 2023, 2024 and 2025. In turn, it issued longer-tenure securities maturing between fiscal 2028-2030. The switch was done with the objective of 'smoothening the liability profile' — implying the rollover of maturing debt to future would lessen the immediate repayment burden.

Maturity profile of Centre's outstanding dated securities

*Rising stock of securities maturing in the next five years (graph on the left) account for 30% of total outstanding securities of the central government (graph on the right)**





Note: Data as of September 2021; this does not take into account the government's switch operations of January 28, 2022 which are likely to impact its' securities' maturity profile
Source: Ministry of Finance, CRISIL

The fiscal roadmap to deficit and debt reduction

Even if the budget estimates the fiscal deficit at 6.4% of GDP for the next fiscal, lower than the 6.9% for this year, it will be higher than the 3.1% rolling target envisaged for next fiscal in the Budget 2021 (prior to the onset of Covid-19). Given the economy is still battling the scars from the pandemic, this budget has outlined the need to continue deviation from the Fiscal Responsibility and Budget Management Act.

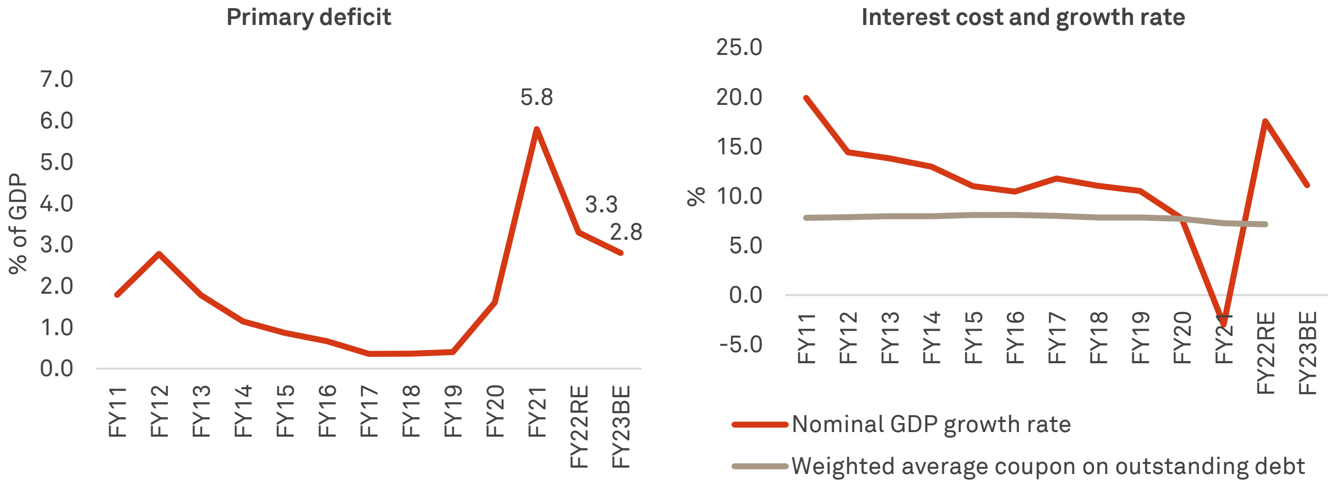
Last fiscal, the government had refrained from indicating a medium-term path for central government debt and fiscal deficit, stating, 'Covid-19 related uncertainty makes any forecast of economic growth and fiscal variables including the specification of a return path challenging'. It had said that return to fiscal consolidation will be possible after economic growth and receipts return to their long-run averages. In this budget, too, debt-deficit projections for fiscals 2024 and 2025 have not been presented, citing the need to retain 'fiscal flexibility' to respond to contingencies, in light of the pandemic. However, the budget did reiterate previous fiscal's indication of attaining a level of fiscal deficit lower than 4.5% of GDP by fiscal 2026. On debt, there is no such guidance.

Irrespective, the sustainability of debt will be guided by how primary deficit (fiscal deficit excluding interest payments) behaves and how interest cost minus nominal growth, or the 'i-g' differential, moves. A persistently negative i-g would imply debt ratios could be reduced even if a primary deficit exists.

During fiscals 2011-19, the centre's primary balance, though in deficit, was declining, and the i-g differential was also negative. As a result, central government debt went down from 53.2% of GDP in fiscal 2011 to 49.9% in fiscal 2019. With primary deficit widening in fiscal 2020, and growth slowing, debt stock rose again. The pandemic years of fiscals 2021 and 2022 added to the burden.

The same factors will influence the debt path going forward. As outlined in the earlier section, interest cost is already trending up this fiscal, and is likely to rise further as recovery takes hold. Hence, faster growth will become critical for bringing down debt.

Lower primary deficit and 'i-g' differential to determine debt path of the central government



Source: Union budget documents, CRISIL

Outlook for FY23

Macro variable	FY22	FY23	Rationale for outlook
Real GDP growth (%, y-o-y)	9.2*	7.8	Lower growth next fiscal would be mainly due to this fiscal's high base. Growth will continue to be supported by investment (largely government, but also private in some pockets, and driven by the PLI scheme to an extent). Consumption will revive only gradually
CPI inflation (y-o-y, %)	5.5	5.2	Inflation is expected to remain elevated — above the mid-point of the RBI's target of 2-6% — for the third year in a row. Firms are expected to pass on cost pressures to a greater extent as domestic demand strengthens next fiscal. While higher crude oil prices will add pressure, it will be partially offset by lower excise duties on petroleum products relative to last year.
Repo rate (fiscal-end, %)	4.00	4.75	Normalisation of monetary policy is expected to gain pace as economic recovery strengthens and inflation risks remain elevated. Rate hikes by the Fed will further constrain space for monetary easing by the RBI. We expect three repo rate hikes of 25 bps each next fiscal, starting from April 2022.
10-year G-Sec yield (fiscal-end, %)	6.8	7.0^	Increase in gross market borrowing by the government, rate hikes by the RBI and the Fed, and surging crude oil prices will impose pressure on yields next fiscal
Exchange rate (fiscal-end, Rs/$)	75	76	The Fed's tapering of its asset purchases and raising its policy rate are expected to impose downward pressure on the rupee as demand for the dollar increases. And widening of the current account deficit will add to the depreciation pressure on the rupee
Current account balance (% of GDP)	-1.4	-1.8	The current account balance is expected to slip further into deficit as trade deficit widens, with imports increasing as Brent crude oil prices rise and domestic demand improves. External demand may not support exports next fiscal to the extent seen it happened this fiscal, as global growth is seen slowing

** NSO estimate; ^with upside risk*

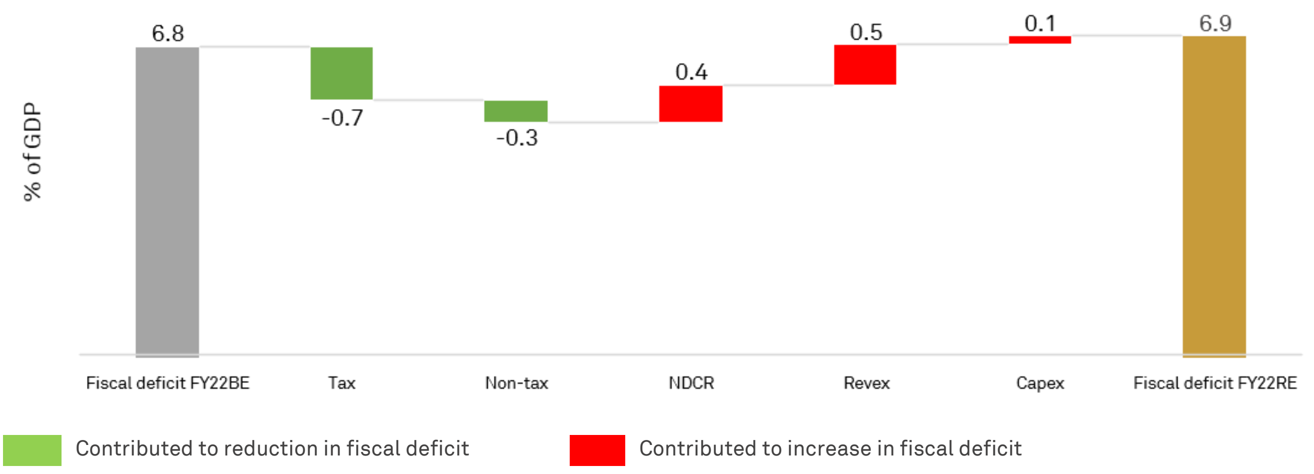
Annexure

How the deficit target exceeded this fiscal

In the second year of the pandemic, the central government just about overshot its fiscal deficit target of 6.8% of GDP in fiscal 2022BE to 6.9% in fiscal 2022RE. Budget documents said the slippage is because of 'surge in socio-economic welfare-related expenditure' on account of successive pandemic waves and settlement of past Air India dues.

- In fiscal 2022RE, tax revenue grew 14.2% over fiscal 2022BE. The increase was broad-based across direct and indirect taxes — income tax, corporate tax, GST and and excise duties. The recovery in economic activity after the second wave, higher nominal growth (due to higher prices) and high excise duty on fuels until November, helped tax collections rise above budget estimates. The overachievement in tax revenues helped ensure the revised fiscal deficit for this year was not too off the budgeted mark.
- Non-tax revenue collections also grew by a robust 29.1% over the budgeted receipts of fiscal 2022, pushed up by larger dividend from the RBI (which grew almost 90% from fiscal 2022 BE to RE)
- Collection of non-debt capital receipts, particularly disinvestment, continued to disappoint as they were lower by about 55.4% over budget estimates
- With the pandemic in the second year, and the extension of welfare expenditure requirements (such as the free food grain scheme, PM Garib Kalyan Ann Yojana) and rising interest payments, total expenditure as per fiscal 2022RE was thus 8.2% higher than the budget estimates.

How the fiscal deficit changed between FY22 BE and RE



Note: NDCR= Non-debt capital receipts, Revex= Revenue expenditure, Capex= capital expenditure
Source: Union budget documents, CRISIL

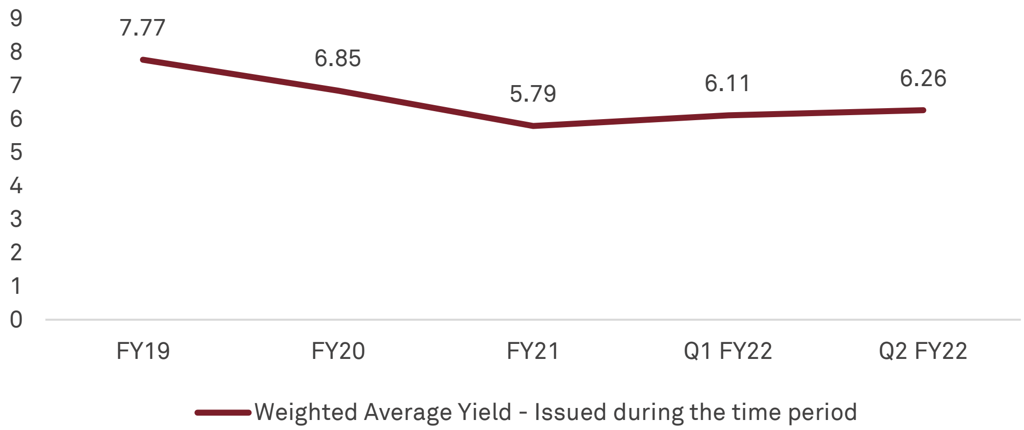
Rising cost of government borrowings

The Centre's cost of borrowing had been declining even before the pandemic, thanks to rate cuts by the RBI. In February 2020, the repo rate was 5.15%, down from 6.25% in end-fiscal 2019. In fiscal 2020, the government's borrowing cost, too, was down at 6.85%, from 7.77% the previous fiscal *(see the chart below).*

Responding to the deep impact of the pandemic on the economy, the RBI further brought down repo rate to 4.00%. Not just that, it also took a number of unconventional steps 'in order to maintain the orderly market conditions along with ensuring that the financial needs of the governments are met, while keeping in mind the major objectives of cost minimisation, risk mitigation and market development'.

Subsequently, the government's weighted average cost of borrowing fell to a 17-year low of 5.79% in fiscal 2021. With the marginal cost of borrowing coming down significantly, the average cost of borrowing (on the outstanding stock) as of end-fiscal 2021 stood at 7.27%, down from 7.71% a year ago.

But this fiscal, as the RBI started normalising its ultra-easy monetary policy, the weighted average cost of borrowing has started going up again. It stood at 6.26% in the second quarter. With 10-year G-sec yield rising and the expected policy rate hikes next fiscal, weighted average cost, i.e., the marginal cost of borrowing is set to go up further. This could also push the average cost of borrowing up with a lag.



Source: Ministry of Finance, CRISIL

Capital markets

Budget impact

Neutral

Key budget announcements

Fiscal deficit and market borrowing

- Government to borrow Rs 11.6 lakh crore from the market in fiscal 2023, with gross borrowing at Rs 14.95 lakh crore
- Fiscal deficit at 6.9% in fiscal 2022 versus the budget estimate of 6.8%, down from 9.2% in fiscal 2021. It is expected to reduce to 6.4% in fiscal 2023 and further to 4.5% by fiscal 2026
- An additional Rs 1 lakh crore as interest free loans for a tenure of 50 years to be provided to the states next fiscal to catalyse investments
- Green bonds to be issued next fiscal for mobilising resources for green infrastructure

Financial inclusion, digital banking and investments

- Digital payments and digital banking to be promoted. All 1.5 lakh post offices to be included in the core banking system; 75 digital banks to be set up
- Government to launch thematic funds to finance sunrise opportunities in the country. Financing of these funds would be blended with 20% government share and these funds will be managed by private fund managers
- An expert committee will be set up to examine and suggest appropriate measures to scale up venture capital (VC) and private equity (PE) funds
- The surcharge on long-term capital gains (LTCG) tax to be rationalised, capped at 15% for all assets
- Provisions related to bonus and dividend stripping to be made applicable to securities and units, including infrastructure investment trusts (InvITs), real estate investment trusts (REITS) and alternative investment funds (AIFs)

Digital assets

- Government to introduce central bank digital currency (CBDC) in fiscal 2023
- Digital assets to be taxed at 30% for any income from transfer of such assets; loss from these assets not to be set off against any other income. Tax deducted at source (TDS) to be charged at 1% for transfer of assets; a gift of such assets to be taxable in the hands of the recipient

Other measures

- State government employers' contribution to the National Pension System (NPS) hiked from 10% to 14%
- The government procurement process to be enhanced to improve transparency and reduce delays. Surety bonds, as per the framework provided by the Insurance Regulatory and Development Authority of India (IRDAI), can be used as a substitute for bank guarantee in government procurement

Impact

Fiscal deficit and market borrowing

The market was expecting lower fiscal deficit target on the back of improved tax collections. The recent government security (G-sec) swap with the RBI had also strengthened sentiment. But the announcement of a higher deficit (and, hence, likely higher primary G-sec issuance) could put upward pressure on yields in the short term. Further, higher market borrowing will equal higher supply even after the adjustment of redemptions next year. Additionally, the G-sec market would be skeptical about foreign investor support amid a rise in interest rates globally.

The plan to launch sovereign green bonds will allow for setting up of a benchmark rate and will accelerate the increasing funding coming through this route. There could be demand from foreign portfolio investors (FPIs) as well for their specific set of clients, though it will depend on the actual issuance size, operational modalities such as issuance cost, demand for Indian government paper, and tenor. However, we will have to wait for it to take real shape to gauge the actual impact.

Financial inclusion, digital banking and investments

The government's continuing focus on digital payments and digital banking will materially enhance financial inclusion in the country, especially in the rural areas, while linking post offices to core banking will deepen penetration.

The move to promote PE and VC funds is a win-win, both for the investment climate in the country and the underlying start-ups they invest in.

Meanwhile, the government has also worked on rationalising the tax structure wherever disparities existed. Surcharge on LTCG tax for equity mutual funds and securities has been capped at 15%, but is based on the income tax slabs for other capital assets such as property, unlisted shares and artefacts. The new rule will bring parity so that all investment options are on a level-playing field.

The government has also plugged the tax loophole for InvITs, REITS and AIFs, which were allowed to strip dividends and bonus shares to reduce tax liability for investors. Earlier, this rule covered only mutual funds and listed stocks.

Digital assets

The introduction of CBDC will deepen digital penetration of finance in the country. Meanwhile, taxation of digital assets such as cryptocurrencies and non-fungible tokens (NFTs) suggests there is no immediate move to do away with them — which provides clarity to investors.

Other measures

Hike in state government employers' contribution to NPS will bring in parity between central and state government employees and enhance social security benefits. Further, formal laws governing surety bonds by the IRDAI and the government's promotion of these bonds for their contracts are a good augury for the insurance industry, giving them an additional business opportunity while improving the credit profile of such projects.

Sectoral impact

Automobiles

Neutral

Key budget announcements

- A battery swapping policy will be introduced with focus on interoperability standards
- Energy storage systems, including dense charging infrastructure and grid-scale battery systems, will be included in the harmonised list of infrastructure
- Allocation for the National Highways Authority of India (NHAI) and the Pradhan Mantri Gram Sadak Yojana (PMGSY) has been increased by ~3% and ~36%, respectively, versus fiscal 2022RE
- Allocation for Department of Food and Public Distribution is budgeted at Rs 2,15,959 crore for the next fiscal, which is 28% and 15% lower than fiscal 2022RE and fiscal 2022BE, respectively

Sr no	Schemes	FY21 actuals (Rs crore)	FY22RE (Rs crore)	FY23BE (Rs crore)
1	Faster Adoption and Manufacturing of Hybrid and Electric Vehicles (FAME II)	318	800	2,908
2	NHAI	111,097	130,060	134,015
3	PMGSY	13,687	14,000	19,000

Source: Union Budget 2022-23

Impact

- Given that batteries account for ~40% of the cost of an electric vehicle (EV), standardising battery swapping infrastructure will accelerate economies of scale and hasten EV adoption, which currently stands at less than 1% for the automobile segments
- Battery swapping and interoperability will propel EV adoption for commercial use (three-wheelers, taxis and light commercial vehicles), as this would reduce waiting time for charging, enabling higher asset utilisation and supporting operator profitability
  - This could also provide impetus to newer business models, wherein vehicles can be sold without fixed batteries, and batteries can be availed on a pay per basis. This is expected to reduce acquisition cost for buyers
- Inclusion of energy storage systems in the harmonised infrastructure list would reduce borrowing cost for charging service providers and battery swapping entities
- Spends on roads maintained at the high level seen in 2022, with 3% incremental allocation, which is expected to support sales of medium and heavy commercial vehicles
- For PMGSY, while allocation has increased by a meaningful 36%, the achievement ratio over the past few years has not crossed 70%, so the benefits could be limited
- Decline in food subsidy bill by 28% next fiscal compared with fiscal 2022RE will lead to lower crop procurement by government, thereby having a negative bearing on farm income. This does not bode well for the two-wheeler and tractor industry

Agriculture and rural

Neutral

Key budget announcements

- Allocation to the Department of Agriculture, Cooperation and Farmers' Welfare (DACFW) has increased 4% over fiscal 2022RE
- Allocation under the Department of Rural Development (DoRD) declined 11% over fiscal 2022RE. MGNREGA (56% share in allocated budget under DoRD) has seen 26% decline over fiscal 2022RE, but is similar to fiscal 2022BE levels
- Fertiliser subsidy has been cut 25% for the next fiscal compared with fiscal 2022RE. However, fertiliser subsidy for fiscal 2022RE is 76% higher than fiscal 2022BE. Urea subsidy has reduced 17%, while nutrient subsidy has declined 35% for fiscal 2023 over fiscal 2022RE.
- Allocation for the Livestock Health and Disease Control Programme has been increased to Rs 2,000 crore in fiscal 2023 from Rs 886 crore in fiscal 2022RE
- Minimum alternative tax (MAT) for cooperative societies has been cut to 15% from 18.5%. Further, surcharge on cooperative societies has been reduced to 7% from 12% for those with revenue between Rs 1 crore and Rs 10 crore
- Allocation towards Production Linked Incentive (PLI) Scheme in food processing has been increased to Rs 1,022 crore from Rs 10 crore
- Rs 900 crore and Rs 600 crore have been allocated under the edible oil-oil palm and edible oil-oilseeds schemes for next fiscal, respectively. As per fiscal 2022RE, only Rs 100 crore had been allocated under National Mission on Edible Oils (Oil Palm)
- Allocation of Rs 60 crore to digitalise agriculture for fiscal 2023. However, its share in the Ministry of Agriculture and Farmers' Welfare's (MoA&FW) total allocation is negligible

Allocations under various government schemes

Sr no	Parameter	FY22BE (Rs crore)	FY22RE (Rs crore)	FY23BE (Rs crore)	Growth in FY23BE over FY22RE(%)	5 year CAGR (FY18RE-FY23BE)
1	Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)	73,000	98,000	73,000	-26%	6%
2	Pradhan Mantri Gram Sadak Yojana (PMGSY)	15,000	14,000	19,000	36%	2%
3	Pradhan Mantri Awas Yojana(Rural)	19,500	20,389	20,000	-2%	-2%
4	Pradhan Mantri Fasal Bima Yojana (PMFBY)	16,000	15,989	15,500	-3%	10%
5	Market Intervention Scheme (MIS) and Price Support Scheme (PSS)	1500	3595	1500	-58%	16%
6	Pradhan Mantri Annadata Aay Sanrakshan Abhiyan (PM-AASHA)	400	1	1	0%	NA
7	Pradhan Mantri Kisan Samman Nidhi (PM-Kisan)	65,000	67,500	68,000	1%	NA
8	Food subsidy	2,42,836	2,86,469	2,06,831	-28%	16%
9	Agriculture Infrastructure Fund	900	200	500	150%	NA

Sr no	Parameter	FY22BE (Rs crore)	FY22RE (Rs crore)	FY23BE (Rs crore)	Growth in FY23BE over FY22RE(%)	5 year CAGR (FY18RE-FY23BE)
10	Formation and Promotion of 10,000 Farmer Producer Organizations (FPOs)	700	250	500	100%	NA
	Total (MoA&FW, MoRD, Department of Fertilizers and Department of Food and Public Distribution	**6,03,529**	**7,27,267**	**5,95,858**	**-18%**	**13%**

Note: MoA&FW: Ministry of Agriculture and Farmers' Welfare; MoRD: Ministry of Rural Development

Impact

- Total budget allocation for MoA&FW, DoRD and Department of Fertilizers has declined 11% over fiscal 2022RE, but shows a 9% increase over fiscal 2022BE
  - MGNREGA included under DoRD allocations provides income support to 34% of rural households. Therefore, a 25% decrease in allocation over fiscal 2022RE is anticipated to impact rural income
  - Fiscal 2022RE for fertiliser subsidy is more than enough to take care of the current subsidy, which is due to manufacturers. While allocation has been reduced for the next fiscal, it is in line with expectations for a reduction in key inputs such as gas and phosphorus. No carry-forward of subsidy is a positive for fertiliser manufacturers
- Allocation for food subsidy has decreased ~25% for next fiscal over fiscal 2022RE. This has been necessiated due to higher than buffer stocks for wheat and rice with Food Corporation of India. Procurement for wheat and paddy reached record highs last year at 40% and 44% of production, respectively. Lower allocation implies a decline in government procurement for crops at minimum support price (MSP), which is expected to have a negative bearing on farmer income
- Owing to the second wave of Covid-19 in fiscal 2022, most farmers invested less in animal health as most of their earnings were used for human medical care. Many skipped the artificial insemination cycle, which led to lower milk production. Higher allocation towards animal health will aid better artificial insemination services, resulting in better yields, and prevent foot and mouth disease among animals
- MAT for all cooperatives has been reduced to 15% from 18.5%, which will lower the tax burden for dairy cooperatives (who procure ~50% of the milk marketable surplus). Further, small cooperatives with revenue of Rs 1 crore-10 crore will benefit from a reduction in surcharge to 7% from 12%. This is expected to improve their profitability, thereby supporting farmer income
- Increased allocation for the PLI scheme in the food processing sector will boost export of value-added products, thereby fetching higher realisations for food processors
- Higher allocation to support oilseeds production (Rs 1,500 crore budgeted for next fiscal) is expected to reduce import dependency to 36% from 52% in the next five years
- Allocation for digitalising agriculture at Rs 60 crore, though considerably low for widespread impact, will aid pilot projects across India

Banking

Neutral

Key budget announcements

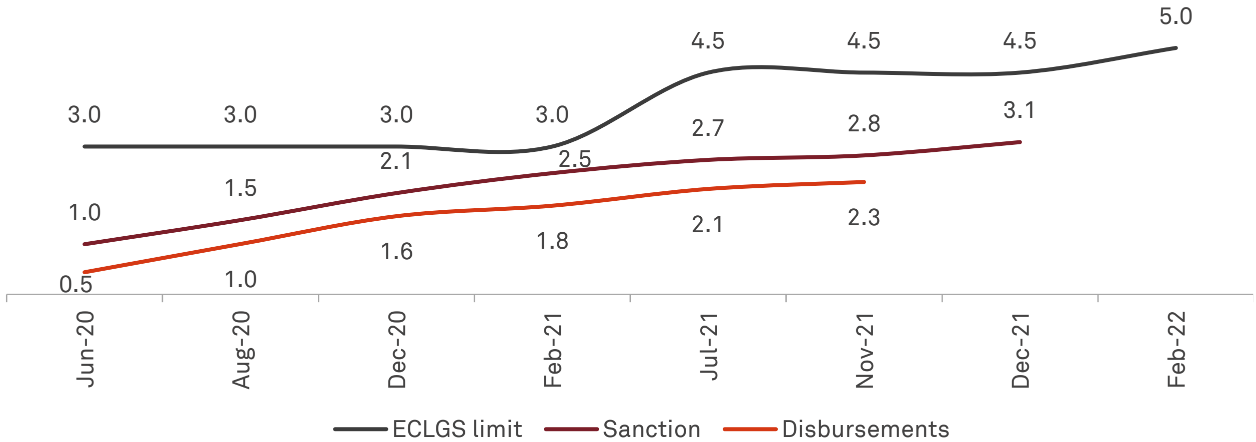
- Allocation under Emergency Credit Line Guarantee Scheme (ECLGS) increased from Rs 4.5 lakh crore to Rs 5.0 lakh crore, and the timeline for sanctions has been extended till March 2023. The enhancement of Rs 50,000 crore will be earmarked exclusively for hospitality and related enterprises
- National Bank for Financing Infrastructure and Development and National Asset Reconstruction Company Ltd (NARCL) have commenced operations
- Recapitalisation provision for public sector banks (PSBs) has been revised to Rs 15,000 crore compared with the budgetary allocation of Rs 20,000 crore for fiscal 2022. For regional rural banks, recapitalisation provision of Rs 1,361 crore has been budgeted for fiscal 2023 compared with revised estimate of Rs 4,084 crore for fiscal 2022
- Proposal to add 1.5 lakh post offices to the core banking system to enable financial inclusion and access to accounts through net and mobile banking, and ATMs; and provide online fund transfers between post office and bank accounts

Impact

- ECLGS was announced as a part of Atmanirbhar Bharat Package in 2020, with the objective to support businesses, including micro, small and medium enterprises, to meet their operational liabilities and resume operations amid the pandemic-induced distress. The scheme coverage and limit were enhanced in the past two years. As of November 2021, the scheme recorded 63% utilisation (in terms of sanctions), of which 80% guarantees were already issued
- After a sequential growth of 65% in the third quarter of fiscal 2022, domestic passenger traffic declined 30% on-quarter in the first two weeks of January 2022. This will further stretch recovery of the tourism sector. Hence, extension of the ECLGS by a year and additional limit of Rs 50,000 crore will benefit vulnerable sectors such as travel and tourism

ECLGS progress

(Rs lakh crore)



Note: Disbursement data for December 2021 is not provided by the respective authority
Source: CRISIL Research

- Total gross non-performing asset (NPA) of scheduled commercial banks aggregated Rs 8.3 lakh crore in March 2021. Banks have identified 38 accounts totalling Rs 82,845 crore to be transferred to NARCL in a phased manner. So far, banks have finalised plans to transfer 15 NPAs totalling ~Rs 50,000 crore to ease stress by this fiscal-end. Transference of bad loans to NARCL will potentially result in banks freeing capital for growth. However, modalities around possible haircut and provision reversal remain monitorable
- In fiscal 2022BE, provision of Rs 20,000 crore was made for recapitalisation of banks, of which Rs 11,500 crore was disbursed to three banks – UCO Bank, Indian Overseas Bank, and Central Bank of India. Further, average capital to risk assets ratio for PSBs increased from 12.11% in fiscal 2020 to 14.57% in fiscal 2021, because of improved profitability of PSBs and capital infusion in the past. Owing to this, recapitalisation will unlikely be required soon
- As on March 31, 2020, the Department of Post had a network of 156,721 post offices, of which 90% were located in rural areas. As physical banking penetration in rural area is limited, linking post offices with the core banking system will enable interoperability and improve financial inclusion
- Credit growth to the wholesale sector (64% of outstanding bank credit as of March 2021), which has been muted so far, is expected to pick up amid improving utilisation and PLI-linked capex. CRISIL Research expects bank credit to grow 10-12% in fiscal 2023 over an 8-10% growth in fiscal 2022. However, given that the RBI has started normalising its monetary policy from this fiscal, weighted average cost of borrowing has started going up again. Hence, net interest margins remain monitorable amid high competition in retail segments

Infrastructure

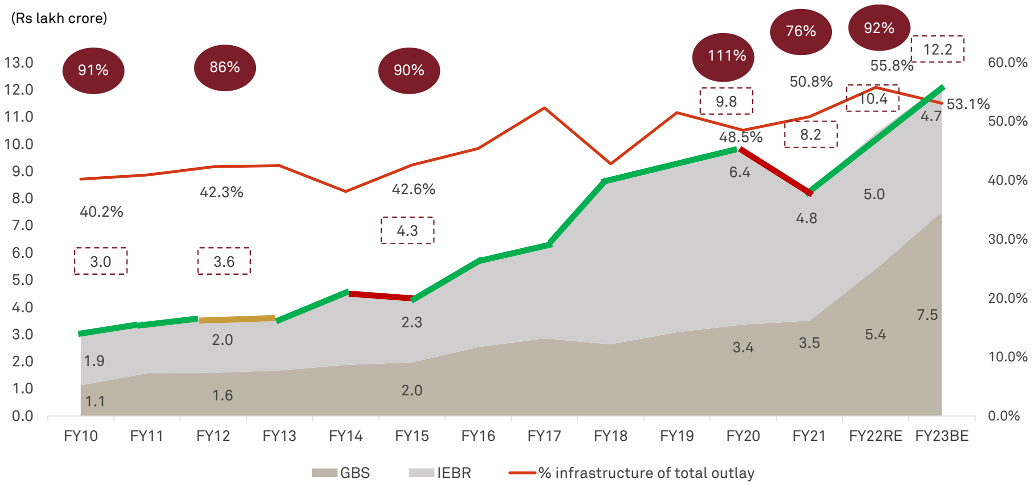
Positive

Key budget announcements

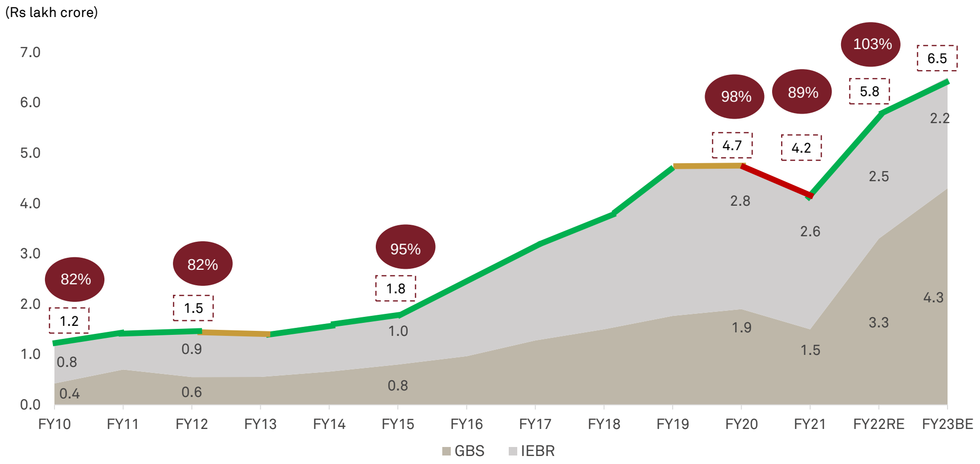
- At Rs 7.5 lakh crore, aggregate budgetary support (gross budgetary support or GBS) for capex next fiscal is up 39% over fiscal 2022RE. For infrastructure sectors, budgetary support is 30% up at Rs 4.3 lakh crore. These exclude Rs 62,057 crore equity infusion into AI Assets Holding Ltd (AIAHL) in fiscal 2022RE
- PM Gati Shakti Master Plan for expressways is to be formulated. The national highways network will be expanded by 25,000 km next fiscal
- In the railways sector, 2,000 km of tracks will be brought under train collision avoidance system, Kavach; 400 new generation Vande Bharat trains will be introduced in the next three years
- Four multi-modal logistics parks will be awarded through the PPP mode next fiscal

Capex allocation

Aggregate capex



Infrastructure ministries



Notes: GBS: Gross budgetary support; IEBR – Internal and extra budgetary resources
% in the circle indicates achievement ratio for the year
Sectors included in nine core infrastructure sectors: Road transport and highways, housing and urban affairs, railways, civil aviation, shipping, power, rural development including Pradhan Mantri Gram Sadak Yojana (PMGSY), water resources, and new and renewable energy
Source: Budget documents, CRISIL Research

Impact

Aggregate capex of Rs 12.2 lakh crore for next fiscal is up 17% over fiscal 2022RE, excluding equity infusion for AIAHL. Interestingly, the GBS is up a steeper 39% on-year. This increases the government's direct spend to 62% of aggregate capex next fiscal from 55% in the current fiscal. This reflects a shift in the government's financing pattern — an increase in the reliance on direct budgetary support and a reduction in funding from central public sector enterprises (CPSE)

With direct budgetary support for infrastructure rising a faster 30% for next fiscal, the share of infrastructure segments, which account for 54% of the aggregate capex, rises a modest 11% over fiscal 2022RE. In the infrastructure basket, the railways, water, and green energy get a stronger impetus.

Asset monetisation as an infrastructure funding mechanism was largely missing in the budget proposals. It found mention only in the roads sector, where it is expected to generate Rs 20,000 crore and fund 10% of the National Highways Authority of India's (NHAI) requirement for the next fiscal. This fiscal, the share is estimated to be 5-8% dependent on the realisation of toll-operate-transfer (TOT) bundles 6-8.

Outlay for core infrastructure ministries

	FY21 A			FY22 BE			FY22 RE				FY22 BE				
Rs crore	Budget	IEBR	Total	Budget	IEBR	Total	Budget	IEBR	Total	FY22 RE vs BE	Budget	IEBR	Total	vs FY22RE	vs FY22BE
Ministry of Railways	29925	125255	234578	107100	107758	214858	117100	97700	214800	0%	137100	108500	245600	14%	14%
Ministry of Road Transport and Highways	89195	65035	154230	108230	65000	173230	121251	65000	186251	8%	187744	0	187744	1%	8%
National Highway Authority of India	46062	65035	111097	57350	65000	122350	65060	65000	130060	6%	134015	0	134015	3%	10%
Ministry of Water Resources	11077	4172	15249	60352	5197	65549	44987	17	45004	-31%	60059	18	60077	33%	-8%
Ministry of Power	370	47265	47635	1565	59991	61555	1086	49006	50092	-19%	13	51470	51483	3%	-16%
Ministry of Housing and urban affairs	10304	10293	20597	25759	24595	50354	25957	12227	38184	-24%	27341	17873	45214	18%	-10%
Ministry of New and Renewable Energy	150	9506	9656	10	11778	11788	2610	18974	21584	83%	12	28571	28583	32%	142%
Ministry of Shipping	169	2652	2821	183	4817	5000	609	3684	4293	-14%	574	4460	5034	17%	1%
Ministry of Civil Aviation	50	0	50	41	9274	9314	4562	3182	7744	-17%	76	4574	4650	-40%	-50%
Ministry of Rural Development	0	0	0	0	17867	17867	0	0	0	-100%	0	0	0	N.M	-100%
Pradhan Mantri Gram Sadak Yojana	13687	0	13687	15000	0	15000	14000	0	14000	-7%	19000	0	19000	36%	27%
Infrastructure capex	154927	264178	498503	318239	306277	624516	332162	249790	581952	-7%	431919	215466	647385	11%	4%
Aggregate capex	346919	477650	824569	554236	582831	1137067	540654	502489	1043143	-8%	750246	469453	1219699	17%	7%

Note: Rs 79398 crore one-time loan extended to Railways under capex excluded from fiscal 2021

Rs 62057 crore equity infusion in AIAHL excluded from revised estimates of fiscal 2022

Only capital and IEBR considered in Ministry of Power and Ministry of New and Renewable Energy which does not include any revenue expenditure on schemes

Source: Budget documents, CRISIL Research

Roads and highways

- Roads and highways capex for next fiscal is only 0.8% higher than fiscal 2022RE. And, crucially, the entire Rs 1.88 lakh crore is via GBS, which is 55% higher on-year. The IEBR limit has been completely eliminated for next fiscal, reducing dependence on the NHAI's borrowings. At Rs 20,000 crore, asset monetisation target for the next fiscal is 54% up on-year, indicating a shift in funding modes where it shall fund 10% of its requirements.

- The GBS for the current fiscal is 36% higher than fiscal 2021, which is also evident in the 37% increase in the ministry's capex during April-December. However, this is not reflected in road building, as construction has shrunk 14% to 6,185 km during the period. This is attributable to execution of high-value expressways as part of Bharatmala, under which cost of construction is three-fold that of four-lane highways
- Allocation for the PMGSY for the next fiscal is Rs 19,000 crore, up 36% over fiscal 2022RE. But, over the past two years, achievement ratio under the scheme has been a low 70-75%. Therefore, actual expenditure against the allocation remains a monitorable

Railways

- Railways capex for next fiscal is 14% higher than fiscal 2022RE. The rise in GBS is 17%, while that in IEBR is only 11%. Between fiscals 2019 and 2021, the capex allocation for the sector has logged a healthy CAGR of 23%, thereby doubling the spends. The healthy rise for the next fiscal is led by new lines, track doubling and deployment of the Kavach system across a further 2,000 km of tracks
- The budget proposes to introduce 400 Vande Bharat trains over the next three years. But the allocation for rolling stock is down 29% over fiscal 2022RE and up just 14% over actual spends in fiscal 2021

Power and renewable energy

Positive

Key budget announcements

- Total outlay under the Production-Linked Incentive (PLI) scheme for manufacturing of high-efficiency solar modules has been increased by Rs 19,500 crore to Rs 24,000 crore
- Basic customs duty (BCD) of 40% and 25% will be imposed on imported solar photovoltaic (PV) modules and cells, respectively
- States will be allowed a fiscal deficit of 4.0% of gross state domestic product (GSDP), of which 0.5% will be tied to power reforms. Further, states will be allocated Rs 1 lakh crore as 50-year interest-free loan in fiscal 2023 for capital expenditure. This is a significant enhancement from Rs 15,000 crore in fiscal 2022RE
- BCD on imported smart meters has been hiked to 25% from 15%
- Thrust on using 5-7% biomass pellets to run coal-based power plants with total input of 3.5 crore tonne
- Allocation for schemes related to distribution infrastructure for fiscal 2023BE is at Rs 7,600 crore, up 27% from fiscal 2021; this is similar to the allocation in fiscal 2022RE
- Fresh and increased allocations for national green hydrogen mission and smart grids, respectively
- Allocation has been increased by 25% for solar power for fiscal 2023BE. A new category of hydro has also been created, combining small as well as large hydro power, though with slightly lower allocation of Rs 52 crore for fiscal 2023BE compared with Rs 70 crore in fiscal 2022RE for small hydro alone

Parameter	Rs crore			Growth (%)			
	FY21	FY22 RE	FY23 BE	FY21	FY22 RE	FY23 BE	3-year average (FY21-FY23)
Ministry of Power	**57,912**	**64,328**	**67,544**	**-26%**	**11%**	**5%**	**-3%**
Distribution sector schemes	5,948	7,677	7,566	-37%	29%	-1%	-3%
Smart grids	16	28	36	163%	77%	26%	89%
Investment by CPSUs	44,746	48,972	51,433	-24%	9%	5%	-3%
Ministry of New and Renewable Energy	**12,149**	**29,156**	**35,472**	**-12%**	**140%**	**22%**	**50%**
Solar power (on and off grid)	1,199	2,685	3,366	-40%	124%	25%	36%
Wind power (on and off grid)	1,061	1,100	1,050	3%	4%	-5%	2%
Small Hydro Power	41	70	0	-47%	72%	-100%	-25%
Hydro power (on and off grid)	0	0	52	-	-	-	-
Bio-power	18	93	70	260%	417%	-25%	217%
Green energy corridors	179	168	313	225%	-6%	86%	102%
Kisan Urja Suraksha Evam Utthaan Mahabhiyan	0	690	1,716	-	-	149%	-
National Green Hydrogen Mission	0	0	0.01	-	-	-	-
SECI	579	1,834	999	38%	217%	-46%	70%
IREDA	8,926	19,640	27,572	-11%	120%	40%	50%

BE: Budget estimates; RE: revised estimates

Note:

1) The budgetary totals of the ministries include revenue expenditure, capital expenditure and IEBR funds raised by government owned entities.

2) Only key schemes for the sector have been highlighted, and scheme-wise allocations will not add up to total allocation mentioned for the respective ministry

3) Distribution schemes included Deen Dayal Upadhyaya Gram Jyoti Yojna and Integrated Power Development Scheme till fiscal 2022BE. However, both schemes have been subsumed under Revamped Distribution Sector Scheme for fiscal 2022RE and fiscal 2023BE

4) GEC consists of allocations under Ministry of Power as well as Ministry of Renewable Energy. Allocations by the Ministry of Power was on an average ~9% of total allocations for GEC over the past three fiscals

Source: Budget documents, CRISIL Research

Impact

- Currently, India's dependency on PV module import is 75-80% and for PV cells, ~90%. Increase in PLI funding to Rs 24,000 crore can enable the setting up of 30-35 GW of solar PV module capacities and 25-30 GW of solar PV cell capacities by fiscal 2024. Awarding mechanism of the enhanced outlay, though, will be a key monitorable
- Customs duty rate of 40% on solar PV modules and 25% on solar cells (not assembled into modules) will be effective from April 1, 2022. This will raise project costs until domestic manufacturing capacity is scaled up to support demand from solar project developers, who have a pipeline of 40 GW under execution currently. Imposition of the BCD implies a 20-25% increase in capital cost to Rs 4.8-5.0 crore per MW[8], which

[8] The capital costs are estimated considering mono-crystalline modules with average price of $0.23 per watt-peak [wp), PLF of 25%, debt equity ratio of 75:25, GST of 12%, DC overloading of 40% & interest rate of 7%

may result in bid tariff increase of 30-40 paise per unit for equity returns of 10-12%. Considering India is also dependent on imported cells for domestic modules, the 25% BCD on solar cells will have a similar impact.

- The Revamped Distribution Sector Scheme (RDSS) will require state utilities to provide 65% share or ~Rs 2 lakh crore of the total outlay. As per CRISIL Research estimates, the 0.5% allowance in fiscal deficit totals ~Rs 74,000 crore across all states, basis GSDP for fiscal 2020 (pre-pandemic). This amount will comprise 35-40% of the states' funding requirement under RDSS. Further, allocation of Rs 1 lakh crore under 50-year interest-free bonds could also see allocation by states towards RDSS implementation. That said, the erstwhile Integrated Power Development Scheme and Deen Dayal Upadhyaya Gram Jyoti Yojana have been subsumed within RDSS, and, accordingly, budgetary allocation has sustained at similar levels
- Higher BCD will raise the price of imported smart meters to Rs 5,000-6,000 from Rs 4,000-5,000. While this is still lower compared with the Rs 6,000-7,000 cost for domestic smart meters on average currently, the paring of the price gap is significant. However, a key challenge would be scaling up domestic smart meter manufacturing capacities, considering the ambitious targets under RDSS
- Coal gasification will help lower carbon emissions. As per CRISIL Research estimates, 3.0-3.5 crore tonne can potentially be replaced each year, leading to a similar reduction in carbon dioxide annually (emission factor for coal is roughly one per tonne of coal consumed)
- In line with greater government focus on clean energy, budgetary allocation for the GEC scheme has risen by 86% to Rs 313 crore for fiscal 2023BE. The scheme focuses on grid integration of renewable energy via setting up of dedicated transmission infrastructure connecting renewable energy projects to the mainstream network

Other key announcements

Oil and gas

Neutral

An additional differential excise duty of Rs 2 per litre will be levied on petrol as well as diesel that is not blended as per Bureau of Indian Standards specifications with effect from October 1, 2022.

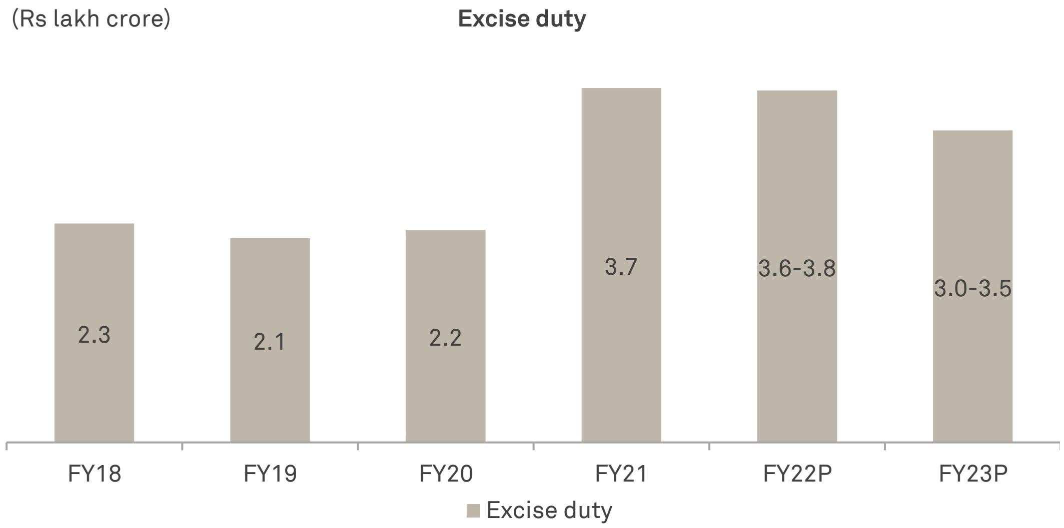
Impact

The additional levy will increase basic excise duty on non-blended petrol and diesel to Rs 3.4 and Rs 3.8 per litre, respectively. With this, total excise duty, including basic excise duty, special additional excise duty, additional excise duty (road and infrastructure cess), and agriculture infrastructure and development cess, will rise to Rs **29.9** and Rs **23.8 per litre for unblended petrol and diesel**, respectively.

However, states such as Arunachal Pradesh, Assam, Manipur, Meghalaya, etc, which currently do not blend petrol with ethanol, constitute a mere 4% of total petrol consumption. Therefore, we do not expect significant change in excise duty collections.

That said, we expect excise duty collections to drop 10-12% on-year in fiscal 2023 to Rs 3.0-3.5 lakh crore on account of a drop in excise duty in November 2021 to Rs 27.9 per litre from Rs 32.9 for petrol, and to Rs 21.8 per litre from Rs 31.8 for diesel.

Revenue from excise duty to decline in fiscal 2023



P: Projected
Source: Petroleum Planning & Analysis Cell, CRISIL Research

Production Linked Incentive scheme

Positive

The government has budgeted Rs 7,400 crore under the PLI scheme across 10 sectors in the first year (fiscal 2023), as part of its overall outlay of Rs 2 lakh crore. Also, the PLI scheme for solar PV manufacturing has been enhanced by Rs 19,500 crore.

Impact

While the outlay will be spread across 10 sectors, 84% has been budgeted for electronics and food processing industries. Revision of incentive for solar PV manufacturing to Rs 24,000 crore from Rs 4,500 crore has enhanced the overall incentives to Rs ~2 lakh crore over the scheme period (up 11%).

As per CRISIL's estimates, the PLI scheme will entail Rs 2.5-3.0 lakh crore of capex and generate incremental revenue of Rs 30-35 lakh crore over its tenure, auguring well for private capex recovery.

Healthcare

Neutral

- Budgetary allocation towards healthcare for fiscal 2023 retained at Rs 1 lakh crore
- In addition, provision of Rs 5,000 crore for Covid-19 vaccines in fiscal 2023

Impact

- Healthcare spending by the central government has increased significantly over the past two years. At Rs 1 lakh crore, the budgeted healthcare spend outlay for fiscal 2023, which includes allocation to the Ministry of Health and Family Welfare, the Ministry of Ayush, and towards Finance Commission grants for health, is 1.5 times the average annual healthcare spend over fiscals 2019 to 2021
- In addition to the above healthcare expenditure, fiscal 2022RE indicates the central government spend on Covid-19 vaccination programme will be Rs 39,000 crore. The outlay has been reduced for fiscal 2023 to Rs 5,000 crore as 75% of the country's 18+ year old population is fully vaccinated

Housing

Neutral

- Total budgetary allocation towards Pradhan Mantri Awas Yojana (PMAY), rural and urban, for fiscal 2023 is at Rs 0.48 lakh crore

Impact

- Of the total Rs 0.48 lakh crore allocated for fiscal 2023, Rs 0.28 lakh crore is towards PMAY-Urban and Rs 0.20 lakh crore for PMAY-Gramin. This is only 4% higher for PMAY-Urban and ~2% lower for PMAY-Gramin compared with fiscal 2022RE
- PMAY-Urban has a completion target of 1.14 crore houses by fiscal 2023, of which ~0.53 crore has been delivered. CRISIL Research estimates total spend by the central government on the scheme from fiscal 2016 to fiscal 2022 at Rs 1.2 lakh crore. This will lead to incremental funding requirement of Rs 0.62 lakh crore in fiscal 2023. As budgetary allocation of only Rs 0.28 lakh crore has been made for next fiscal, reliance on internal and extra budgetary resources appears to be aggressive, considering past trends

Sector	Commodity	Rate of customs duty		Rate of excise duty		Impact	Remarks
		From	To	From	To		
Chemicals	Methanol	10%	2.5%				India imports 90% of its methanol requirement. The cut in import duty will reduce landed cost of imported methanol by 6-7%.
	Acetic acid	10%	5.0%				India imports 85-90% of its acetic acid requirement. Reduction in duty will lower input cost for end-users.
Fuel	Unblended petrol - unbranded (effective October 1)			Rs 1.4 per litre	Rs 3.4 per litre		The share of states that currently do not blend petrol with ethanol (such as Arunachal Pradesh, Assam, Manipur, and Meghalaya) constitutes a mere ~4% of total petrol consumption. Therefore, we do not expect the additional excise duty to result in any significant change in the government's revenue.
	Unblended diesel - unbranded (effective October 1)			Rs 1.8 per litre	Rs 3.8 per litre		
Gems & jewellery	Cut and polished diamonds and gemstones	8%	5.0%				Cut and polished diamond and gemstones account for less than 10% of overall gems and jewellery imports in India. The customs duty cut is expected to help improve exports of studded diamond jewellery to some extent and bring down cost for players. However, the benefits are expected to be limited.
Aquaculture	Live vannamei shrimps	30%	10.0%				The customs duty cut will lower the cost of feed, seed and other inputs, boosting growth and helping the fisheries sector achieve the export target of Rs 1 lakh crore by 2025.
	Black tiger shrimps	30%	10.0%				
	Frozen krill	30%	15.0%				
	Frozen mussels	30%	15.0%				
	Frozen squids	30%	15.0%				

Sector	Commodity	Rate of customs duty		Rate of excise duty		Impact	Remarks
		From	To	From	To		
Power	Smart meter	15%	25%				While the increase in customs duty would support domestic manufacturing capabilities in the long term, costs for smart metering initiatives may increase in the interim period in line with the ambitious targets.
	Goods required for use in high-voltage power transmission projects	5%	7.5-20%				The budget for fiscal 2023 raises customs duty (or removes applicable exemptions) on several electronic/capital goods used as inputs for power generation and transmission projects. This will provide impetus to domestic manufacturing in the electrical equipment space, which is often hampered by dumping of cheap imports from China and East Asia.
	Machinery for supply to power generation plants	5%	7.5-10%				
	Power projects registered under Project Imports	0/2.5/ 5%	7.50%				
	Coal projects registered under Project Imports	0%	7.50%				
	Parts and sub-parts of wind-operated electric generators	5%	10%				Exemption of basic customs duty (BCD) on inputs for wind generation projects has been removed, leading to a higher BCD rate from April 2022/2023 (as the case may be). This will support domestic wind power OEMs and help expand the domestic manufacturing base. However, in the short term, this may increase capital costs for those wind projects that may import equipment.
	Photovoltaic cells not assembled in modules	20%	25%				BCD exemption has been removed, and the base rate of 25% for non-assembled cells and 40% for assembled cells (solar modules) has been applied. While this provides support to the domestic supply chain, over the medium term, as the Indian supply scales, solar projects will witness a 20-25% rise in capital costs.
	Photovoltaic cells assembled in modules	20%	40%				

About CRISIL Limited

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