India's Budget for the Ages

The Indian Finance Minister yesterday delivered a Budget to the Nation which certainly took the fancy of stock market investors. India's bellwether Nifty 50 Index has jumped 8% in the last 2 days as both local and global investors applauded the bold reformist moves taken by the Government. The Government also forecasts growth of 11% for FY22 (year ending March) after a contraction of 7.7% in FY21. Agencies like the IMF and World Bank are now upgrading economic growth assumptions for India given its resilience during COVID and economic recovery.

The budget focused on 6 pillars:

- Health and Wellbeing
- Physical and Financial Capital and Infrastructure
- Inclusive Development for Aspirational India
- Reinvigorating Human Capital
- Innovation and R&D
- Minimum Government, Maximum Governance

The initial stimulus package delivered over a week in May 2020 has a theme of Atmanirbhar Bharat (*a self-reliant India*). However, the package was supportive mainly to the needy and addressed the immediate needs of the lower socio-economic groups. The strategy employed by the Indian Government was one of a barbell, with the intention being to address the immediate concerns and threats posed by COVID-19 and to leave some fuel in the tank for when the economic recovery was underway, such that it could be directed towards areas which would lead India to the fastest growing major economy in world again – a mantle it had taken over from China in the last decade.

The Budget delivered yesterday focused on Infrastructure, Agriculture, Growth, Consumption and Job Creation. To do this, the Government did not seek to "balance the books" with higher taxes or a burden on broader society. However, they accepted that the Budget Deficit would blow out and would need fixing in the long-term, given the economy had encountered a significant impact which had the likelihood of 1-in-100 type odds. The fiscal deficit therefore will blow out to a predicted 6.8% of GDP for FY22 (after a re-adjusted 9.5% for FY21), with an aim to reduce it to 4.5% by FY26. There is a recognition that this was the need of the hour and whilst Credit Rating agencies might find it an issue, it was required to move India forward.

One key item was the intention to provide US$4.8bn to vaccinate 70% of India's 1.3bn population against COVID-19. This will provide significant health security for the country and allow growth, consumption, manufacturing, and infrastructure to be the main agenda items. Health spending in the budget was significantly increased addressing the need of the nation at a time when India must achieve the highest productivity it can.

Services and Consumption are also critical given this is over 60% of India's GDP contribution. However, this will be achieved by job creation rather than handing out payments to people for spending. The Government proposes to spend significantly on Capex (US$75bn) which is significantly higher than the previous year. Additionally, a further US$27bn will be spent by the States of India.

This has the impact of creating jobs, increasing wealth, and therefore boosting consumption. Meanwhile it reduces bottlenecks in economic productivity by modernising India's infrastructure i.e., Clean Water, Power, Solar Energy, Recycling Capacity, Roads & Highways, Railways, Freight Corridors. This should start to have a positive impact on logistical costs for businesses.

The Government's goal of taking Manufacturing share of GDP towards 25% from the current 14% also received significant attention. Aside from the infrastructure push and scrappage policy for automobiles, the Government will also focus on continuing to promote great self-reliance and localised industry. Apart from creating jobs this will also continue to improve India's external position.

Other significant announcements in the Budget are summarised below:

- Launching a new vehicle scrappage policy to allow faster turnover of vehicles and enhance a move to a more efficient and less pollution emitting new fleet. Must scrap personal vehicles over 20 years old and business vehicles over 15 years old.
- Plan to build 7 textile parks over the next 3 years. Textiles and its integrated activities are a significant employer in India given their labour intensiveness.
- Social security benefits to be extended to India's informal labour. Database will be set up on informal labour patterns to allow a greater understanding of the shifts occurring.
- Allocation of resources (US$23bn) for paddy procurement. Additionally hiked agriculture credit target and allowing loans for allied activities in the sector. More privatised and less bureaucratic to drive greater efficiency.
- Recapitalise State run banks to the tune of US$2.7bn
- Increase foreign direct investment into India's insurance companies.
- Set up an asset reconstruction company which will take over toxic assets of banks and allow greater credit growth going forward to facilitate growth via private investment (Financial Sector rose over 7% yesterday in response).
- Incentivise the use of digital payments.

It is accepted that the Indian Government will have a significant financing need which will need to be funded by bond issuance in the immediate term. However, over the medium term the Government will seek funding by monetising some of its assets. The Government has set a divestment target of US$24bn for the next 12 months. The divestment targets will be State owned Banks, General Insurance and other State-run companies and monetise surplus land held by these entities.

<u>Our View</u>

We expect that the Budget will pivot the economy towards growth and rather than providing handouts as a stimulus has tackled the root cause of issues holding back India. Cleansing of banks, improving infrastructure, greater self-reliance through a focus on manufacturing locally and building strong partnerships with global firms will set up India to expand its capital formation, external position and create jobs and consumption. The vaccination process and increasing consumer confidence places India in a sweet spot for the beginning of this decade. We feel the rating agencies will look beyond the cyclical nature of India's deficit and identify the long-term structural positives.

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