INSTITUTIONAL EQUITY RESEARCH

Covid (V): Fiscal Impact

Lower capital exp + stimulus = Higher revenue expenditure

INDIA | INDONOMICS | FISCAL ANALYSIS

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We received a lot of interest from our clients about the fiscal health of the central government, so we attempted to provide some perspective on the extent of fiscal stress that could occur due to the ongoing Covid crisis. As we all understand, these are early days; there is extreme uncertainty on the extent of the economic slowdown and the government's views on the degree of fiscal slippage. Please note these are not our final estimates for FY21. In our analysis, we are avoiding the influence of the quantum of fiscal stimulus announced globally (we have highlighted the stimulus doled out by key global economies along with the durations of the lockdowns below). While global fiscal stimulus is substantial, we remain watchful about growth reversal trends in India, in case the government takes a more guarded approach towards fiscal slippage.

We have highlighted three scenarios under which fiscal deficit could stand in the range of 5.5%-7.0%-9.0% of GDP vs. 3.5% budgeted for FY21. The state's fiscal deficit will also surge on account of the ongoing crisis. We see excessive cuts in capital expenditure in FY21 in order to meet covid-crisis-related spend – stimulus (shift from capex to revenue expenditure; no priority revenue exp can also be curtailed). While health is a state subject, covid is a national pandemic, thus, both centre and states will consider health expenditure as their first priority. This will be followed by social, rural (functional segment of the economy), and economic stimulus; capital expenditure will receive the last priority in FY21. That said, lower borrowing costs would be a positive in case funds are raised externally for capex funding.

Government had set out the highest-ever disinvestment target of Rs 2.1tn for FY21, focusing on strategic disinvestment; this is at huge risk now. Due to likely strong earnings of the telecom sector, the government may be able to receive higher AGR payments from telecom companies in FY21. As it is the beginning of the financial year, both central and state governments are crunched for funds, and they may have to depend on borrowings, as revenue stream will take few more months. While gross borrowings will surge for centre and states, they are expected to also rely on funding through T-bills to manage interest burden. We view the RBI's liquidity support for the financial system, centre, and states, as a form of economic stimulus due to its wide-ranging impact. Additionally, we expect the government to take measures to stimulate the most impacted segment (MSME) and sectors like aviation, hotels & tourism, real estate, construction etc.

Scenario 1: Fiscal deficit of 5.5% of GDP is largely seen just on the basis of lower GDP (2% GDP growth), tax revenue, and disinvestment scenario, no stimulus (additional expenditure), and shift of capital expenditure to revenue expenditure.

Scenario 2: Fiscal deficit of 7% of GDP because of same GDP growth as scenario 1, lower (than scenario 1) tax and non-tax revenue and disinvestment, additional stimulus (expenditure) to the tune of 0.7% of GDP, in addition to higher shift of capital expenditure to revenue expenditure.

Scenario 3: Fiscal deficit at 9% of GDP because of GDP growth of -1%, substantially lower tax and non-tax revenue growth, lower disinvestment, higher stimulus (expenditure) to the tune of 1% of GDP with minimal capital expenditure and higher revenue expenditure.

FY20 Fiscal deficit:

- Assuming lower revenue (97% of RE) and capital (92% of RE) expenditure.
- Assuming lower tax revenue and disinvestment.
- Lower GDP growth for FY20 at 4.2%.
- Fiscal deficit for FY20 should stand approx. at 4% of GDP vs. 3.8% announced during the budget. With no spending reduction, fiscal deficit will stand at c.4.5%.

Series of previous COVID-19 related macro & strategy reports:

Covid Series (IV): ***30-day lockdown factored; a longer one will spell peril:*** (7th April 2020) **Click here**

Covid Series (III): ***First ever GLOBAL shutdown: FEAR!!! And GREED (???)*** (23rd March 2020) **Click here**

Macro and Strategy Outlook: ***Slowdown to aggravate; domestic and global*** (12th March 2020) **Click here**

Coronavirus Impact: ***Manageable in the near term | Prolonged – detrimental*** (12th February 2020) **Click here**

Central government fiscal account likely Scenarios for FY21

	Rs bn						% of GDP						yoy growth (%)					
	FY20RE	FY20PC	FY21BE	FY21PCE			FY20RE	FY20PC	FY21BE	FY21PCE			FY20RE	FY20PC	FY21BE	FY21PCE		
				GDP 2%	GDP 2%	GDP -1%				GDP 2%	GDP 2%	GDP -1%				GDP 2%	GDP 2%	GDP -1%
Budget statistics					+ Fiscal stimulus						+ Fiscal stimulus						+ Fiscal stimulus	
Nominal GDP	**204422**	**202565**	**224894**	**210111**	**210111**	**203983**							**7.5**	**6.6**	**10.0**	**3.7**	**3.7**	**0.7**
Revenue receipts	**18501**	**17344**	**20209**	**17202**	**16065**	**13266**	**9.1**	**8.6**	**9.0**	**8.2**	**7.6**	**6.5**	**19.1**	**11.7**	**9.2**	**-0.8**	**-7.4**	**-23.5**
Tax (net)	15046	13889	16359	13352	12565	10266	7.4	6.9	7.3	6.4	6.0	5.0	14.2	5.4	8.7	-3.9	-9.5	-26.1
Non – tax	3455	3455	3850	3850	3500	3000	1.7	1.7	1.7	1.8	1.7	1.5	46.6	46.6	11.4	11.4	1.3	-13.2
Capital receipts	**8485**	**8775**	**10213**	**13220**	**15857**	**19156**	**4.2**	**4.3**	**4.5**	**6.3**	**7.5**	**9.4**	**11.3**	**15.1**	**20.4**	**50.7**	**80.7**	**118.3**
Recovery of loans	166	166	150	150.0	150.0	150.0	0.1	0.1	0.1	0.1	0.1	0.1	-8.0	-8.0	-9.8	-9.6	-9.6	-9.6
Other reciepts(disinvt)	650	500	2100	1200.0	800.0	500.0	0.3	0.2	0.9	0.6	0.4	0.2	-31.4	-47.2	223.1	140.0	60.0	0.0
Borrowings and other liab.	7669	8109	7963	11869.6	14906.9	18505.6	3.8	4.0	3.5	5.6	7.1	9.1	18.1	24.9	3.8	46.4	83.8	128.2
Total receipts	**26986**	**26119**	**30422**	**30422**	**31922**	**32422**	**13.2**	**12.9**	**13.5**	**14.5**	**15.2**	**15.9**	**16.6**	**12.8**	**12.7**	**16.5**	**22.2**	**24.1**
Total revenue Exp	23496	22909	26301	28922	30922	31922	11.5	11.3	11.7	13.8	14.7	15.6	17.0	14.1	11.9	26.2	35.0	39.3
Total capital Exp	3489	3210	4121	1500	1000	500	1.7	1.6	1.8	0.7	0.5	0.2	13.4	4.3	18.1	-53.3	-68.8	-84.4
Total expenditure	**26986**	**26119**	**30422**	**30422**	**31922**	**32422**	**13.2**	**12.9**	**13.5**	**14.5**	**15.2**	**15.9**	**16.6**	**12.8**	**12.7**	**16.5**	**22.2**	**24.1**
Fiscal deficit	**7669**	**8109**	**7963**	**11870**	**14907**	**18506**	**3.8**	**4.0**	**3.5**	**5.6**	**7.1**	**9.1**	**18.1**	**24.9**	**3.8**	**46.4**	**83.8**	**128.2**
Revenue deficit	**4995**	**5565**	**6092**	**11720**	**14857**	**18656**	**2.4**	**2.7**	**2.7**	**5.6**	**7.1**	**9.1**	**9.9**	**22.4**	**22.0**	**110.6**	**167.0**	**235.2**

Source: PhillipCapital India Research, Budget documents

Country/Region-wise periods of Covid-led lockdown

Country	Lockdown	No of Days
United States	State wide lockdown since 16th-21st March in selected states, extended till 30th April in rest of the states and till 15th May in New York and other east coast states	Excluding east coast states(~46 days), only East coast states (~61 days)
United Kingdom	Lockdown since 24th March, to be extended till 7th May (could last till June)	(45 days), if till June than (~69 days)
Canada	Emergency since 18th March, announced on 14th April that it is likely to be extended for several more weeks	(~60 days)
European Union	Started with Italy on 9th March, followed by Switzerland, Spain, France and rest of EU, easing of restrictions from 3rd week of April- 2nd week of May in most affected regions.	(~50-60 days)
Japan	Lockdown started from 7th April (Tokyo, Osaka) to last till 6th May. Nationwide state of Emergency declared on 16th April	(30 days)
Russia	Open-ended quarantine in Moscow and other regions since 30th March, extended till 30th April.	(32 days)
India	Nationwide lockdown since 25th March, extended till 3rd May.	(40 days)
China	From 23rd January in Wuhan and other cities in Hubei, ended in Wuhan on 8th April.	(~77 days)

Source: PhillipCapital India Research

Multi-pronged approach taken by major economies to handle COVID-19

Country	Interest rate cut	Liquidity measures	Fiscal measures	Socio-economic	Fiscal Stimulus (% of GDP)
United States	Federal funds rate lowered by 150bps in March to 0-0.25%	CP Funding - Facilitate CP issuances by companies and municipal issuers	Total US$ 2.3tn CARES Act (11% of GDP)	US$ 250bn(1.2% of GDP) to expand unemployment benefits	11%
		PDs Credit Facility - Provide financing to Fed's 24 primary dealers	US$ 150bn (0.7% of GDP) in transfers to state and local governments	US$ 24bn (0.1% of GDP) to provide a food safety net for the most vulnerable	
		Money Market Mutual Fund Liquidity Facility - Provide loans to depository institutions in order to purchase assets from prime money market funds	US$ 510bn (2.4% of GDP) to prevent corporate bankruptcy	US$ 100bn (0.4% of GDP) for hospitals	
		Primary Market Corporate Credit Facility - to purchase new bonds and loans from companies	US $359bn (1.7% of GDP) in forgivable Small Business Administration loans and guarantees to help small businesses that retain workers	US$ 49.9bn (0.2% of GDP) for international assistance	
		Secondary Market Corporate Credit Facility - provide liquidity for outstanding corporate bonds	US$ 250bn (1.2% of GDP) to provide one-time tax rebates to individuals	US$ 8.3bn (0.03% of GDP) Coronavirus Preparedness and Response Supplemental Appropriations Act	
		Term Asset-Backed Securities Loan Facility (TALF) - enable issuance of asset-backed securities backed by student loans, auto loans, credit-card loans, etc.		US$ 83.4bn (0.4% of GDP) Families First Coronavirus Response Act.	
		Purchase short term notes directly from state and eligible local governments		US$ 1.25bn in international assistance	
United Kingdom	Reduced Bank Rate by 65bps to 0.1%	Expanded the central bank's holding of UK government bonds and non-financial corporate bonds by £200bn (9% of GDP)	Total £360bn (16% of GDP) worth of fiscal stimulus	£5.7bn (0.2% of GDP) funding for the NHS, public services and charities	16%
		New Term Funding Scheme for transmission of the rate cut, with additional incentives for lending to the real economy, especially SMEs	£27bn (1.2% of GDP) worth property tax holidays, direct grants for small firms in the most-affected sectors, and compensation for sick pay leave	~ £7bn (0.3% of GDP) for increasing payments under the Universal Credit scheme, other benefits	
		Extended use of government's overdraft account at the BoE to provide short-term source of additional liquidity to the government	£330bn of loans and guarantees available to businesses (15% of GDP);	Payment of 80% earnings of self-employed workers and employees temporarily on leave (to a max. of £2,500 per employee per month) for an initial period of 3 months	
		Contingent Term Repo Facility to complement the Bank's existing sterling liquidity facilities			
		US dollar liquidity swap line arrangement to enhance provision of liquidity			

Country	Interest rate cut	Liquidity measures	Fiscal measures	Socio-economic	Fiscal Stimulus (% of GDP)
Canada	Reduced the overnight policy rate by 150 bps in March to 0.25%	Extension of bond buyback program across all maturities	Key measures of $193bn CAD (8.4% of GDP)	$3.175bn (0.1 % of GDP) to the health system	8%
		Expanded the list of eligible collateral for Term Repo operations to the full range of eligible collateral for the Standing Liquidity Facility (SLF), except the Non-Mortgage Loan Portfolio (NMLP)	$85bn CAD (3.7% of GDP) in support to businesses through income and sales tax deferrals	$105bn CAD (4.6 % of GDP) in direct aid to households, including payments to workers without sick leave and access to employment insurance, an increase in existing GST tax credits and child care benefits	
		Canada Mortgage Bond (CMB) purchase in the secondary market			
		Announced an increase in the target for settlement balances to $1,000mn CAD from $250mn CAD			
		Provision of liquidity via the standing US dollar liquidity swap line arrangements			
		Standing Term Liquidity Facility, under which loans could be provided to eligible financial institutions in need of temporary liquidity support			
		Government will purchase up to $150bn CAD of insured mortgage pools through the Canada Mortgage and Housing Corporation (CMHC)			
		$65bn CAD in credit facilities to lend to firms under stress			
		$5bn CAD in lending capacity to producers, agribusinesses, and food processors			
European Union	TLTRO's - cheaper loans to banks, interest rate cut by 25bps to -0.75%	Additional auctions of the full-allotment, fixed rate temporary liquidity facility at the deposit facility rate and more favorable terms on existing targeted longer-term refinancing operations (TLTRO-III) between June 2020 and June 2021	Total of €3.2tn (24% of EU27 GDP)	Support public investment for hospitals, SMEs, labor markets, and stressed regions	24%
		ECB Banking Supervision asked banks to not pay dividends for the financial years 2019 and 2020 or buy back shares during COVID-19 pandemic, and the conserved capital should be used to support households, small businesses and corporate borrowers and/or to absorb losses on existing exposures to such borrowers	Up to 2% of 2019 GDP i.e €240 billion in total for each euro area member to finance health related spending	Up to **€800mn** EU Solidarity Fund to include a public health crisis within its scope, with a view of mobilizing it if needed for the hardest-hit EU member states	
		€25bn in government guarantees to the European Investment Bank to support up to **€200bn** to finance companies, with a focus on SME	**€37bn** (0.3% of EU27 GDP) from EU budget to combat COVID-19	Credit holidays to existing debtors that are negatively affected	

Country	Interest rate cut	Liquidity measures	Fiscal measures	Socio-economic	Fiscal Stimulus (% of GDP)
		€1bn from the EU Budget as a guarantee to the European Investment Fund to incentivize banks to provide liquidity to hit SMEs and midcaps	Temporary loan-based instrument (SURE) of up to **€100bn** to protect workers and jobs, supported by guarantees from EU member states.		
		Additional asset purchases of €120bn until end-2020 under the existing program **€750bn** asset purchase program of private and public sector securities, expanded range of eligible assets under the corporate sector purchase program	Half-a-trillion euros worth of support for the coronavirus-battered economies		
Japan	Policy rates remain unchanged	Liquidity provision through an increase in the size and frequency of Japanese government bond purchases	Adopted the Emergency Economic Package Against COVID-19 of ¥108.2tn (20% of GDP)	Preventive measures against the spread of infection and strengthen treatment capacity (expenditure of 0.5% of GDP)	20%
		Special funds-supplying operation to provide loans to financial institution to facilitate financing of corporates, an increase in the annual pace of BoJ's purchases of (ETFs), (J-REITs), and a temporary increase of targeted purchases of CP and corporate bonds	Regain economic activities after containment (1.6% of GDP)	Protect employment and businesses (15.1 % of GDP)	
		Enhanced the provision of U.S. dollar liquidity, by lowering the pricing on the standing U.S. dollar liquidity swap arrangements by 25bps Concessional loans from public and private financial institutions	Rebuild a resilient economic structure (3% of GDP) Enhance readiness for the future (0.3% of GDP)	Cash handouts to affected households and firms, deference of tax payments and social security contributions	
Russia	Policy rates remain unchanged	Increased the limit on its FX swap operations	Fiscal package at around 1.4% of GDP	Increased compensation for medical staff as well as for health and safety inspectors	1.4%
		Interest rate subsidies for SMEs		Individuals under quarantine to receive sick leave benefits	
		Introduced temporary regulatory easing for banks intended to help the industries affected by COVID-19, and more favorable treatment for FX loans issued to certain sectors		All children up to 3yrs of age in families eligible for maternity capital to receive an additional lumpsum benefit for 3 months, starting in April, and all families with children to get an additional lumpsum benefit for each child if parents lose jobs	
		CBR has introduced a new RUB 500bn facility for SME lending and reduced the interest rate on the existing RUB 175bn facility		Sick leave pay to equal at least the minimum wage until the end of 2020; benefits to equal at least the minimum wage for three months starting in April	

Country	Interest rate cut	Liquidity measures	Fiscal measures	Socio-economic	Fiscal Stimulus (% of GDP)
		Approved a law that guarantees the possibility for affected citizens and SMEs to receive deferrals of loan payments for upto six months		For SME's - Deferrals on social contributions in affected sectors for 6 months; social contributions on wages in excess of the minimum wage permanently reduced from 30 to 15%; deferment in rent payments to the government	
		Measures to ease liquidity regulations for systemically important credit institutions, availability of payments system to the population, online trading platforms, and insurance services		Zero import duties for pharmaceuticals and medical supplies and equipment	
		Tax deferrals for most affected companies on most taxes (excluding VAT and social contributions)		Guaranteed loans to SMEs and affected industries	
India	Reduced the repo and reverse repo rates by 75 and 115bps to 4.4% and 3.75%	Targeted Long Term Repo Operations (TLTRO) of upto 3 year tenure: Rs 1,000bn at a floating rate linked to policy repo rate	Rs 1,700bn Relief package (0.8% of GDP)	Insurance cover of Rs 5mn per health worker fighting COVID-19	0.8%
		CRR reduced by 100bps to 3%, releasing Rs 1,370bn banking funds for credit. Available for a period of one year		800mn–poor people (two thirds of India's population) will get 5 kg wheat or rice and 1 kg of preferred pulses for free every month for the next three months	
		Marginal Standing Facility (MSF) Accommodation increased to 3% of deposits from 2%, additional Rs 1,370bn liquidity		200mn women Jan Dhan account holders to get Rs 500/month for next three months	
		3-months - moratorium on term loans by lending institutions and deferment in working capital interest payment		Free of cost gas cylinders to be provided to 80mn poor families for next three months	
		Initial TLTRO of ₹500bn, to be invested in investment grade bonds,CP'S, non-convertible debentures of NBFCs, with at least 50% of the total amount availed going to small and mid-sized NBFCs and MFIs		Govt proposes to pay 24% of monthly wages in specific PF accounts for next three months	
		₹250bn to NABARD for refinancing RRBs, cooperative banks and MFIs; ₹150bn to SIDBI for on-lending/refinancing; and ₹100bn to NHB for supporting housing finance companies (HFCs)		Increase in MNREGA wages to Rs 202 a day from Rs 182	
		Increase in the WMA limit of states by 60% over and above the level as on March 31, 2020 to provide greater comfort to the states, and to plan their market borrowing programmes better. The increased limit will be available till September 30, 2020		An ex-gratia of Rs 1,000 to 30mn poor senior citizen, poor widows and poor disabled	

Country	Interest rate cut	Liquidity measures	Fiscal measures	Socio-economic	Fiscal Stimulus (% of GDP)
India (Contd)				Front-load Rs 2,000 to farmers in first week of April under PM Kisan Yojana	
				SHG's limit of collateral free lending would be increased from Rs. 1mn to Rs 2mn Non-refundable advance of 75% of the EPF amount or three months of the wages, whichever is lower	
China	7-day reverse repo rate reduced by 20bps in March to 2.20%, One-year medium-term lending facility (MLF) loans to financial institutions reduced by 20bps to 2.95%	Liquidity injection into the banking system via open market operations, including RMB 3tn in the H1 of February and 170bn in late-March	RMB 2.6tn (or 2.5 % of GDP)	Increased spending on epidemic prevention and control.	2.5%
		Expansion of re-lending and re-discounting facilities by RMB 1.8tn to support manufacturers of medical supplies and daily necessities micro,small and medium-sized firms and the agricultural sector at low interest rates	Overall fiscal expansion is expected to be significantly through an increase in the ceiling for special local government bonds of 1.3% of GDP	Production of medical equipment.	
		Targeted RRR cuts by 50-100 bps for large-and medium-sized banks that meet inclusive financing criteria which benefit smaller firms, an additional 100 bps for eligible joint-stock banks, and 100 bps for small-and medium-sized banks in April and May to support SMEs	Enhanced fiscal support for credit guarantees	Accelerated disbursement of unemployment insurance	
		Reduction of the interest on excess reserves from 72 to 35 bps	Flexibility in the implementation of the asset management reform	Tax relief and waived social security contributions	
		RMB 350bn Policy banks' credit extension to micro- and small enterprises		Improvements of the national public health emergency management system, and automatic stabilizers	
		Additional financing support for corporates via increased bond issuance by corporates		Delay of loan payments and other credit support measures for eligible SMEs and households	

Source: PhillipCapital India Research, IMF, PIB

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