CARE Ratings
Professional Risk Opinion

Second wave fallout: Fiscal deficit for FY22 to widen

May 29, 2021 I Economics

The second wave of the pandemic which has been more intense and widespread than the first has been a setback for India's fledging economic recovery. Economic growth in FY22 is expected to be lower than earlier anticipated and this would perforce have implications on the fiscal math of the government.

Following the sharp widening in fiscal deficit to 9.4% of GDP in FY21, the central government with the aim of gradually bringing down the fiscal deficit to less than 4.5% of GDP by FY26, budgeted a fiscal deficit of 6.8% for FY22. Given the prevailing and evolving situation, this target is unlikely to be met.

The resurgence in the pandemic would inevitably lead to shortfalls in income of the government and would be accompanied by an increase in expenditure towards controlling the pandemic and alleviating the impact of the same on the most vulnerable sections. This has already been witnessed in the last month on food and fertilizers to protect the vulnerable. Though there has been limited direct intervention by the government so far on the expenditure front, we believe that there would be more action expected given the transmission of the pandemic to rural areas.

Tax collections will be pressurized as the first two months of the financial year have been characterized by pervasive lockdowns which look unlikely to be eased to any significant extent in June too. Therefore, Q1 will be a low growth quarter in terms of revenue collections, even though it would be better than last year.

We have estimated here the likely slippage in the central government's fiscal deficit from the budgeted number for FY22. Towards this end, we have examined the trends in the central government's financial profile during the various quarters of the financial year and factored in the likely slippages in revenues as well as the additional expenditure that will have to be incurred. Also, as our base case scenario for GDP growth in now 9.2%, there would be an impact on the nominal GDP growth rate too which was assumed at 14.4% during the drawing up of the Budget. This slippage does not take into account the higher borrowings which the government spoke of yesterday to compensate states for shortfalls in GST collections.

Basis for estimation of slippages in fiscal deficit for FY22

Major revenue slippages
Most parts of the country have been under some form of lockdown since the start of the current financial year. These restrictions are expected to be in place for nearly the whole of Q1 (Apr-Jun) with the unlock process being moderate in July. Tax collections during this period are expected to be lower as a result. We have buffered in the very high GST collections in April but expect slippages in May. Also, the corporate tax collections will be impacted to an extent especially for the smaller companies which have been under pressure. While imports are rising and customs should increase, the current slowdown will temper their growth as demand for non-oil imports moderates. The slowdown in e-way bills is indicative of the pace of activity. There will be only minimal impact on income tax collections as job losses in the white collared category has been low so far.

As per past trends, on an average nearly 20% of the net tax revenues for the financial year are accrued during the first quarter (Apr-Jun). Owing to the lockdown, we expect a tax shortfall of 15% to 20% from the budget estimates for FY22. This would amount to Rs. 0. 46 lakh crs to Rs.0.62 lakh crs

Question mark against disinvestment
There have been plans put in place to put the disinvestment programme in motion. The first two months have witnessed limited traction as attention has been more on controlling the pandemic and hastening the vaccination programme. We do believe that there will be more traction from Q2 onwards but some of the big questions remain especially for the targets in the financial sector. While there are some aggressive plans, it is also important to push through them before the end of the year and all approvals procured. We believe that the shortfall could be between 25% to 33% of the disinvestment target of Rs.1.75 lakh crs. The shortfall on this account would be Rs. 0.44 lakh crs to Rs.0.58 lakh crs with a possibility of further slippage. Such action will also be contingent on the state of the stock markets and the appetite for a large dose of PSU shares for sale.

Expenditure will be higher for sure
Additional expenditure over the budgeted expenditure would be incurred during the year towards welfare programmes, employment support and relief to most impacted sectors. We estimate that this additional expenditure will be in the range of Rs.0.49 lakh crs to Rs. 0.66 lakh crs. This will be for NREGA, health, welfare and other relief to specific sectors (which can also partly be in tax cuts instead of direct expenditure as on covid related items). Schemes like interest rate subvention can be considered to help the SMEs. As the vaccination drive intensifies the government may have to import doses at market prices. This amount can again increase.

The government has already announced additional expenditure amounting to Rs. 0.41 lakh crs towards additional fertilizer subsidy and free food grains for two months for 80 crs beneficiaries. This we believe will be a big benefit for the rural

community especially so given the increase in price of fertilizers recently. It will also ensure that there will not be cost-induced food inflation.

There is good news however,
The RBI has transferred Rs. 99,122 crs to the central government which is Rs. 45,612 crs more than the budget estimate. This provides a good cushion for the government during these stressful times.

As in the case of the RBI, public sector bank (PSB) dividends could be better than expected provided there is no new rule on the payment of the same this year. Some of the results of the PSBs have been promising.

What it all boils down to
Factoring the likely revenues and additional expenditure, the overall fund shortfall could be in the anywhere between Rs.1.34 lakh crs to Rs.1.80 lakh crs.

Here is how it looks:

The fiscal slippage matrix

Rs crore	Conservative	Stress case
Revenue scenario		
Tax revenue shortfall in Q1 by 15-20%	46,362	61,816
Disinvestment shortfall by 25-33%	43,750	57,750
Revenue shortfall	90,112	1,19,566
Revenue benefit		
Excess RBI surplus transferred	45,612	45,612
Net revenue shortfall	44,500	73,954
Expenditure compulsions		
Announced additional expenditure on food and fertilizers	40,775	40,775
Higher NREGA spending	25,000	30,000
Additional expenditure on vaccination/welfare measures	14,000	21,000
Expected relief for most impacted sectors in course of the year	10,000	15,000
Expenditure overshooting	89,775	1,06,775
Increase in fiscal deficit	1,34,275	1,80,729

Projected Fiscal deficit for FY22
The fiscal deficit for FY22 has been budgeted at Rs. 15.06 lakh crs and 6.8% of GDP. The fund shortfall (due to additional expenditure and lower income) would push up the fiscal deficit to Rs. 16.41 lakh crs to Rs. 16.87 lakh crs.

The nominal GDP for FY22 was estimated to be Rs. 222.9 lakh crs which tantamount to a 14.4% growth over FY21. There is a downside risk to this growth estimate given that this projection was made before the onset of the second wave of the pandemic. We estimate a nominal GDP growth of 12.2% for FY22 (9.2% growth in real GDP).

The increase in the quantum of fiscal deficit coupled with the decline in the GDP would potentially push up the fiscal deficit to 7.5% to 7.7% of GDP in FY22 which is a 0.7% to 0.9% increase over the budget estimate. As such, the fiscal consolidation intentions of the government would necessarily have to be deferred.

Contact:

Madan Sabnavis	Chief Economist	madan.sabnavis@careratings.com	+91-22-6837 4433
Author: Kavita Chacko	Senior Economist	kavita.chacko@careratings.com	+91-22-6837 4426
Mradul Mishra	(Media Contact)	mradul.mishra@careratings.com	+91-22-6754 3573

Disclaimer: This report is prepared by CARE Ratings Limited. CARE Ratings has taken utmost care to ensure accuracy and objectivity while developing this report based on information available in public domain. However, neither the accuracy nor completeness of information contained in this report is guaranteed. CARE Ratings is not responsible for any errors or omissions in analysis / inferences / views or for results obtained from the use of information contained in this report and especially states that CARE Ratings has no financial liability whatsoever to the user of this report

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Tel. : +91-22-6754 3456 I CIN: L67190MH1993PLC071691

Connect :