

Union Budget 2021-22

February 1, 2021

The Finance Minister presented the Union Budget for FY22 with a backdrop of a sharp global and domestic economic downturn in FY21, due to the impact of Coronavirus (Covid-19) and a need to revive the economy and the sentiments. The economic activity slowed down sharply (as reflected in the GDP data) with National Statistical Office's (NSO) estimate for full year FY21 GDP growth being pegged at -7.7% YoY. **Since this budget came with the backdrop of weak economic activity and gradually reviving demand conditions, it was expected to give a fillip to demand conditions on one hand the revive infrastructure spending on the other, with slippage on the fiscal side.** The Government has been battling with the challenge of low tax collections and imperative of reviving the economy so far in FY21. For FY22, while the growth is likely to revive due to opening up of the economy and a low base, high public spending is required to continue to create conditions for sustainable growth recovery. On the one hand, there was expectation of some sort of stimulus to rural economy, tweaks in the tax rates, focus on targeted infrastructure spending to shore up new job creation; on the other hand, there was also an expectation by some segments of the market of slip up in the fiscal maths to push up growth was quite likely and an immediate need. **Given the slow revival of the private capex, there were also expectations that the government would add more sectors in the PLI (production linked incentives) scheme to further incentivise manufacturing to create more jobs and boost the economic growth. Apart from these, the current administration has been known for its commitment to push through large structural reforms.** Focus on infrastructure is a key to drive government's flagship programs like Housing for all, Water for all and Make in India. The budget seems to have walked on the path of higher public spending with counter cyclical fiscal policy to support the nascent recovery in the economic growth.

The economic survey released prior to the budget, projected the gross domestic product (GDP) growth for FY22 at 11% YoY and nominal GDP growth at 15.4% YoY, mainly on the back of a low base and a strong recovery backed by reforms in agriculture, mining, labour, etc. in a post pandemic world. It also feels that the FY22 GDP growth estimates could be a conservative estimate. While economy's returning to normalcy brought closer by the initiation of a mega vaccination drive, hopes of a robust recovery in services sector, consumption, and investment have been rekindled, **however, the survey felt that the economy could take two years to go past the pre-pandemic level.** As per the Survey FY 2021-22 is expected to see **counter cyclical Fiscal Policy** (higher fiscal deficit) to support the **recovery in aggregate demand. The Survey also said that adding the growth recovery would facilitate buoyant revenue collections in the medium term and enable a sustainable fiscal path. The Survey argued that the higher debt due to higher fiscal deficit would be manageable as it would lead to higher GDP growth which would lead to higher revenues for the government. Thus it advocated that fiscal policy that provides an impetus to growth will lead to lower debt-to-GDP ratio in future.** The survey also suggested at reducing the over regulation in many sectors of the economy, as it felt that it leads to non-transparent discretion. Thus for ease of doing business and ease of living, the survey suggested to simplify regulations and invest in greater supervision; balanced with transparency, systems of ex-ante accountability and ex-post resolution mechanisms. On inflation from the survey expects that easing supply constraints and lower food inflation would lead to lower CPI inflation, while improving demand conditions could see WPI inflation remaining steady, suggesting that manufacturers would see improved pricing power. On the Industry and infrastructure side, the survey observed that huge impetus to this sector has come through with the various Atmanirbhar Bharat policies. It estimated that measures equivalent to Rs.29.8 trillion or 15% of India's GDP were introduced as a measure of relief and support to the economy. With the objective of enhancing India's manufacturing capabilities and exports, the Government introduced the PLI Scheme in the 10 key sectors under the aegis of Atmanirbhar Bharat. It felt that the revival of the industrial and infrastructure sector would be key to overall economic growth and macroeconomic stability. Thus, it felt that FY22 would require sustained and calibrated measures to facilitate the process of economic recovery and to enable the economy to get back to its long-term growth trajectory. On the external account front the survey sounded very confident. With lower trade deficit, buttressed by robust FDI and FPI inflows, the foreign exchange reserves rose to an all-time high of USD 586.1 billion as on January 8, 2021. Overall, India is expected to witness current account surplus during the current financial year after a gap of 17 years in FY21. It suggested that the

RBI's interventions in the forex markets ensured financial stability and orderly conditions and have been largely successful in controlling the volatility and one-sided appreciation of the rupee. It also felt that various initiatives undertaken to promote exports, including PLI Scheme, Remission of Duties and Taxes on Exported Products (RoDTEP), improvement in logistics infrastructure and digital initiatives would go a long way in strengthening external sector in general and exports in particular. The survey stated that reforms in tax administration have set in motion a process of transparency, accountability and more importantly, enhancing the experience of a tax-payer with the tax authority, thereby incentivising tax compliance. The survey stated that the focus of the Government is to embark on a significant privatisation exercise of CPSEs and speeding up big-ticket strategic sale/ privatisation of large CPSEs such as Air India, BPCL, CONCOR and SCI. This also gels well with the government's plan of minimum government and maximum governance. However, the survey did have a word of caution for the regulatory forbearance regime in the financial sector. It stated that forbearance represents emergency medicine that should be discontinued at the first opportunity when the economy exhibits recovery, not a staple diet that gets continued for years. Thus is nudged the policy makers to lay out the milestones in economic recovery which would decide on the reversal of such measures. It also suggest that an Asset Quality Review be conducted immediately after the forbearance is withdrawn. **Nevertheless, with the economy's returning to normalcy brought closer by the initiation of a mega vaccination drive, hopes of a robust recovery in services sector, consumption, and investment have been rekindled driving the expectations for a very strong FY22 growth.**

Given all the above considerations, the government chose to a move towards helping economic revival by pushing up fiscal spending. The Fiscal deficit for FY21 is estimated at 9.5% of GDP, higher than 3.5% of the GDP projected by the government and the Fiscal deficit for FY22 is now projected at 6.8% of the GDP. The budget was also a statement of intent of the government for many sectors and road map was laid out for key projects of the government for such period. **The government has also laid down plans to bring down the fiscal deficit to 4.5% of GDP by FY26.** The Government expects to achieve the consolidation by increasing the buoyancy of tax revenue through improved compliance, and secondly, by increased receipts from monetisation of assets, including Public Sector Enterprises and land. **The budget for FY22 reflected government's commitment to substantially boost Rural/Agri sector, Infrastructure, Ease of doing business, Minimum government maximum governance and Employment generation.**

The gross fiscal deficit was pegged at Rs.15.06 trillion or 6.8% of the GDP in FY22 as against 9.5% in FY21. The fiscal deficit number was more than what the markets expected, as the needs of pushing growth in the economy and building transparency in the government balance sheet led to higher number. For FY22, the government has brought the borrowings of the Food Corporation of India (FCI) into its own balance sheet against it being shown as an off balance sheet item. That also is estimated to push up the deficit number for FY22 higher, as the estimate of FCI borrowing for FY21RE stood at Rs.846.36 bn. **Most of the major estimates on the Expenditure, Revenue receipts and Capital receipts looked credible, given that the government expects the nominal GDP to rise by 14.4% to Rs.222.8 trillion and expects higher proceeds from Revenue receipts (15% YoY growth) and higher borrowing. The budget also estimated disinvestment proceeds to be to the tune of Rs.1.75 trillion, which would also include disinvestment of government stake in Public sector banks and an insurance company.** Given, the solid pipeline of disinvestment that is lined up including BPCL, BEML, Concor and LIC IPO, thus number looks quite achievable. The recent green shoots showing up from the economy and the lower base effect is likely to help the country achieve a 14.4% YoY nominal GDP growth rate. The tax revenues are expected to grow by 14.94% YoY (tax revenues net to centre) to Rs.15.45 trillion on the back of broadening of the tax base, improved corporate/personal incomes tax collection and higher GST/customs due to higher growth dynamics and large capital spending by the government. It is expected that total gross tax to GDP ratio would improve to 10% from 9.8% in FY21RE. Total expenditure in FY22 is pegged at Rs.34.8 trillion, which is an increase of ~1% over FY21RE (Revised Estimates). Revenue Expenditure is estimated to be Rs.29.2 trillion in FY22BE (Budgeted Estimates) reflecting a decline of 2.7% YoY over FY21RE. Capital expenditure is expected to increase to Rs.5.5 trillion in FY22BE growing by 26.2% YoY over FY21RE. **We think that the key to manage the fiscal deficit number would be the ability of the government to go ahead with the planned sale of securities/disinvestment to the tune of Rs.1.75 trillion, transfer from RBI and financial institutions**

to the tune of Rs.1.04 trillion, communication (Spectrum) receipt of Rs.539 bn and managing the current subsidy burden on Food, Petroleum and Fertilizer at Rs.3.35 trillion (decline of ~43% against FY21RE). With the big fiscal spending on the way, especially through the capital expenditure route, the expectations of revival in growth and jobs creations in the economy gets reinforced.

There were six major focus areas of the budget- 1) Health and Wellbeing, 2) Improving Physical & Financial Capital, and Infrastructure, 3) Inclusive Development for Aspirational India, 4) Reinvigorating Human Capital, 5) Innovation and R&D, and 6) Minimum Government and Maximum Governance. Strong emphasis was given to Job creation, Financial sector reforms and Agriculture, along with pushing ahead with infrastructure thrust through investment on roads, railways and airports. This would eventually help in improving the Ease of Living, helped by improved governance and financial sector reforms.

Considering that the economy is coming out of the Covid-19 related slowdown, the budget clearly tried to push through with the agenda of supporting the nascent growth recovery through big spending on the Infrastructure sector. Large public spending in the infra space was one of the key demand of the industry experts and economists alike, even at the cost of higher fiscal slippage. This is expected to quicken the pace of Economic Development and Job Creation. Investments in physical infrastructure is the key to pushing the Make in India and the Production Linked Incentive of the government. **The focus in the infrastructure sector continued to be on Roads, Urban development, Oil&Gas, Shipping and Railways. Accelerated development of highways would help in strong job creation and improved connectivity.** Total investment in the Road sector is projected at ~Rs.1.18 trillion reflecting a growth of 15.9% over FY21RE. The budget talked about awards of 8500 km of road projects and completion of about 11,000 km of road projects in FY22. For FY22BE, the total government support to Railways has been pegged at Rs.1.1 trillion, flat growth from FY21RE. **On the railways front, the budget envisaged more sections of the Dedicated Freight Corridors to be taken up.** Urban development allocation saw 16.6% increase to Rs.545 bn over FY21RE. New scheme at a cost of Rs.180 bn to support augmentation of public bus transport services is proposed to be launched. The scheme will facilitate deployment of innovative PPP models to enable private sector players to finance, acquire, operate and maintain over 20,000 buses. The scheme will boost the automobile sector, provide fillip to economic growth, create employment opportunities and enhance ease of mobility for urban residents. On the Metro rail front, the budget envisaged supporting the expansion of the metro rail system in some of the existing cities and funding the launch of metro rail system in new city. It also envisages deployment of two new technologies i.e., 'MetroLite' and 'MetroNeo' to provide metro rail systems at much lesser cost with same experience, convenience and safety in Tier-2 cities and peripheral areas of Tier-1 cities. In the Power sector the budget proposed to bring about a framework to give consumers alternatives to choose from among more than one Distribution Company, to improve customer experience and reduce monopolies of the distribution companies, which would improve the service quality. Considering the focus of the government to reduce the pollution factor, the budget proposed addition of 100 more districts in next three years to the City Gas Distribution network. To push scheme world class infrastructure with plug and play facilities to enable create global champions in exports in textile, the budget proposed launching of Mega Investment Textiles Parks (MITRA) addition to the PLI scheme. This would create 7 Textile Parks will be established over 3 years. Over and above the Central government capital expenditure, the budget also provided more than Rs.2 trillion to States and Autonomous Bodies for their Capital Expenditure. To fund the large Infrastructure requirement in the country the budget also proposed the creation of professionally managed Development Financial Institution with a capital of Rs.200 bn and to eventually have a lending portfolio of Rs.5 trillion in the next three years. The budget also talked about monetizing operating public infrastructure as a financing option for new infrastructure construction. It proposed to monetise road assets of NHAI. Transmission assets of PGCIL, airports, warehousing assets etc. **Continued focus on infrastructure creation by the government is likely to have two benefits, firstly it would lead to increased job creation in the economy and secondly it would also lead to pick up in the allied sectors like steel, metals, cement etc which can drive capex in these sectors and drive further economic growth.**

As the Covid-19 pandemic impacted the Indian economy, need is being felt for high allocation to health care sector to ensure that enough care is available if and when health scares of such magnitude hits us. The Budget proposed a new centrally sponsored scheme, PM AtmaNirbhar Swasth Bharat Yojana, to be launched with an outlay of about Rs.641.8 bn over 6 year; to develop capacities of primary, secondary, and tertiary care Health Systems, strengthen existing national institutions, and create new institutions, to cater to detection and cure of new and emerging diseases. This will be in addition to the National Health Mission. It proposed to strengthen nutritional content, delivery, outreach, and outcome and launch the Mission Poshan 2.0 to improve nutritional outcomes across 112 Aspirational Districts. With an outlay of Rs.2.87 trillion over next 5 years the budget proposed to launch Jal Jeevan Mission (Urban) universal water supply in all 4,378 Urban Local Bodies with 28.6 mn household tap connections. The budget has also provided Rs.350 bn for the Covid-19 vaccine. The budget also announced the much awaited voluntary Scrappage policy to phase out old and unfit vehicles to reduce the air pollution and bring in newer fuel efficient vehicles. The overall outlay for the Health and wellbeing segment of the budget swelled from Rs.944 bn in FY21BE to Rs.2.23 trillion in FY22BE, a jump of 137%. On the inclusive development side, the budget anticipates strong focus on the rural economy especially through the development of the Animal husbandry, fisheries and dairy farming sectors through higher credit flow. The budget expects a total agri credit target of Rs.16.5 trillion. On the labour reforms side the budget expects the four labour codes to be implemented which would give social security benefits to most category of workers. The budget also proposed an outlay to increase the number of schools and improve the standards of higher education in the country. **With all these proposals, the focus of the government would be on providing maximum livelihood opportunities in the rural areas, push up income generating opportunities in agriculture and allied activities.**

Financial and PSU sector reforms continued to remain on the top of Government's agenda. The budget proposed to consolidate the provisions of SEBI Act, 1992, Depositories Act, 1996, Securities Contracts (Regulation) Act, 1956 and Government Securities Act, 2007 into a rationalized single Securities Markets Code. The recent bond market upheaval during the Covid-19 related lockdown seems to have led the government to bring about a permanent institutional framework with a body that would purchase investment grade debt securities both in stressed and normal times and help in the development of the Bond market. **The budget also proposed to increase the permissible FDI limit from 49% to 74% in Insurance Companies and allow foreign ownership and control with safeguards.** This has been the demand from the sector and is likely to see more global players entering/raising stake in the Indian insurance sector. **However, the big announcements which took the markets by complete surprise was the proposal to setting up an Asset Reconstruction Company Limited and Asset Management Company would be set up to consolidate and take over the existing stressed debt and then manage and dispose of the assets to Alternate Investment Funds and other potential investors for eventual value realization.** The budget also allocated Rs.200 bn for further PSU bank recapitalisation. **Another big surprise for the equity markets was the proposal to take up the privatization of two Public Sector Banks and one General Insurance company in FY22.** This is a huge step in the journey of disinvestment and privatisation of PSU companies in India and the equity markets cheered the news. As these steps get executed, the markets could start to rerate the whole PSU sector in anticipation of further such moves for other banks, therefore timely execution is important.

The higher fiscal deficit could worry the bond markets due to large borrowing program. However, if the higher deficit fuels a strong growth momentum in the economy, then the growth would ensure gradual lowering of the deficit in the coming years. The government too seems to be expecting the same outcome. However, higher supply, further global stimulus and growth led inflationary pressure could ensure the bottoming out of the yields.

The budget did not alter much on the direct taxation front nor did it touch the capital gains taxes. This also came as a relief for the equity markets. For senior citizens who only have pension and interest income, the budget proposed exemption from filing their income tax returns. It also reduced the time-limit for re-opening of assessment to 3 years from the present 6 years. It proposed establishment of a National Faceless Income Tax Appellate Tribunal Centre where all communication between the Tribunal and the appellant shall be electronic. In another instance of ease of living the budget proposed that details of

capital gains from listed securities, dividend income, and interest from banks, post office, etc. will also come pre-filled in income tax returns. **On the indirect tax proposals the budget did make tweaks in the customs duties of various products with twin objective of promoting domestic manufacturing and helping India get onto global value chain and export better.**

Clearly this was a budget that surprised the market in terms of the big risk that the government has taken on the fiscal side to propel growth in the economy. The budget proposals anticipate economic revival through higher capex spending, big ticket disinvestment to get higher capital flows in the economy and improving ease of doing business which could revive the job creation and lead to a virtuous cycle, with execution being the key. The budget was not used to make lot of new flagship programs, but was an exercise to divide the resources into existing flagship programs. The budget proposals talked about many ideas like one person company, faceless ITAT, improving effectiveness of tax administration, Investor Charter, ease of compliance etc. This government is known to come out of big ticket reforms and policy measures outside the budget and this is a trend we could see in the next fiscal also. The strong infrastructure and rural income generation push in the budget is likely to drive the growth in the capital formation and improve demand conditions in the economy. In conditions where the growth in the country is decelerating, it's important for India to be able to create robust domestic market which would allow it to leverage its demographic dividend and bring in more global capital. Of course, the big stimulus that the budget has given in the form of higher capital outlay would have to be matched by the industry in terms of being nimble to fulfil the demand kicker that could accompany it. If the domestic manufacturing sector doesn't keep up with the increased demand, it could slip into higher imports which may not be the intention of the budget.

The markets ended on a strong note post the budget as most of the expectations of the markets were met with few big positive surprises (PSU bank privatisation, ARC for stressed assets) and lack negative surprise on the taxation front. We think that the budget has the ability to drive the growth, by stimulating investment demand and thus earnings for the corporates. From here on the Indian equity markets are likely to move on the back of improved corporate earnings and upcoming macro-economic data points. Given the strong global liquidity and reviving growth dynamics in the economy and expectations of unleashing of the animal spirits in the economy we remain positive on the Indian equity markets over the medium term. With a big booster dose being administered to the economy through the budget we change our investment deployment strategy to 40% Lumpsum and 60% staggered over the next 4-5 months. From an Equity Mutual Fund perspective, investors could look at investing in Multicap/Flexicap funds, Large & Midcap funds, Midcap funds and Small cap funds in line with their risk profile and product suitability.

Sectoral Impact

Automobiles and Auto Ancillary

Budget Expectations

- Incentive for scrapping old vehicles and support for setting up scrapping centres
- Allocation of funds for manufacturing of hybrid/electric vehicles
- Reduction in custom duty on key components used in Electric Vehicles
- Increase in allocation towards rural focused schemes
- Focus on infrastructure segment with higher allocation
- Increase in exemption limit/tax bracket to increase spending power
- To increase customs duty on imported tyres

Budget recommendations

- Allocation for total expenditure on Agriculture and Allied Activities increased to ~Rs.1483 bn in FY22BE vs Rs.1454 bn in FY21RE
- Allocation for Road transport and highways increased to ~Rs.1082 bn in FY22BE, ~18% YoY over FY21RE

- Increased the allocation to the Rural Infrastructure Development Fund from Rs.300 bn to Rs.400 bn in FY22BE
- To announce a voluntary vehicle scrapping policy to phase out old (20 years in case of personal vehicles and 15 years in case of commercial vehicles) and unfit vehicles.
- A new scheme to be launched at a cost of Rs.180 bn to support augmentation of public bus transport services
- Proposed to increase basic customs duty on certain auto parts like ignition wiring sets, safety glass, parts of signaling equipment, etc. have been raised from 7.5%/10% to 15%

View:

The major outcome for Automobiles sector was announcement of Scrappage policy, which was much awaited by the industry participants. While it is a step in the right direction for the sector but granular details on the policy would be the key to determine the impact on the sector. The continued focus of the government on improving the income for agricultural sector and Rural India is likely to be positive for Tractor and two wheeler sectors. On the Commercial vehicle segment, Scrappage policy, large infrastructure spending plan and a new scheme to support public bus transport services seems to be positive. Few auto component parts also saw a rise in custom duty, which would be marginally positive for Auto component sectors.

Banking and Insurance

Budget Expectations

- Re-capitalization of PSU Banks
- Creation of Bad Bank
- Higher allocation of funds to core sectors like infrastructure, housing and urban development
- Incentivize cashless/digital transactions, impose taxation on high value cash transactions
- Increase in tax exemption limit for home loans to boost low cost housing demand
- Relaxation in banks' lending to infrastructure sector
- Hike in Tax incentives for insurance products
- Hike in FDI Cap in Insurance

Budget recommendations

- Estimated Fiscal deficit at 9.5% and 6.8% for FY21 and FY22, respectively
- Proposed to amend the Insurance Act, 1938 to increase the permissible FDI limit from 49% to 74% in Insurance Companies
- Proposed to come up with an Initial Public Offer (IPO) of LIC in FY22
- Proposed further recapitalization of Rs 200 bn in Public Sector Banks (PSBs) in FY22
- Also, proposed to take up the privatization of two PSBs and one General Insurance company in FY22
- Proposed to set up an Asset Reconstruction Company and Asset Management Company to consolidate and take over the existing stressed debt of PSBs and then manage and dispose of the assets to Alternate Investment Funds

View:

The budget seems to be positive for the BFSI sector. Insurance companies are likely to get a boost from higher FDI limits. PSBs are likely to get benefitted from the announcement of recapitalization plan and proposal of setting up separate company to manage stressed asset, which is likely to improve the financial position of PSBs. The budget proposal indicated a stake sale in LIC and further divestment of two PSBs and one general insurance company in FY22. The focus on spending growth in the economy is likely to be key driver of credit growth going forward.

Consumer Goods & Retail

Budget Expectations

- Increase in allocation towards rural focused schemes like PM-Kisan, MGNREGA

- Rationalization of IT slabs of 10% & 20% to help push the disposable income with consumers.
- Increase in standard deduction for salaried employees
- Reduction in import duty on gold/diamond
- Hike in Customs duty on footwear and related products

Budget recommendations

- Allocation for total expenditure on Agriculture and Allied Activities increased to ~Rs.1483 bn in FY22BE vs Rs.1454 bn in FY21RE
- Mahatma Gandhi National Rural Employment Guarantee Program (MGNREGA) Outlay increased by 18.7% YoY to Rs.730 bn for FY22BE over FY21BE.
- Proposed to increase customs duty on certain types of Leathers from nil to 10%
- Proposed to increase customs duty on Prawn Feed, Fish feed in pellet form and Flours, meals and pellets of fish from 5% to 15%
- Proposed to increase customs duty on Synthetic Cut and Polished Stones from 7.5% to 15%
- Proposed to increase customs duty on parts of mobile phones (Printed Circuit Board Assembly [PCBA] and Moulded Plastic, for manufacture of charger or adapter) from 10% to 15%
- Proposed to increase basic customs duty on Compressor of Refrigerator/Air Conditioner to 12.5% from 15%
- Proposed to reduce basic customs duty on Precious Metals (Gold and silver) to 10% from 12.5%
- Proposed to levy Agriculture Infrastructure and Development Cess (AIDC) on Gold, Silver and dore bars; Crude soyabean and sunflower oil; Kabuli chana, Cotton (not carded or combed) and certain Alcoholic beverages

View:

The budget has been mixed for the Consumer Goods sector, where announcement of levy of AIDC on some of the items is likely to be marginally negative, while announcement of increase in basic custom duty for few sub sectors (Mobile Phones, fishery products, Leathers) supporting domestic manufacturing is likely to be positive. Absence of major changes in Cigarettes is likely to be key positive for Cigarettes industry. Steady allocation to rural and agriculture related schemes are likely to continue to support rural demand in coming times, which in general is positive for overall consumer goods sector.

Infrastructure

Budget Expectations

- Higher allocation to Infrastructure, with outlay for Roads and Highways and Pradhan Mantri Gram Sadak Yojana to rise sharply
- Higher allocation towards urban infra via metro projects and also increased spending on Smart Cities project. Apart from this increase allocation towards Airports, Ports etc
- Announcement of separate body or Self-Regulatory Organization to keep a check on stalled projects

Budget Recommendations

- Overall capital expenditure to be increased sharply to Rs.5.54 trillion for FY22BE v/s Rs.4.39 trillion for FY21RE.
- The government would also be providing more than Rs.2 trillion to States and Autonomous Bodies for their Capital Expenditure.
- To implement Jal Jeevan Mission (Urban) with outlay of Rs.2.87 trillion to cover 28.6 mn household tap connections and to be implemented over five years.
- Urban Swachh Bharat Mission 2.0 will be implemented with a total financial allocation of Rs.1.41 trillion over a period of five years from 2021-2026
- National Infrastructure Pipeline has been expanded to 7,400 projects from 6835 projects
- To introduce a bill to set up Development Financial Institution with a capital outlay of Rs.200 bn for infrastructure financing

- A National Monetization Pipeline of potential brownfield infrastructure assets will be launched to fund new infrastructure projects
- To augment road infrastructure, the government would be allotting Rs.1.03 trillion for National Highway Projects in Tamil Nadu; Rs.650 bn for National Highway Projects in Kerala; Rs.250 bn for National Highway Projects in West Bengal and an additional Rs.340 bn for National Highway Projects in Assam
- Allocation of Rs.1.10 trillion to Railways for FY22BE, of which Rs.1.07 trillion is for capital expenditure.
- A revamped reforms-based result-linked power distribution sector scheme would be launched with an outlay of Rs.3.06 trillion over 5 years.
- Ujjwala scheme, which has benefitted 80 mn households would be expanded to include 10 mn more
- Increased the allocation to the Rural Infrastructure Development Fund from Rs.300 bn to Rs.400 bn in FY22BE
- To increase the corpus of Micro Irrigation Fund, created under NABARD from Rs.50 bn to Rs.100 bn in FY22BE
- Tax holiday for affordable housing projects to be extended for another year till March 31, 2022
- Notified infrastructure debt funds to be eligible to raise tax-efficient zero-coupon bonds

View:

The Government came out with a series of announcement on infrastructure and increased the budget allocation for developing Road, Rail and Rural infrastructure, which would be positive for infrastructure sector. Finance Minister also increased the number of projects under the National Infrastructure pipeline, which may further support the growth for the sector. The government also focused on alleviating the stress in the power sector and is planning to come out with the scheme with an outlay of Rs.3.06 trillion over 5 years. The government also extended its support to affordable housing projects by extending the tax holiday for another year. Overall, the budget seems to be positive for infrastructure and its allied sectors like cement, metal, realty, power etc.

Oil & Gas**Budget Expectations**

- Increase/maintain allocation for Petroleum Subsidy for FY22
- Inclusion of petroleum fuels (especially Aviation Fuel and Natural Gas) under GST and also reducing GST rates on CNG vehicles
- Announcement of Privatization path/timeline for Oil PSUs
- Reduction in excise duty on petrol and diesel
- Exemption of custom duty on LNG import

Budget Recommendations

- Provided ~Rs.130 bn subsidy on petroleum for FY22BE against ~Rs.388 bn allocation in FY21RE.
- An independent Gas Transport System Operator would be setup for facilitation and coordination of booking of common carrier capacity in all-natural gas pipelines on a non-discriminatory open access basis
- Proposed to add 100 more districts in next 3 years to the City Gas Distribution network
- Ujjwala Scheme which has benefitted 80 mn households would be extended to cover 10 mn more beneficiaries
- A gas pipeline project would be taken up in Union Territory of Jammu & Kashmir
- Proposed to levy Agriculture Infrastructure and Development Cess (AIDC) of Rs.2.5 per litre on petrol and Rs.4 per litre on diesel. However, Basic excise duty and Special Additional excise Duty have been reduced.
- Decreased Custom duty on Naptha from 4% to 2.5%,
- Announced the strategic disinvestment of BPCL in FY22

View:

The budget announcements were neutral to positive for the Oil & Gas sector. While Oil companies are unlikely to see any major impact of AIDC levy as there was a reduction in custom duty as well, which is likely to neutralize the impact of AIDC. However, extension of City Gas distribution to 100 more districts is likely to drive the demand for Gas in the country and thereby announcement is likely to be positive for Gas infrastructure industry.

Personal Income Tax

There is no change proposed in tax rates in Section 115BAC. The rates provided in this Section for the Assessment Year (AY) 2021-22 would be same as already enacted.

Following are the Income Slabs and Tax Rates

For individual Tax Payers

| Tax Slabs | (2021-22) |
|--------------------|---------------------|
| Income (Rs) | Tax Rate (%) |
| 0 mn – 0.25 mn | 0% |
| 0.25 mn – 0.5 mn | 5% |
| 0.50 mn – 1 mn | 20% |
| Above 1 mn | 30% |

From the AY 2021-22 (FY 2020-21), individual and HUF tax payers have an option to opt for taxation (as mentioned in the below table) under section 115BAC of the Act, on satisfaction of certain conditions.

For individual Tax Payers

| Tax Slabs | (2021-22) |
|--------------------|---------------------|
| Income (Rs) | Tax Rate (%) |
| 0 mn – 0.25 mn | 0% |
| 0.25 mn – 0.50 mn | 5% |
| 0.50 mn – 0.75 mn | 10% |
| 0.75 mn – 1.0 mn | 15% |
| 1.0 mn – 1.25 mn | 20% |
| 1.25 mn – 1.5 mn | 25% |
| Above 1.5 mn | 30% |

Surcharge on income-tax:

- of 10% for income (including the income by way of dividend or income under the provisions of section 111A and section 112A of the Income-tax Act) exceeding Rs.5 mn but not exceeding Rs.10 mn.
- of 15% for income (including the income by way of dividend or income under the provisions of section 111A and 112A of the Act) exceeding Rs.10 mn but not exceeding Rs.20 mn.
- of 25% for income (excluding the income by way of dividend or income under the provisions of section 111A and section 112A of the Income-tax Act) exceeding Rs.20 mn but not exceeding Rs.50 mn.

- d) of 37% for income (excluding the income by way of dividend or income under the provisions of section 111A and section 112A of the Income-tax Act) exceeding Rs.50 mn.
 - e) of 15% for income (including the income by way of dividend or income under the provisions of section 111A and section 112A of the Income-tax Act) exceeding Rs.20 mn, but is not covered under clauses c) and d).
- For AY 2021-22 - "**Health and Education Cess**" is to be levied at the rate of 4% on the amount of income tax so computed, inclusive of surcharge wherever applicable, in all cases.
 - The existing provision of the section 80EEA of the Act, inter alia, provides a deduction in respect of **interest on loan taken for a residential house property** from any financial institution up to Rs.0.15 mn subject to the condition that the loan has been sanctioned during the period beginning on 1 April 2019 and ending on 31 March 2021. This provision allows deduction to the first time home buyers, in respect of interest on home loan. In order to help such first time home buyers further, it is proposed to amend the provision of section 80EEA of the Act to extend the outer date for sanction of loan from 31 March 2021 to 31 March 2022.

This amendment will take effect from 1 April 2022 and will accordingly apply to the AY 2022-23 and subsequent AY.

- Section 139 of the Act provides for filing of return of income. In order to provide **relief to senior citizens having age of 75 years** or above and to reduce compliance for them, it is proposed to insert a new section to provide a relaxation from filing the return of income, if the following conditions are satisfied:- (i) The senior citizen is resident in India and of the age of 75 years or more during the previous year; (ii) He has pension income and no other income. However, in addition to such pension income he may also have interest income from the same bank in which he is receiving his pension income; (iii) This bank is a specified bank. The Government will be notifying a few banks, which are banking company, to be the specified bank; and (iv) He shall be required to furnish a declaration to the specified bank.

Once this is done, there will not be any requirement of furnishing return of income by such senior citizen.

This amendment will take effect from 1 April 2021.

- Clause (10D) of section 10 of the Act provides for the exemption for the sum received under a life insurance policy, including the sum allocated by way of bonus on such policy in respect of which the premium payable for any of the years during the terms of the policy does not exceed 10% of the actual capital sum assured. It is proposed to provide for the followings:

A fourth provision has been inserted to clause (10D) of section 10 of the Act to provide that the exemption under this clause shall not apply with respect to any ULIP issued on or after the 1st February, 2021, if the amount of premium payable for any of the previous year during the term of the policy exceeds Rs.0.25 mn.

A fifth provision has been inserted to this clause to provide that, if premium is payable by a person for more than one ULIPs, issued on or after the 1st February, 2021, exemption under this clause shall be available only with respect to such policies aggregate premium whereof does not exceed the amount of Rs.0.25 mn, for any of the previous years during the term of any of the policy.

These amendments will take effect from 1 April 2021 and will accordingly apply to the AY 2021-22 and subsequent AYs.

- Consequential amendment has also been proposed in Finance (No 2) Act, 2004 to make security transaction tax applicable on maturity or partial withdrawal with respect to unit linked insurance

policy issued by insurance company on or after the 1 February 2021 [to which exemption under clause (10D) of section 10 of the Act does not apply on account of the applicability of the fourth and fifth provision]

This amendment will take effect from 1 February, 2021.

- Clause (11) of section 10 of the Act provides for exemption with respect to any payment from a provident fund to which the Provident Funds Act, 1925 (19 of 1925) applies or from any other provident fund set up by the Central Government and notified by it in this behalf in the Official Gazette. Similarly, Clause (12) of this section provides for exemption with respect to the accumulated balance due and becoming payable to an employee participating in a recognised provident fund, to the extent provided in rule 8 of Part A of the Fourth Schedule.

It is proposed to insert provision to clause (11) and clause (12) of section 10 of the Act, providing that the provisions of these clauses shall not apply to the interest income accrued during the previous year in the account of the person to the extent it relates to the amount or the aggregate of amounts of contribution made by the person exceeding Rs.0.25 mn in a previous year in that fund, on or after 1 April, 2021, computed in such manner as may be prescribed.

These amendments will take effect from 1 April, 2022 and shall apply to the AY 2022-23 and subsequent AYs.

Note: For any tax query, please check with your tax consultant.

Debt Market Outlook

Markets entered the FY22 Union Budget announcement, expecting a larger government borrowing programme and an expanded fiscal deficit target for FY22. This was not only because economies the world over have been providing fiscal push to economic growth; but also because the Economic Survey had mentioned that the government should priorities growth, and not worry about fiscal deficit. The finance minister on few occasions earlier had also indicated a similar intent. Despite this background, the budget announcement on both the fiscal deficit as well as government's market borrowings, were higher than expectations. The Fiscal deficit target of 6.8% of GDP for FY22, is higher than the market expectation of ~5.5% of GDP. Even for FY21 the fiscal deficit RE of 9.5% of GDP is higher than the consensus expectation of ~7.2% of GDP.

While the markets were expecting a higher fiscal deficit and government borrowing, there was still a hope that the government may support the economy while staying within the realms of fiscal deficit consolidation. However, the government has taken this opportunity, to propel the economic recovery amidst the Covid-19 pandemic by announcing a higher fiscal deficit target. The Finance Minister also jotted down the fiscal consolidation path albeit at a slower pace and not really targeting the levels pegged in previous budgets, given the scale of fiscal support that the economy is going to require. We should not forget that the economy was slowing even before the pandemic began and thus a slightly longer term and more comfortable fiscal consolidation path looks reasonable. In terms of fiscal consolidation for states, they will be expected to reach a fiscal deficit of 3% of GSDP by FY24.

The divestment target has been moderated to Rs.1.75 trillion for FY22 in comparison to the BE of Rs.2.10 trillion for FY21. Additionally, the government has revised the FY21 divestment target sharply lower to Rs.320 bn.

Coming to the government's market borrowing programme; the markets have been finding it difficult to absorb the increased bond supply for FY21. They were able to do so with the support and intervention by the RBI. The government's borrowing programme for FY22 is higher than expectations at ~Rs.12.06 trillion; and the Finance Minister also announced a further increase in borrowing for FY21, by another

Rs.800 bn, which will be borrowed over the course of the last two months of the current fiscal year. The additional borrowing announced for FY21 takes the total borrowing to ~Rs.13.90 trillion, including ~Rs.1.1 trillion for providing back to back loans to States and UTs for GST compensation cess shortfall. The net government borrowing for FY22 have been pegged at ~Rs.9.68 trillion in FY22 as against ~Rs.12.74 trillion RE for FY21. In case of state governments, the center has allowed a ceiling of net borrowing for the states at 4% of Gross state Domestic Product (GSDP) for FY22. Additional borrowing ceiling of 0.5% of GSDP will also be provided subject to conditions.

On the corporate bond market front, to instill confidence amongst the participants in the Corporate Bond Market during times of stress and to generally enhance secondary market liquidity, the Union Budget proposed to create a permanent institutional framework. The proposed body would purchase investment grade debt securities both in stressed and normal times and help in the development of the Bond market. This is likely to be positive for corporate bond markets.

Investment Strategy

The bond market reaction to the Union Budget announcement on fiscal deficit and market borrowings has been negative. However, when it comes to the expansion of fiscal deficit as well as the higher government borrowings for FY22, the bigger question is, is there any other choice available? The need of the hour today is to support economic growth while also remaining fiscally prudent to the extent possible. The government has tried to balance the act between trying to tow the economy back on the path of growth normalization, as well as not forgetting its responsibility of long term fiscal consolidation. Domestically, economic activity has rebounded better than anticipated earlier and that is likely to be helpful in achieving the tax revenue targets, as well as possibly the Nominal GDP target. Looking at the quality of the expanded fiscal deficit, the government has increased the capital expenditure by ~34% YoY over the FY21 BE and by ~26.20% over FY21 RE. A higher Capex target is likely to be beneficial in addressing supply side issues, and is likely to be beneficial for a long term sustainable economic recovery.

While so far, the RBI has provided strong support to bond markets during the pandemic, going forward it could get challenging for the RBI, given the scale of the support that may be required to government's large borrowing programme. The government's borrowing programme has sailed smoothly on the back of supply absorption support from the RBI. Despite a large borrowing calendar for FY21, bond yields have not seen a meaningful spike, thanks to the measures from RBI. However, FY22 could be marked by volatility due to a host of factors. Firstly and more importantly, the continuing higher supply of dated government securities may lead to supply fatigue in the market thereby imparting upward pressure on bond yields. The extent of upward pressure is likely to be determined by the extent of support from the RBI. Secondly, the trajectory of inflation may also impart volatility to bond yields. While inflation has cooled off recently, rise in commodity prices and further pick up in domestic demand could impart upward pressure to inflation. Commodity prices have seen a gradual rise since the mid of CY20 and domestic demand conditions represented by the Core CPI inflation have also remained strong. Thirdly, since major economies of the world are continuing to face fresh waves of Covid-19 infections, policy makers are likely to continue pumping fiscal fuel, to push the economic growth engine. This could also lead to hardening of bond yields globally. Additionally, more fiscal stimulus globally has the potential to drive global inflationary pressures.

The upcoming monetary policy of the RBI, scheduled to be announced on 5 February 2021 will be another important event to watch out for bond markets. Though RBI is likely to remain accommodative at least till the next financial year, the market participants would closely watch RBI's comments on the government's fiscal deficit as well as market borrowings. While some flattening of the yield curve has already taken place recently, post resumption of the normal liquidity management operations by the RBI; the yield curve continues to remain steep. Given the bond supply pressure, the longer end of the yield curve is likely to remain elevated and volatile. However, the shorter end of the yield could stay relatively protected given the high surplus liquidity conditions. Thus, at the current juncture, it will be prudent to invest in fixed income strategies that are oriented towards the very short to short end of the yield curve, in order to stay relatively protected from volatility.

Fixed Income Mutual Fund Strategy:- Given the expected volatility in bond markets, currently investors should look at Ultra Short Duration Funds/Low Duration/Money Market/Arbitrage Funds for a horizon of 3 months and above. Investors with an investment horizon of 12 months and above can look at short duration funds. Whereas, for a horizon of upto 3 months investors can consider Overnight Funds and Liquid Funds. Investors should invest in line with their risk profile and product suitability.

Budget at a Glance

| Particulars Rs. Bn | 2019-20 Actual | 2020-21 BE | 2020-21 RE | 2021-22 BE | % Change |
|------------------------------------|-------------------|------------------|------------------|------------------|----------------|
| A. Revenue Receipts | 16840.59 | 20209.26 | 15551.53 | 17884.24 | 15.00% |
| <i>Tax Revenue (net to centre)</i> | 13569.02 | 16359.09 | 13445.01 | 15453.96 | 14.94% |
| <i>Non-tax Revenue</i> | 3271.57 | 3850.17 | 2106.52 | 2430.28 | 15.37% |
| B. Capital Receipts | 10022.71 | 10213.04 | 18951.52 | 16948.12 | -10.57% |
| Total Receipts (A+B) | 26863.30 | 30422.30 | 34503.05 | 34830.00 | 0.95% |
| Total Expenditure | 26863.30 | 30422.30 | 34503.05 | 34832.36 | 0.95% |
| Revenue Expenditure | 23506.04 | 26301.45 | 30111.42 | 29290 | -2.73% |
| Capital Expenditure | 3357.26 | 4120.85 | 4391.63 | 5542.36 | 26.20% |
| Revenue Deficit | 6665.45 | 6092.19 | 14559.89 | 11405.76 | -21.66% |
| as a % of GDP | -3.30 | -2.70 | -7.50 | -5.10 | |
| Fiscal Deficit | 9336.51 | 7963.37 | 18486.55 | 15068.12 | |
| as a % of GDP | -4.60 | -3.50 | -9.50 | -6.80 | |
| GDP | 202967.61# | 224894.20 | 194819.75 | 222873.79 | |

*All figures in Rs. Bn, except the YoY % figures. % Change is FY22BE over FY21RE.

Calculated basis fiscal deficit numbers.

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Mutual fund investments are subject to market risks, read all scheme related documents carefully.