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Press Release

Fiscal deficit may still be limited to 3.5-3.6%

Additional non-tax revenues, particularly disinvestment profits, can be a key driver

Acuité Ratings believes that there is still a significant scope to limit India's fiscal deficit to 3.5-3.6%, if the government gives high priority to disinvestment and there is a sustainable revival in consumption and market sentiment, expected to be brought in by the sharp cut in corporate taxes up to 10%, over the next two quarters. The government is already working on the disinvestment of a few large public sector companies and if the equity markets responds well to the efforts made to revive economic growth, the government may succeed in exceeding the disinvestment target of Rs. 1.05 Lakh Cr. Acuité's analysis further suggests that over and above the use of the 'escape clause' under the FRBM Act, which permits an additional 0.2% slippage, any sharp increase in the fiscal deficit triggered by the liberal corporate tax cuts can be offset by the special dividend from RBI, additional non-tax revenues brought about by the cuts and a likely reduction in interest obligations due to larger rate reductions by RBI than expected in the budgetary figures.

Surely, the cut in base corporate taxes from 30% to 22% for existing companies and for new manufacturing companies at 15% is expected to spur a revival in the economy, which has recorded one of the slowest rates of growth over twenty years in Q1FY20. Acuité Ratings has been consistently reiterating the need for fiscal measures in the context of strong headwinds in both the domestic and the global economy. The corporate tax rationalization measures along with the ongoing accommodative monetary policy of RBI should help to boost corporate savings and translate into higher demand as also a pickup in private sector investments over the medium term. However, such economic advantages notwithstanding, the booster package comes at a cost to the fiscal commitments. While the government has estimated that it will have to forego Rs. 1.45 Lakh Cr of tax revenues, the actual shortfall may be even higher in the context of weaker consumption and lower indirect tax revenues than the budgeted figures. The market, therefore, anticipates a significant slippage in the fiscal deficit from the proposed 3.3% to a figure closer to 4.0%.

Acuité, however, believes that the fiscal position can be significantly better than what the fiscal mathematics suggests if there is a focus on augmenting non-tax revenues. Already, there has been a windfall gain of Rs. 59,000 Cr over and above the budgeted Rs. 90,000 Cr dividend income from RBI in the current fiscal. The government has an aggressive disinvestment target of Rs. 1.05 Lakh Cr in the current year; this can be exceeded if the government targets the disinvestment of large and profitable PSUs such as the oil companies over and above the planned ones such as Air India. Clearly, such a disinvestment programme has to scout for interested global players who may be keen to make an entry into India, thereby translating into big-ticket foreign investments. Further, non-tax revenues such as dividend and dividend taxes should witness an uptick in the current year. With higher post tax profits, PSUs are expected to declare higher dividends and the government should also gain from higher dividend taxes from improved private sector profits and dividends. Acuité expects such additional inflows in the order of Rs. 20,000-30,000 Cr. Our calculations further indicate that the government will be able to save on interest expenses to the extent of another Rs. 59,000 Cr given the lower bond yields and an expectation that yields will go further lower as inflation continues to sustain at moderate levels. All the above figures add up to around Rs. 1.5 Lakh Cr, which potentially can address the tax shortfall to almost the entire extent or at least up to 80% of that amount.

What is also interesting is the fact that the Government of India has the option of using FRBM Act's escape clause. The clause can be triggered in special circumstances and can be put at 0.2% (20 bps) of GDP. Given the urgency of action and the state of the economy, the current situation qualifies as 'special circumstances', thereby providing another Rs. 40,000 Cr of fiscal flexibility.

To sum up, the risks of a large fiscal slippage in the current year is expected to be addressed through larger non-tax revenues and the savings on interest expenses. Acuité, therefore, believes that the fiscal deficit in the current fiscal may remain limited to 3.5%-3.6% i.e. moderately higher by 0.2%-0.3% over the budgeted levels.

About Acuité Ratings & Research Limited:
Acuité Ratings & Research Limited *(Erstwhile SMERA Ratings Limited)* is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

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