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NEW PACKAGE AND FISCAL DYNAMICS

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The Government has announced a cumulative package of Rs 20 lakh crore (nearly 10% of GDP) to provide relief to various segments of the economy. This includes Rs 1.7 lakh crore of fiscal stimulus announced in the first phase, Rs 5.6 lakh crore stimulus provided through various monetary policy measures and Rs 5.94 lakh crore through the second phase, implying Rs 6.70 lakh crore package still to be announced. **The cumulative actual fiscal impact is only around Rs 1.14 lakh crores /0.6% of GDP**. It may be noted that the additional borrowing announced by the Centre is around Rs 4.2 lakh crore / 2.1% of GDP. The cumulative relief provided by India through monetary and fiscal measures is now comparable with other countries of same rating and/or per capita income.

The proposed definitional change for MSME is considered progressive and suitable because of introduction of Goods and Services Tax (GST). Under the new tax regime, turnover details of enterprises are being captured by Goods and Services Tax Network (GSTN) and turnover declared by GST registered MSME units can be easily verified through GSTN. Hence, turnover based definition would be transparent, progressive and easier to implement. As lender will get 100% credit guarantee on principal and interest which will save capital of around Rs 25000 – Rs 30000 crore for banks (zero risk weights) and increase in credit disbursal which will translate into a direct credit growth of 20% to the eligible accounts. As on March'20 around Rs 14 lakh crore is outstanding to MSME sector, which translates into Rs 2.80 lakh crore immediate credit boost.

The second set of measures is also reasonably drafted having only a small impact on the fiscal situation. After taking into account cash outflow of today's measures as well as the previous and the recent excise duty hike and DA freeze (amounting to around 0.8% of GDP), we now revise our Baseline Fiscal Deficit (excluding EBR) to 7.9% of the revised GDP in FY21 (from 3.5% earlier) owing to lower revenues and higher expenditure against the backdrop of COVID-19 pandemic. Baseline Fiscal deficit at CSO earlier estimates of GDP is around 7.1% of GDP. **We estimate a 4.5% direct impact on fiscal deficit purely because of revenue shortfall / automatic fiscal stabilizer and a 0.9% indirect effect because of GDP change**.

With higher deficit, issue about sustainable debt limit arises. In India the Government debt (Combined domestic liabilities of Centre & States) as percentage of GDP has been on a rising trend since FY11. In the last 8 years, Government debt has risen from 62% in FY11 to 66% in FY19. During the same time period interest rate (Repo rate) has declined from as high as 8.5% to as low as 6%. In FY20, the Repo rate was reduced further to 4.4%. This raises two related questions: how much Government debt can India sustain? Does the decline in nominal interest rates following the possible financial crisis originating due to COVID-19 mean that Government can safely borrow more? There have been studies which show that if the difference between interest rate and nominal growth rate is negative then there is no level of debt which is unsustainable, i.e. the Government can borrow easily. **Only if the differential becomes positive then the question about maximum sustainable debt exists. Thus, in India as we expect the ratio to become positive by end-FY21 we would have to look into the upper limit of debt which is sustainable. Against this background, it is imperative that we give growth a definite push. Rating action during Asian financial crisis also shows that growth has been of paramount importance.**

We also need to highlight the issues that have been raised persistently to finance the deficit. We still believe financing the fiscal deficit will not be a problem as the Government can resort to monetization of deficit through several innovative options. One such option is issue of sovereign perpetuity bonds. Sovereign perpetuity bonds have been used by the UK and US in the 18th and 19th centuries to finance war mobilisations. But long-term government bonds, going up to even 100 years (the Austrian government issued a 100 year bond last year) are common enough. The rationale for a perpetual sovereign bond is quite simple – the principal amount will never have to be repaid. The other option could be issue of a zero coupon bond. Both these bonds could be issued by the sovereign and privately placed with RBI or could be incentivized for larger participation by banks and even retail market participants. The other option is issue of tax free bonds for which there could be a huge market appetite in the current market environment. RBI would have to monetize or do OMO purchases or through some other method (tax free bonds) to the tune of Rs 4 lakh crore to fulfill the demand supply gap.

STIMULUS PACKAGE OF RS 20 LAKH CRORE ANNOUNCED

- India has announced total stimulus package of Rs 20 lakh crore (around 10% of GDP) amid the ongoing Covid-19 outbreak. Of this Rs 1.7 lakh crore was announced earlier as Pradhan Mantri Garib Kalyan Yojana, of which Rs 73,000 crore (43%) was the direct cash outgo and the rest was re-allocation.
- Consequent to the announcement by PM yesterday, FM has announced the 1st set of economic package under the "Atmanirbhar Bharat Movement" to support an economy battered by weeks-long lockdown to contain the coronavirus pandemic. The major announcements for MSMEs are: Collateral free Automatic Loans for Business, Subordinate Debt for MSMEs, equity infusion through MSME Fund of Funds, New definition of MSMEs, Global tender to be disallowed upto Rs 200 crore. The measures for MSME through guarantees, equity infusion and debt support will incentivize bank lending to MSMEs as well as providing crucial support to stressed entities in the current situation.
- The proposed definitional change for MSME is considered progressive and suitable because of introduction of Goods and Services Tax (GST). Under the new tax regime, turnover details of enterprises are being captured by Goods and Services Tax Network (GSTN) and turnover declared by GST registered MSME units can be easily verified through GSTN. Hence, turnover based definition would be transparent, progressive and easier to implement. It would also help in removing the bias towards manufacturing enterprises in the existing definition and would improve the ease of doing business.
- As lender will get 100% credit guarantee on principal and interest which will save capital of around Rs 25000 – Rs 30000 crore for banks (zero risk weights) and increase in credit disbursal which will translate into a direct credit growth of 20% to the eligible accounts.

India's Response to COVID-19 (Rs Crore)

Package	Support Area	Announced Amount	Actual Fiscal Impact
Total Intended Package	-	2000000	114500
First Package	-	735200	73000
Government (PMGKY)	Free Cash and Food	170000	73000
RBI	Liquidity Support	565200	0
Second Package	-	594250	41500
MSMEs	Collateral free Loans/Debt/Equity Support	370000	14000
EPF	Support & Contribution	9250	2500
NBFC/HCs/MFIs	Liquidity Support	75000	0
Discoms	Liquidity Support	90000	0
TDS/TCS reductions	Liquidity Support	50000	25000
Residual Package	Labourers & Farmers/Middle Class	670550	

Source: SBI Research

- As on March'20 around Rs 14 lakh crore is outstanding to MSME sector, which translates into Rs 2.80 lakh crore immediate credit boost. Further, Businesses/ MSMEs will also benefit by way of lower interest rate, as interest rate is capped, and 12 months moratorium on principal repayment with loan tenor of four years. The scheme can be availed till 31st October'2020 without any fresh collateral or guarantee fee. It is estimated that around 45 lakhs unit can be benefitted and resume business activity.
- To facilitate stressed as well as non-performing MSMEs, Government will create a provision of Rs 20000 crore as Subordinated debt with support of Rs 4000 crore to CGTMSE. With this, CGTMSE will provide partial credit guarantee support to Banks. In this scheme Banks will lend directly to promoters as debt which will then be infused by the promoters in the MSMEs and this will also improve the financials of the unit including debt equity ratios.
- Additionally, to support small Business Government announced EPF support for Businesses and Workers for 3 more months and EPF contribution has been reduced for Business & Workers for 3 months.
- **Measures for NBFCs/HFCs/MFIs**: Since NBFCs/HFCs/MFIs are finding it difficult to raise money in debt markets, Government has also launched Rs 30,000 crore Special Liquidity Scheme. Under this scheme investment will be made in both primary and secondary market transactions in investment grade debt paper of NBFCs/HFCs/MFIs and will be fully guaranteed by GoI. Apart from providing liquidity support for NBFCs/HFC/MFIs and mutual funds this measure will create confidence in the market. Separately, Government has also announced Partial Credit Guarantee Scheme 2.0 for NBFCs. Through this scheme liquidity support of Rs 45,000 crore will be provided by the Government.
- As on date around 375 NBFCs/HFCs/MFIs i.e. 2/3rd in the rating space, including Housing Finance and Micro Finance Institutions are investment grade i.e. having external rating of BBB and above (all rating agencies) and can directly benefit from this. These set of measures will not only help NBFCs to manage better ALM but also create confidence in the system specially to the Mutual funds that have reduced their share of holdings in NBFC papers from 17.6% in March'2018 to 10.5% in March'2020. Even from March'2019 level / Rs 80000 crore.
- Other measures are: Liquidity Injection for DISCOMs, Relief to Contractors, Extension of Registration and Completion Date of Real Estate Projects under RERA, liquidity through TDS/TCS reductions. Direct Tax measures include: Extension of due date of all income-tax returns and Extension of Vivad se Vishwas Scheme. The liquidity support of above measures is equivalent to Rs 5.94 lakh crore.

WHAT OTHER COUNTRIES ARE DOING

- Across the globe countries have given various relief packages to help their ailing economies amid the lockdown and lower economic activity with scale of fiscal packages varying from as high as 14.5% of GDP to as low as 0.1% of GDP.
- While nearly all countries have announced measures to support the small businesses, expanded unemployment benefits, spared amount for hospitals and testing, providing food safety net, tax rebates as well as deferrals, some of the unique measures taken include export support measures by Germany, suspension of school tuition fees by France, a temporary subsidy for household employees by Spain, Special State guarantees to unleash liquidity for businesses and households by Italy, subsidized interest payments by Bangladesh, reduction of various tax rates for providing relief to tax payers by Kenya.
- On the other hand, Saudi Arabia has tripled taxes on basic goods and cut spending on major projects by around $26 billion as it grapples with blows from the Covid pandemic and low oil prices on its economy. Saudi citizens will also lose a bonus cost-of-living allowance that had been in place since 2018. Against this backdrop, India's cumulative package stands at 10% of GDP which is comparable with economies with similar per capita income.
- As far as monetary policy is concerned, different countries have adopted different measures to support the economy. In the Euro Area, the ECB decided to provide monetary policy support through additional asset purchases of €120 billion until end-2020 under the existing program (APP).

Rating distribution in NBFC space

Rating	NBFC	HFC	Microfinance	Total	Share
AAA	41	7	-	48	8.56
AA	59	20	2	81	14.44
A	57	9	22	88	15.69
BBB	103	21	34	158	28.16
BB	70	7	28	105	18.72
B	34	-	12	46	8.20
C	4	-	-	4	0.71
D	23	2	6	31	5.53
Total	391	66	104	561	100.00

Source: CRISIL; SBI Research

Mutual fund holdings in NBFC Papers

Descriptions/ Period ending	Amount (Rs crore)			Share (%)		
	CP	Bond	Total	CP	Bond	Total
Mar'18	105094	118488	223582	8.28	9.34	17.62
Jun'18	127950	106045	233995	9.52	7.89	17.41
Sept'18	126972	99640	226612	9.50	7.45	16.95
Dec'18	114331	115700	230031	8.54	8.65	17.19
Mar'19	106130	110508	216638	8.13	8.46	16.59
June'19	101809	100488	202297	7.45	7.35	14.80
Sep'19	92115	95099	187214	6.76	6.98	13.74
Dec'19	68192	96642	164834	4.66	6.6	11.26
Mar'20	43755	94591	**138346**	3.33	7.19	**10.52**

Source: SEBI; SBI Research

Stimulus by Select Economies

Country	Rating	Per Capita Income (Current US$)	Tax to GDP ratio	Fiscal Stimulus	Net rate cut since Jan'20
Germany	AAA	47603	11.5	4.9	-
USA	AA+	62795	9.6	14.5	150
Spain	A	30371	13.9	3.0	-
Philippines	BBB+	3103	14.7	0.1	125
Italy	BBB	34483	23.1	1.4	-
Cyprus	BBB-	28159	24.0	4.3	-
Romania	BBB-	12301	15.4	2.0	50
Russia	BBB-	11289	11.5	2.8	75
Kazakhstan	BBB-	9813	11.7	9.0	-25
Morocco	BBB-	3238	21.9	2.7	-
India	BBB-	2010	11.2	10.0	75
Vietnam	BB	2567	-	4.2	-
Bangladesh	BB-	1698	8.8	3.3	75
Honduras	B+	2500	17.3	2.8	100
Kenya	B+	1711	15.7	0.4	150
Nigeria	B	2028	-	0.3	-

Source: SBI Research, World Bank, * Kazakhstan raised rates by 2.75% in Mar and cut by 2.5% in Apr

- It also went for an additional €750 billion asset purchase program of private and public sector securities (Pandemic Emergency Purchase Program, PEPP) until end-2020. Besides that there has been easing of regulatory ratios and support to SMEs. Among developing countries, Russia has earmarked RUB 500 billion facility for SME lending. In Vietnam, the authorities announced a credit package totaling VND 285 trillion (about 3.8% of GDP) from the banking sector for affected firms and households. A common theme is providing support to the households and small businesses, with many countries extending moratorium on loan payments. Rate cuts have also been done by most of the countries.

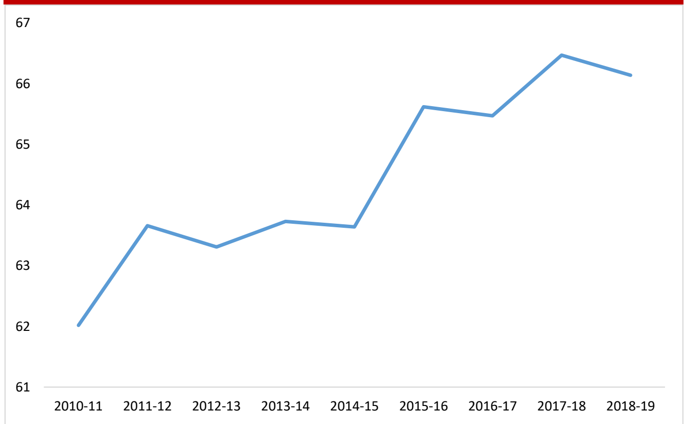
HOW MUCH DEBT IS SUSTAINABLE?

- In India the Government debt (Combined domestic liabilities of Centre & States) as percentage of GDP has been on a rising trend since FY11. In the last 8 years, Government debt has risen from 62% in FY11 to 66% in FY19. During the same time period interest rate (Repo rate) has declined from as high as 8.5% to as low as 6%. In FY20, the Repo rate was reduced further to 4.4%. This raises two related questions: how much Government debt can India sustain? Does the decline in nominal interest rates following the possible financial crisis originating due to COVID-19 mean that Government can safely borrow more?
- The critical factor determining a country's maximum sustainable debt level is the difference between its future nominal interest and growth rates. This interest-growth differential determines the rate at which a country's Government debt rises relative to its output, sometimes termed the "natural" debt dynamics. A higher interest-growth differential means that a country must raise larger surpluses in order to stabilize its debt-GDP ratio.
- In India the quarterly average interest-growth differential (for the period of FY13 to FY20) was -4.4% with differential rising continuously since Q1 FY19. In Advanced Economies also, average risk-free interest-growth differentials since 1960 is usually less than zero. The average annual interest-growth differential in six advanced economies has been -1.7% since 1880 and -0.8% since 1960.
- In the current situation in India both the key interest rate and GDP are expected to fall further. Our nominal GDP growth is likely to contract and based on this our interest-growth differential may turn positive also.
- Further, if interest rates are higher than expected, then the cost of rolling over a given debt increases. There have been studies which show that if the difference between interest rate and nominal growth rate is negative then there is no level of debt which is unsustainable, i.e. the Government can borrow easily.
- The Government should only think of the interest-growth differential and not slippage in fiscal deficit. Even a downgrade with decent GDP growth is far better situation compared to the downgrade with negative growth and manageable fiscal deficit.

RATING DOWNGRADE

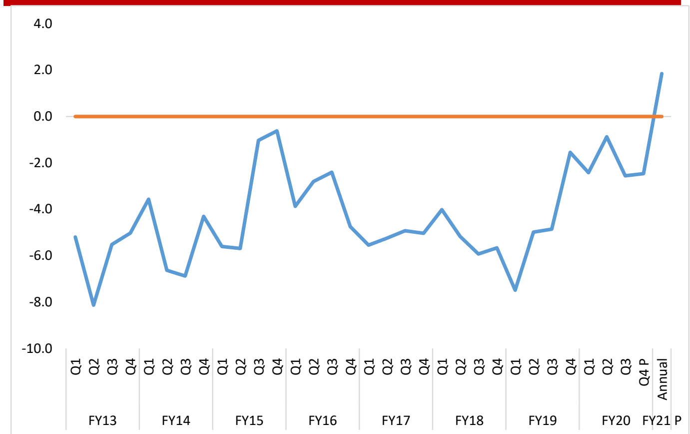
- It is widely expected that both the GDP growth and fiscal deficit will deteriorate in FY21 due to heavy repercussions of COVID-19. Hence the danger of rating downgrade is looming over India. We believe that between the two factors (GDP growth and fiscal deficit), GDP growth will be the deciding factor for the downgrade. Our observation is based on the rating downgrades of countries during 1997-98 Asian Financial crises when some Asian economies were downgraded significantly.
- This is clearly visible from the data that the huge decline in GDP growth (except China each country's GDP growth plummeted into negative territory) led to rating downgrade not the slippage in fiscal deficit. Fiscal slippage is not huge in countries during 1997 and 1998.
- On the same lines we believe that India should focus largely on GDP growth and should not think of slippage in fiscal deficit.

Combined Domestic Liabilities of Centre & States (% of GDP)



Source: SBI Research

Interest-Growth Differential (%)



Source: SBI Research

Rating Action during Asian Financial Crisis (1997/98)

Countries	Rating Action (S&P) during 1997/98	GDP Growth (%)		Fiscal Deficit/Surplus (% of GDP)	
		1997	1998	1997	1998
Indonesia	BB+ to B-	4.7	-13.1	-1.0	-1.9
South Korea	A+ to B+	6.2	-5.1	2.4	1.1
Thailand	A to BBB-	-2.8	-7.6	-1.7	-6.3
Hong Kong	A+ to A	5.1	-5.9	6.3	-1.8
Malaysia	A+ to BBB-	7.3	-7.4	4.8	-0.6
China	BBB+ to BBB	9.2	7.8	-0.7	-1.1
Singapore*	Aa2 to Aa1	8.3	-2.2	5.7	2.4

Source: SBI Research; * Moody's

CHANGING OIL DYNAMICS AND FISCAL SITUATION IN INDIA

- India consumed 30 million metric tonne of Motor Spirit (Petrol) and 83 million metric tonne worth of High speed diesel (Diesel) in FY20. The month of April saw consumption declining by 1.49 million metric tonne for petrol and 4.07 million metric tonne for diesel. The Central Government has announced excise duty hike of Rs 10 for petrol and Rs 13 for diesel, from May onwards.
- Although it is difficult to come up with a number for the loss in consumption, due to the lockdown measures, we have constructed two scenarios to figure out the gain to Centre due to increase in excise duties. If we assume that going forward, from May onward, India consumes the same amount as it did in FY20 and the excise remains same, Centre can gain Rs 1.72 lakh crore. Another scenario is if we take the loss in Apr'20 consumption over Apr'19 and scale it for 2 months worth of lockdown, the Centre can compensate its revenues by around Rs 1.55 lakh crore, based on this amount of consumption. Overall, this excise hike will provide some cushion to Central Government finances. If the oil prices go down further, then we can expect more hikes to shore up revenue.
- **Measures announced today only have Rs 41,500 crore as the direct cash outflow, rest is in the forms of loans, liquidity and guarantees, while the first package announced had cash outlay of Rs 73000 crore. After taking this and oil price gain and DA freeze, we believe fiscal deficit in India is likely to come around 7.9% of revised estimates of GDP in FY21 owing to lower revenues and higher expenditure against the backdrop of COVID-19 pandemic. Adding Extra budgetary resources of Centre to this, fiscal deficit of Centre stands at 8.9% of new GDP. Revised fiscal deficit + EBR at FY21 BE of GDP comes around 8.0% of GDP. This difference of 4.5% (8.0% -3.5%, the BE of Fiscal Deficit) is due to change in revenues and is the automatic stabilizer while the remaining 0.9% (8.9-7.9) is purely the direct effect of GDP change. The fiscal situation of the states is also likely to take a hit with around Rs 1 lakh crore shortage in transfer from Centre, taking their fiscal deficit to around 4% of GDP.**

FINANCING OF DEFICIT

- In order to finance higher fiscal deficit, the Centre has already announced higher borrowing by around Rs 4 lakh crore, taking into account the shortfall on account of disinvestment and tax and non-tax revenues. With higher fiscal deficit for states, borrowing is likely to be around Rs 8 lakh crore, thus the total borrowing of the Centre and States now stands at around Rs 20 lakh crore, with net borrowing of Rs 17 lakh crore.
- This in turn raises the question of demand of securities. Even if we assume the same percentage of subscription by market entities in FY21 as in FY20, of the total banks would demand Rs 4.3 lakh crore, insurance companies around Rs 3.7 lakh crore, and mutual funds and FPI around Rs 70,000 crore each and rest by others, totaling to Rs 12.7 lakh crore. However we believe financing the fiscal deficit will still not be a problem as the Government can resort to monetization of deficit which has reference in the FRBM Act. RBI would have to monetize or do OMO purchases or through some other method (tax free bonds) to the tune of at least Rs 4 lakh crore to fulfill the demand supply gap.

Oil Dynamics

		Scenario 1: No loss in consumption effective May'20	Scenario2: Loss in consumption based on change between Apr'20 and Apr'19 due to lockdown*
'000 metric tonne	Consumption in FY20	Consumption in FY21	Consumption in FY21
MS (Petrol)	29976	29976	27003
HSD (Diesel)	82579	82579	74450
Gain due to excise hike (Rs crore)		**172224**	**155214**

Source: SBI Research, *assuming 2 months of loss of demand

Fiscal Deficit Estimate (Rs lakh crore)

GDP FY20 (@6.6% nminal GDP growth)	202.3
GDP FY21 (@0% nominal GDP growth)	202.3
Gross Tax Revenue for FY21*	21.8
Net Tax Revenue for FY21 after adjusting for State's share	12.7
Net Tax Revenue FY21 BE	16.4
Shortfall in Net Tax Revenue	3.7
Revenue Shorfall to States	1.0
Non tax revenue FY21	2.1
Non tax revenue FY21 BE	3.9
Shortfall in Non Tax Revenue	1.8
Shortfall in Disinvestment receipts	1.5
Revenue shortfall to Centre	6.9
Fiscal impact of stimulus package 1	0.7
Fiscal impact of stimulus package 2	0.4
Fiscal Deficit FY21 BE	8.0
Revised Fiscal Deficit	16.0
Revised Fiscal Deficit (% of new GDP)	7.9
Memo:	
Extra Budgetary Resources of Centre	1.9
Revised Fiscal Deficit + EBR of Centre (% of GDP)	8.9
Fiscal Deficit of State	8.5
Fiscal Deficit of State (% of GDP)	4.0

Source: SBI Research, *Taking into account fiscal benefit of Rs 1.7 lakh cr owing to excise hike and Rs 37000 cr on account of DA freeze

Fiscal Estimates (Rs lakh crore)

A	FY20 GDP estimates Pre-Covid (as per CSO)	203.8
B	FY21 GDP BE	224.9
C	Fiscal Deficit BE	8.0
D	Fiscal Deficit BE (% of GDP)	3.5
E	FY20 GDP estimates Post-Covid	202.3
F	FY21 GDP estimates post-Covid	202.3
G	Revised Fiscal Deficit *	16.05
H	Revised Fiscal Deficit (% of estimated GDP for FY21) = G/F	7.9
I	Extra Budgetary Resources of Centre	1.9
J	Revised Fiscal Deficit + EBR of Centre (% of estimated GDP for FY21) = (G+I)/F	8.9
K	Revised Fiscal Deficit + EBR (% of FY21 GDP BE) = (G+I)/B	8.0
	Automatic Stabiliser (% of GDP) = K-D	**4.5**
	Direct Impact of GDP Change (Countercyclical, % of GDP) = J-K	**0.9**

Source: SBI Research

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