February 2, 2022

Union Budget 2022

Low decibel, high action

A budget that did not have many surprises yet has teeth to push India's growth story. The central themes are (a) push to infrastructure and manufacturing and (b) keep development apace in sunrise sectors.

Since the covid outbreak, the finance ministry has been taking a series of steps to ease pain and aid recovery with reasonable fiscal prudence, given the circumstances. It was our expectation, that the budget would build further on the policy push to manufacturing, infrastructure and housing. The budget not only delivered on these, but its capex outlay is higher-than-expected at INR 7.0 lakh crores (ex of Air India debt), a 24.5% increase over FY22 revised estimates. Additionally, policy support for the domestic industry has been extended in the form of protection duties, allocation to domestic companies in the defence sector etc. All of these point to the nascent investment cycle gaining further traction over the next few years.

The budget also addresses the pain of sectors that have been hit hard by the pandemic. The extension of the Emergency Credit Line Guarantee Scheme (ECLGS) and the revamping of the Credit Guarantee Trust for Micro and Small Enterprise (CGTMSE) for increased effectiveness are important measures announced in the budget.

The start-up ecosystem in India has evolved to be very vibrant. There has been an acknowledgement of the same and policy support in the last few years. The extension of tax incentives and capping of long-term capital gains will help start-ups and founders further.

The announcement of a digital rupee certainly comes as a surprise to many. While several economies are evaluating the launch of their own central bank digital currencies (CBDC), India would be one of the first to announce and officially launch its own. A CBDC, we would argue, is the most significant announcement in the budget that could change the face of banking.

The budget also introduced a tax on digital assets which preceded the tabling of the cryptocurrency bill. This could potentially pave way for the acceptance of cryptocurrency. However, it is hard to imagine that the government would allow digital assets to be unregulated. We think a watered-down version of the cryptocurrency bill, could be tabled in the parliament later.

The budget speech lay emphasis on sunrise sectors such as digitalization, climate change, clean energy etc. Although the budget outlay for the various initiatives around these seems limited, we expect policy push post-budget as well.

The negative surprise in the budget was the lack of consumption stimulus. Revenue expenditure growth is barely 1% higher.

The budget prioritizes growth over fiscal consolidation. But that is leading to higher-than-expected fiscal deficit guidance for FY22-23. The lack of any specific measures on the inclusion of Indian bonds in the MSCI is a disappointment.

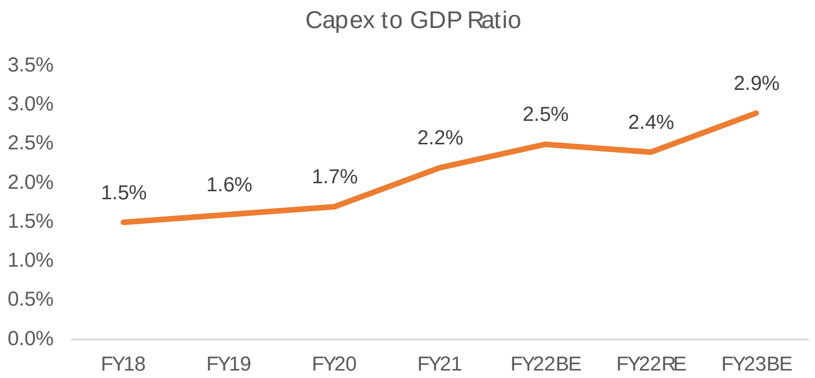
The key sectors that benefit from the budget announcements are labour-intensive and by extension job accretive. Technology, as we all know, is transformative and the policy statement makes it clear that the government intends to bring benefits of technological advancement to rural India. The underlying theme of inclusive welfare is evident in the budget. However, the key is execution.

Overall, the budget, despite being devoid of several big bang announcements, firmly focuses on aiding economic growth.

Key Budget Highlights

Capex push in Infrastructure, Housing and Manufacturing

The capex allocation now stands at almost 2.9% of the GDP, the highest since 2005. This renewed acceleration in capex spend over the last couple of years after a lost decade, makes us believe that we are on the cusp of a capex cycle recovery.



Source: Budget Documents

In continuation of its economic policies of making India AatmaNirbhar, the announcements are largely on expected lines of ease of doing business by focusing on improving logistics and mobility, bringing in more sectors under PLI that enables the development of manufacturing hubs and continued focus on promoting affordable housing.

PM Gati Shakti- The national master programme aims to create modern infrastructure and logistics by focusing on roads, railways, airports, ports, mass transport, waterways, and logistics infrastructure.

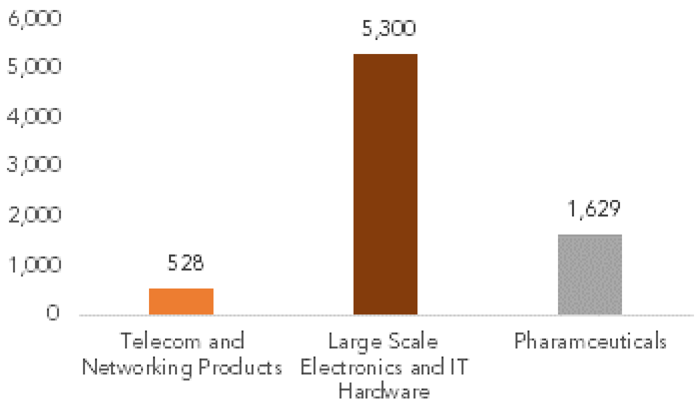
- The plan includes measures like completing 25,000km of national highways in FY23,
- INR 60,000 crore is allocated towards the 'Nal Se Jal' scheme for providing access to tap water to 3.8 crore households,
- River linking project – Ken-Betwa, at an estimated cost of INR 44,605 crore starting in FY23,
- Four multimodal logistics parks, and 100 new cargo terminals to be set up in three years, among others.

The key beneficiaries would be EPC companies, cement players, industrials and companies operating in the logistics infrastructure space.

The government continued its focus and push for affordable housing and urban infrastructure. INR 48,000 crore has been allocated towards PM Awas Yojana and around 80 lakh houses will be completed for the identified beneficiaries of the scheme. This shall aid volumes for financiers in the affordable housing space.

Additionally, there are allocations of INR 7,500 crores towards sectors like Electronics, Pharma and Telecom networking products and another INR 19,500 crore towards solar energy. Also, as part of the AatmaNirbhar plan, 68% of the budgeted defence capital allocation amount will be earmarked for the domestic industry up from 58% in the previous year.

Allocation under PLI Schemes, 2022-23BE (in INR Crores)



Source: Budget Documents

Over the years, India has made a mark on the world stage in certain manufacturing sectors (Pharma, Chemicals, Auto ancillaries). While it is attracting investments now (China +1 strategy), the government seems focused on increasing and developing credibility in many other sectors in turn providing greater impetus to 'Make in India' and increasing its share in global manufacturing.

Credit Guarantee Scheme extension – relief for impacted sectors / entities

Ever since the pandemic broke out the government has come out with multiple measures to ease pain in especially in smaller businesses. The ECLGS, which provided credit guarantees during the pandemic, is now extended to March 2023 (from March 2022) and the guarantee cover under this scheme is also increased by INR 50,000 crores to a total cover of INR 5 lakh crores. The additional amount will be earmarked exclusively for COVID impacted hospitality enterprises.

Additionally, CGTMSE will now facilitate additional credit of INR 2 lakh crores for MSMEs.

These measures should help sustain the smaller enterprises which may otherwise run out of business due to liquidity issues, ultimately impacting the financiers and employees of those businesses.

Outlook

Equities

As mentioned, the fixed-asset-formation focus of the budget will hugely benefit the manufacturing and capital goods sectors. Not surprising since these sectors have been a part of the government's agenda for the last couple of years. Last week, in our annual equities outlook issue, we had mentioned that these are multiyear themes that will prove to be India's growth drivers. We have positioned our flagship strategies i.e., Sanctum Indian Titans (multi-cap) and Sanctum Indian Olympians (large cap) to benefit from these themes as almost 30-35% of our portfolios are constructed around them.

The budget, however, fell short on lifting the spirits of consumers amid already slowing consumption patterns in rural areas and rising inflation. In the near term, global equity sentiments are weak and, in this background, faltering consumption could lead to hurting domestic sentiments as well and question the strength of the recovery.

We have maintained that investors should consider the strength of the long-term fundamentals of the economy even if there is near-term pain.

Fixed Income

While the budget brought cheer to the equity markets, the bond markets sold off sharply. The fiscal deficit is projected at 6.45% against the consensus expectation of 6.2% The budget provision for gross market borrowing of INR 14.95 lakh crores is much higher than anticipated. However, upon analysis of the details, it appears that the estimates could be conservative. Nominal GDP growth assumption is closer to 11% whereas the general market expectations are closer to 13%. The budget assumptions on tax buoyancy, realization from divestment appear reasonable.

Given the higher expected supply, India’s inclusion in the MSCI bond indices gains even more importance. However, the lack of any announcement around bond index inclusion also hurt sentiments.

The RBI has guided for normalization of liquidity. We expect a repo hike towards the normalization of the repo-reverse repo corridor in the next policy meeting. We continue to stay away from duration. We think our approach of barbelling portfolios in low duration funds and well collateralized, high yielding credit with some exposure to REITs and INVITs should continue to deliver reasonable returns while reducing overall portfolio volatility.

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