KEY HIGHLIGHTS

- Union Budget 2021 puts focus back on growth and expansion with significant increase in capex allocation but with reduced dependance on off-balance sheet financing predominantly done through CPSEs.
- The budget also spells out crucial steps for the financial services sector including privatization of public sector banks; transfer of bad loans to a 'bad bank'; increase in FDI limit in the insurance sector; and sufficient resources kept aside for recapitalization.
- The budget has created a roadmap for infrastructure growth proposing a dedicated development finance institution; 15% y-o-y increase in capex allocation in the nine core sectors; and boosting private sector capital via asset monetization.
- PM Aatmanirbhar Health Yojana to spend INR 64,100 crore over 6 years, in addition to National Health Mission. Health budget estimates are at Rs. 2.23 lakh cr. in FY22 up from Budget expectation of Rs. 94 thousand cr. in FY21. Rs.35 thousand cr. allocated for COVID-19 vaccines in FY22.
- The push for 'Make in India' is visible in stipulating higher customs duty for PLI linked segments like mobile components, solar inverters, cotton; Agriculture Infrastructure and Development Cess (AIDC) to be introduced in specific products. As of now Rs. 2.5 per litre has been imposed on petrol and Rs. 4 per litre on diesel.
- For the banking sector, proposals to strengthen the financial system like the creation of more ARCs, Direct Finance Institution to fund infrastructure, PSU bank recapitalization, etc. should go a long way in strengthening the financial sector.
- On the direct tax front, no material changes were announced. There were expectations of a potential imposition of a COVID cess on the rich or corporates, which was avoided.
- On Indirect tax front, import duties on inputs such as gold and steel have been reduced while that on chemicals etc. has been increased. While an additional cess on petrol and diesel has been introduced, excise duty on the same has been reduced by a similar amount. This is unlikely to have much impact on consumers, but it is likely to weigh on state revenues. This is because the amount collected through the cess is not liable to be shared with states.
- Tax changes for ULIPs: The budget now limits exemptions on proceeds from unit-linked insurance plans that have so far allowed large investors to receive tax-free returns. For ULIPs taken on or after Feb. 1, the maturity proceeds of policies with an annual premium of more than Rs. 2.5 lakh will be taxable on a par with equity-linked mutual fund schemes; however, any amount received on death continues to be exempt without any limit on the annual premium. Also, Individuals holding multiple ULIPs with an aggregate premium more than Rs. 2.5 lakh will have to pay tax on the proceeds.

Views on Bond Market by Dhawal Dalal – CIO, Fixed Income

The Union Budget for FY22 was delivered on the backdrop of expectations of pandemic-driven contraction of 7.7% in India's economic output for FY21 and rebounding of economic growth of 11% in FY22 as highlighted by the Economic Survey. Therefore, it was quite natural to expect a growth-oriented Union Budget.

The Union Budget for FY22 was focused on ensuring that the ongoing economic revival remains well supported through higher spending in the infrastructure sector and significant boost to the capital expenditure for FY22. To that extent, the capital expenditure for FY22 is budgeted at Rs. 5.5 trillion – a solid growth of 34% over the previous year. This higher spending is expected to percolate into higher level of economic activities in multiple sectors and boost demand for capital goods.

From the bond market's perspective, fiscal deficit for FY21 was revised higher to 9.5% of the GDP. This was sharply higher than market expectations of ~8%. The upwardly revised fiscal deficit for FY21 was accompanied by announcement of additional borrowing of Rs. 80,000 cr. to be completed in the next two months. This should take the total gross borrowing to Rs. 13.9 trillion in FY21. The Union Budget for FY22 has projected fiscal deficit of 6.8% of GDP and gross borrowing of Rs. 12 trillion. This is higher than the consensus estimates of 5.5% to 6% for the fiscal deficit and around Rs. 11 trillion of gross borrowing in FY22.

Prices of sovereign bonds reacted negatively on the announcement of additional borrowing for FY21 as well as higher-than-expected gross borrowing & fiscal deficit for FY22. Yield of the benchmark 10Y IGB (5.85% IGB 2030) hardened by around 16 bp from its lowest level of the day to 6.05% after the Budget speech was concluded. Similarly, yield of benchmark 5Y IGB (5.15% IGB 2025) hardened by around 25 bp from its low to 5.53% during the same time amid heavy trading volume on NDS-OM.

Yields of AAA-rated CPSE bonds tracked the movement in yields of IGB amid thin trading volume. Yields of liquid 5Y AAA-rated CPSE bonds inched up by around 22-25 bp while yields of liquid 10Y AAA-rated CPSE bonds inched up by around 10 bp from their yesterday's valuations.

Adverse price action in the bond market is aided by expectations of gradual reduction in the banking system liquidity, normalization of economic activities, prospects of revival of credit growth going forward, demand-supply imbalance in IGB in FY22, recent sharp price increase in key industrial commodities and fears of inflation in global economies by a section of influential market participants.

That said, we expect yields of IGB to remain range-bound in the medium-term due to several supporting factors. Firstly, the RBI is expected to maintain the accommodative stance in FY22 and keep sufficient liquidity in the banking system to support economic growth. The RBI is also expected to absorb around Rs. 2 trillion of IGB in FY22 through OMO bond purchases. This should alleviate some pressure on bond prices and help address demand-supply dynamic to some extent. Secondly, headline consumer inflation is expected to trend lower and remain well within the RBI's range of expectations in H1FY22. This should support RBI's accommodative stance. Thirdly, the GOI is likely to increase portion of T-Bills in its net borrowing for FY22, thus helping reduce pressure on IGB to some extent. Lastly, the shape of the yield curve remains quite steep despite recent hardening of yields. Yields spread between 1Y IGB and 10Y IGB still remains around 185 basis points. This makes level of 10Y IGB still quite attractive for investors from real yield's (yields net of current inflation) perspective.

What should investors do?

We recommend investors to continue to focus on high quality AAA-rated liquid PSU bonds maturing in 7-10Y maturity bucket for investment horizon of at least two years. This positioning will not only provide attractive yield to the investors but also reduce potential price volatility in future in our opinion. Our analysis suggests that corporate bonds maturing in 2 to 4-year segment is a crowded trade and prone for a sharp pull-back in yields when interest rate cycle begins to normalize in future. Risk to our view comes from a sharp revival in global economic growth in CY21, sudden increase in geo-political risk, pressure on natural resources & global supply-chains, secular increase in inflation well beyond G7 central banks' expectations in CY22-23.

Views on Equity Market by Harshad Patwardhan, CFA – CIO, Equities

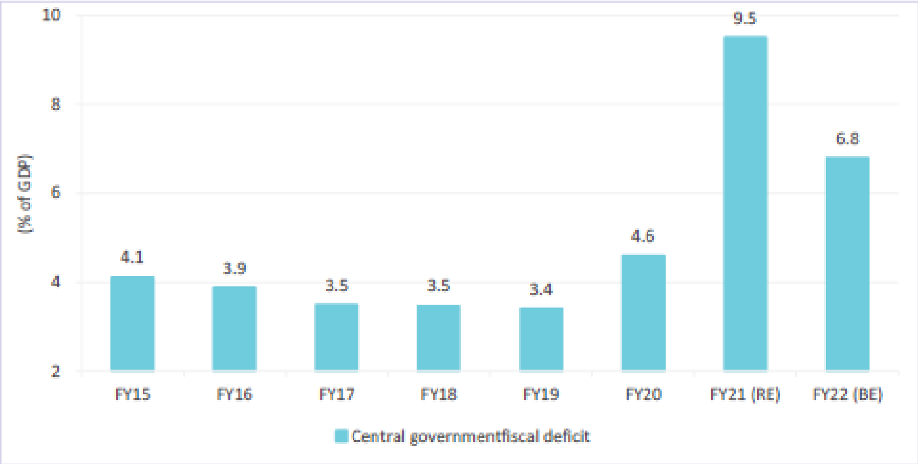
In November last year, after US elections & positive news on vaccines, we had cautioned our clients about the risk of being Underweight on Indian equities link to report With today's budget, we believe that risk has gone up a notch even at higher market levels.

Government's message from the budget is clear: relentless focus on inducing growth and generating employment. Big push to domestic manufacturing and boost to infrastructure are the key elements of its strategy. Huge focus on privatization of PSUs and monetization of government assets is meant to raise resources but will also improve productivity. It's a big positive that government has refrained from raising taxes. This, in a way, is our long-awaited fiscal stimulus. Government has also taken bold steps to encourage foreign investment and untie banks' hands to support growth.

This move should add fuel to the ongoing recovery and support corporate earnings growth. Positive for equity markets, particularly for industrial & BFSI sectors. Midcap and small caps will likely outperform. Risks to our view arises from poor execution of government plans & second wave of infection. Also, don't forget volatility and corrections- which are part of the game.

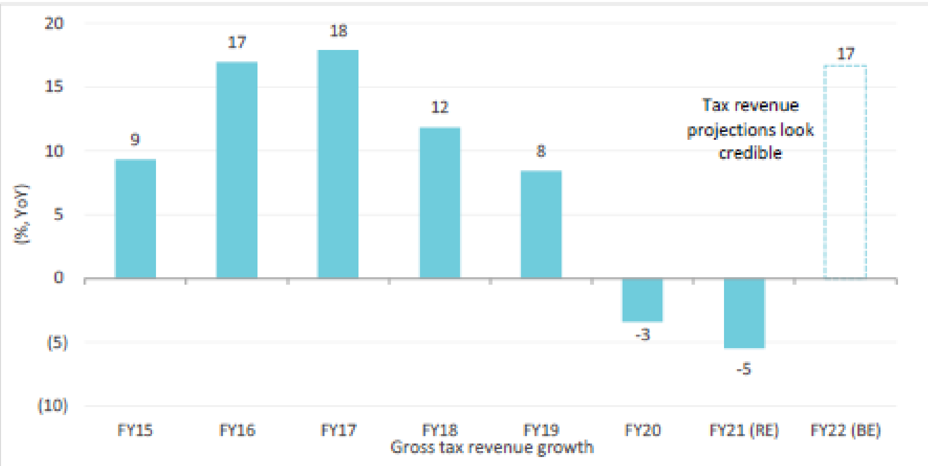
Story in Charts:

Fiscal Deficit has been relaxed…



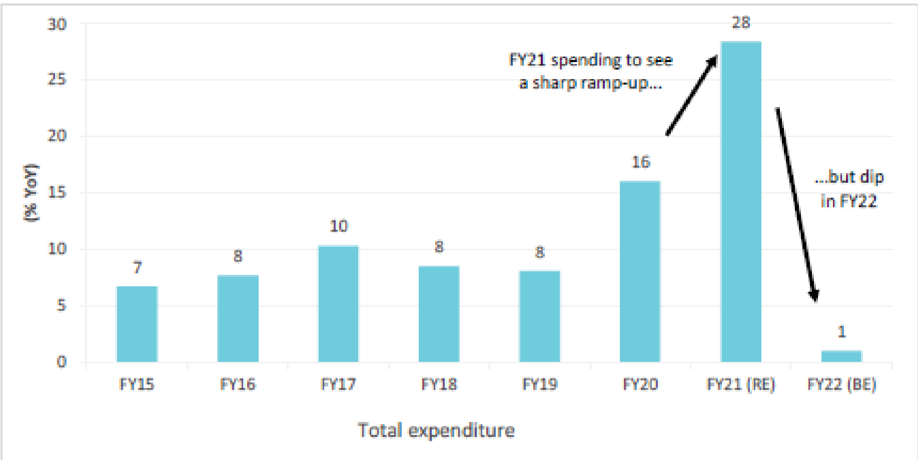
Source: CMIE, Budget documents, Edelweiss research

Gross tax revenue projections seem credible…



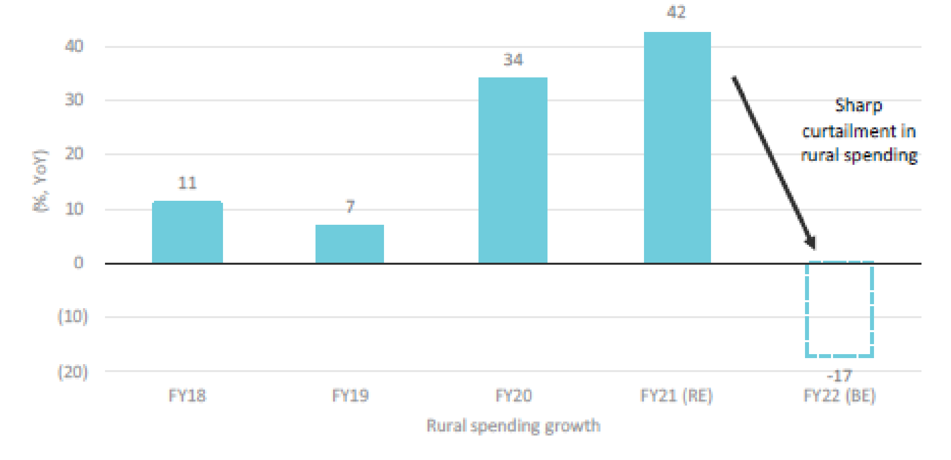
Source: CMIE, Budget documents, Edelweiss research

Total spending ramps up sharply in FY 21…



Source: CMIE, Budget documents, Edelweiss research

Rural Spending likely to see slowdown…



Source: CMIE, Budget documents, Edelweiss research

Note: Rural spending includes agriculture, irrigation, MNREGA, rural roads, affordable housing, national social assistance.

Budget Math – Consolidation begins after 2022…

(INR bn)	FY19 A	FY20 A	FY21 BE	FY21 RE	FY22 BE	FY21RE/ FY21BE	FY22BE/ FY21 RE
Net Revenues	16656	17528.16	22459	16015	19764	-29%	23%
Gross Tax Revenue	20805	20100.59	24230	19002	22170	-22%	17%
Direct Tax	11250	10495.3	13060	9050	11080	-31%	22%
Corporation tax	6635	5568.76	6810	4460	5470	-35%	23%
Income tax	4614.8	4926.54	6250	4590	5610	-27%	22%
Indirect tax	9555	9605.29	11170	9952	11090	-11%	11%
Customs tax	1178	1092.83	1380	1120	1360	-19%	21%
Excise duties	2310	2406.15	2670	3610	3350	35%	-7%
GST**	5815	5987.5	6905	5150	6300	-25%	22%
Less: To States & Union Territories & NCCF	7633	6530	7871	5557	6716	-29%	21%
Net tax revenues	13172	13570.59	16359	13445	15454	-18%	15%
Non-tax revenues (incl dividend, interest)	2357	3271.57	3850.1	2106	2430	-45%	15%
Non-debt capital receipts (incl divestment)	1127	686	2250	464	1880	-79%	305%
Revenue expenditure	20074	23506	26320	30111	29290	14%	-3%
Interest Payments	5826	6120	7082	6929	8097	-2%	17%
Subsidies	2229	2519	2558	6272	3614	145%	-42%
Food	1013	1086	1155	4226	2428	266%	-43%
Fertilizer	706	811	713	1339	795	88%	-41%
Petroleum	248	385	409	387	129	-5%	-67%
Interest on Subsidies	200	237	281	320	262	14%	-18%
MGNREGA	618	716	1015	1115	730	10%	-35%
Capital Expenditure	3077	3357.256	4120	4390	5450	7%	24%
Total Expenditure	23151	26863.26	30440	34200	34800	12%	2%
Fiscal deficit	6495	9335.096	7981	18185	15036	128%	-17%
Fiscal % of GDP	3.4%	0.045896	3.5%	9.50%	6.80%		
Nominal GDP	189712	203398	224894	194819	222873	-13%	14.4%

Source: Budget documents, Edelweiss Wealth Research

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