IMF Report emphasises on fiscal consolidation rather than stimulus

Brickwork Ratings, Mumbai, 06 January 2020: The declining investment, stagnant exports and rising unemployment on the eve of budget presentation pose formidable challenges to the Finance Minister in formulating the budget. The reforms so far have yielded little and despite reducing the policy rate by 135 basis points, its transmission has been sluggish and impact is marginal. The crucial question is whether she can afford to deviate from the fiscal restructuring path laid down by the FRBM Act to provide the stimulus to prop up the declining consumption and investment climate as also the ambitious announcement made regarding infra spending. As it is, it will be very difficult to conform to the fiscal deficit target of 3.3% for the current fiscal laid down in the budget due to likely shortfall in revenue collections from the projected figures. Despite the additional transfer of surplus from the RBI, the commitments for recapitalisation of banks and companies such as BSNL/MTNL has put enormous pressure and it is quite likely that there will be slippage in the deficit estimates, resort to more off-budget financing of expenditures or substantial compression of revenue and capital expenditures. During the first half of the year, public administration was the main contributor to growth and the growth of GVA from the remaining sectors averaged just about 3%. Thus, retrenchment of government expenditure is likely to exert even more pressure and put risks in achieving the whole year growth of 5% estimated by the RBI.

Given the subdued global and domestic environment, lingering twin balance sheet crisis and the relative ineffectiveness of monetary policy in the short term, most observers consider that the time is opportune for providing substantial fiscal stimulus for reviving the growth environment. With both private consumption and investment engines stuttering, exports stagnant and with financial sector continuing to be dragging its feet and reluctant to lend and corporates reluctant to borrow, it is argued that the only way to lift the economy is by the government giving a large fiscal stimulus. However, the IMF Article IV Consultation document released in December continues to argue for continued fiscal consolidation. It expects the growth to rebound due to the lagged effects of accommodative monetary policy, actions to facilitate its transmission, ensuring liquidity, greater clarity on corporate and environmental regulatory uncertainty and additional support by the government to augment rural consumption through programmes like PM-Kisan. For the future, in the baseline scenario it expects the growth to accelerate to a medium-term potential of 7.3% on continued commitment to inflation targeting, gradual macro-financial and structural reforms including the lagged effect of earlier reforms such as
implementation of the Goods and Services Tax (GST) and the Insolvency and Bankruptcy Code (IBC). In the ambitious reform scenario, it wants the government to continue with aggressive fiscal consolidation to contain the general government debt at 60% of GDP from the present level of 69% by 2024-25. In addition, the report recommends continued clean-up of bank balance sheets complemented by strengthening of PSB governance and regulation and oversight of NBFCs and market reforms to enhance labour market flexibility, formalising the economy, improving employment opportunities, enhancing competition and reducing the scope for corruption.

Thus, the IMF is clear in stating that the government should continue to undertake aggressive fiscal consolidation and unequivocally states that fiscal stimulus should be avoided to reduce fiscal dominance which has led to financial repression. The report is categorical in stating that the “fiscal space is at risk” and there is no scope to provide fiscal stimulus at this juncture. According to the report, the growth impetus should essentially come from monetary policy and structural reforms. In addition, it recommends that the immediate focus should be to make more realistic revenue projections, enhance fiscal transparency and make the budgetary coverage more comprehensive to avoid off budget borrowings. It cautions that although the Central government has adhered to the headline fiscal target, it is mainly by resorting to off budget borrowings. More importantly, it cautions that the public sector borrowing including those of local governments, has remained high.

Irrespective of whether it is decided to provide fiscal stimulus or not, the IMF report has strong recommendations to focus on to (i) make the revenue projections more realistic and (ii) enhance budget transparency and budget coverage are noteworthy. It is important to clearly bring out the actual fiscal deficit and taking that as the base, lay down a credible consolidation path to reduce the debt.

The experience shows that the government on its own does not seem to practice realism in projections nor concerned about transparency and comprehensiveness in coverage. It is precisely for this reason that the time is opportune to think of an institutional monitoring mechanism by establishing an independent Fiscal Council reporting to the Parliament by amending the FRBM Act as recommended by the Fourteenth Finance Commission. Besides monitoring the progress in fiscal consolidation, the Council can report to the Parliament on three important issues namely, evaluating the realism of the forecasts, bring out off budget transactions to ensure greater transparency and realistically make cost estimate of various schemes and programmes announced by the government from time to time.
Contacts:

Dr M Govinda Rao  
Chief Economic Advisor  
+91-080-40409940  
govindarao.m@brickworkratings.com

Anita Shetty  
Research Editor  
+91 22 67456633  
anitashetty@brickworkratings.com

Investors and Media Contact  
Liena Thakur  
liena.t@brickworkratings.com  
+91 22 67456668

DISCLAIMER

Copyright © 2019 by Brickwork Ratings India Pvt Ltd., 3rd Floor, Raj Alkaa Park, 29/3 & 32/2, Bannerghatta Main Rd, Kalena Agrahara, Bengaluru, Karnataka 560076. Telephone: +91 80 4040 9940. Fax: +91 80 4040 9941. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources. Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings’ factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings’ ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

THE INFORMATION IN THIS REPORT IS PROVIDED “AS IS” WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, “BWR Reps”) guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.