Anticipating the Budget: Challenges galore

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The third wave has put a check on economic revival, monetary policy has lost steam, and inflation is on the horizon

Usually, speculation on the Union budget dominates the discussion in the media in January.

However, this year, concerns about the exponential spread of the virus has relegated everything else to the background, as it did last year, too. Nevertheless, it is important to think about the measures the government could initiate to enable the economic recovery process, provide relief to victims, and advance reforms to put the economy at least on the pre-pandemic growth trajectory.

Finance Minister Nirmala Sitharaman's challenge this year is particularly formidable as the depressing domestic environment, thanks to the third wave of the pandemic, seems to be putting a check on economic revival. This continues to demand enormous diversion of resources for relief and rehabilitation, and constrains the resources for providing stimulus through increased infrastructure spending.

The finance minister will present the budget when both domestic and international economic environments look uncertain. At the domestic level, the first advance estimate of GDP has pegged the growth at 9.2%, which is lower than the 11% growth projected in the Economic Survey and the RBI's estimate of 9.5%. Even this growth looks optimistic because advance estimates are made by projecting the actual trend in leading indicators of economic activity in the last 6-8 months. This did not consider the economic impact of the third wave, which has led to restrictions on economic activities in the states in varying degrees.

There have also been production constraints caused by the non-availability of semiconductors, supply shortages in coal and power outages hampering the full recovery of both industry and service sectors. In the final count, the actual growth might turn out to be lower, at 8.5-9%. Even if we assume that GDP will grow at 9.2% in absolute terms, at Rs 1,47,53,535 crore, we would have barely surpassed the GDP level of 2019-20 by just 1.2%.
What is more, the services sector's gross value added (GVA) in the current year is estimated to be lower than the 2019-20 level by 0.8%, mainly due to the continued contraction in contact-intensive sectors like trade, hotels, transport, storage and communication by 9.3% and the construction sector, which barely surpassed the 2019-20 level. Thus, the recovery process has been staggered, and with rising Omicron cases, the outlook does not look very promising.

The international environment is not favourable either, and monetary policy, which has been doing the heavy lifting for economic revival so far, seems to have run out of steam. The expectation of rate increase by the US Fed and in other advanced economies is likely to accentuate capital outflow and put pressure on the exchange rate, current account deficit and prices. Of course, the impact may be less than that of the 2013 taper tantrum, but the stress will be real.

In addition, there will be pressure on prices due to the lagged effect of wholesale prices on the consumer price index, rising input costs, semiconductor shortage, and supply bottlenecks. The RBI has already been mopping up surplus liquidity through variable repo rate auctions and it looks like interest rates are set to increase sooner than expected. Thus, there are questions about RBI's capacity to aid the recovery process in the next fiscal.
In formulating the budget, it is the estimate of GDP at current prices that forms the basis for making revenue, expenditure and deficit projections. The estimate of 17.6% growth in nominal GDP will help the finance minister to determine the fiscal space for public spending by taking into consideration the fiscal consolidation plan. It was widely expected that the fiscal deficit estimate of 6.8% for the current fiscal is likely to be breached. This is because the government has already sought supplementary demands amounting to Rs 3.2 lakh crore. Although tax revenue is likely to exceed the budget estimate by over Rs 1 lakh crore, realising Rs 1.75 lakh crore through disinvestment looks doubtful.

The budget for FY22 had projected the nominal GDP growth at 14.4% and the estimated 17.6% growth provides some cushion for the current year and, more importantly, helps in setting the expenditure as well as fiscal consolidation targets higher for the next year. With the spill-over of disinvestment proceeds to the next year, progress in asset monetisation and continued buoyancy in tax revenues, we may expect the fiscal deficit targeted at a little over 6% for the next fiscal, and this will help to stick to the consolidation path to reach the targeted fiscal deficit of 4.5% in 2025-26.

On tax policy, there may not be any significant changes in this budget, except for some attempts to weed out some tax concessions and exemptions. Changes in GST are in the domain of the GST Council. It would have been preferable to reverse the trend in increasing protection by reducing the import duties to make the economy more competitive, but with the 'Atmanirbhar Bharat' chorus, that is not likely to happen.

There may be an expansion in the production-linked incentives to select sectors. On the expenditure side, large allocations will have to continue for both health and MGNREGS. Surely, with the elections in some important states on the horizon and in the background of farmers' agitation, it would not be surprising to see significant allocation to food and fertiliser subsidies. As mentioned earlier, capital expenditure may see a marginal rise, depending on the expectations from monetisation of assets.

The macroeconomic stance taken in the budget will be extremely important. Given the prevailing pandemic situation and elections round the corner, it remains to be seen what reforms will be carried forward in the budget. These are hard times and doing the tight rope walk between increasing expenditure to save lives and livelihoods, containing the deficit towards fiscal consolidation, and providing signals and directions to aid the recovery process will be a challenge never seen before.

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