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Budget's infra plans may take a hit as war fallout spills ove

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Government-led spending plans, leveraging infrastructure and capital expenditure to revive growth in the Budget for next fiscal, runs the risk from the uncertainties emanating from the ongoing Russia-Ukraine conflict. There are multiple red flags: Rising price pressures are expected to strain government finances, both of the Centre and the states, thereby limiting their capacity to undertake expenditure projects.

Oil prices-led inflation is expected to lead to second order effects, even as surging bond yields may force the Reserve Bank of India to reverse its accommodative stance sooner than later and make the central bank's debt management task even tougher. These factors, combined, are anticipated to have a negative bearing on GDP growth next year.

A weak rupee will add to the pressure of import bills, already inflated by higher crude oil prices, and also disrupt the estimated savings for subsidies in the Budget, with the fertiliser subsidies expected to overshoot the Revised Estimates. The Budget math will be directly impacted as the Economic Survey 2021-22 projected oil prices in range of $70-75 per barrel for the next year while also highlighting several risks to this key assumption going wrong. Crude oil imports are nearly 20 per cent of the country's import bill.

"The breaking of war between Russia and Ukraine has created grave uncertainty and poses a serious threat to both growth and stability. The integrity of the budget numbers is under a threat and the much-hyped increase in capital expenditures may not materialise as much as it was hoped. The basic assumption in formulating the budget that the crude oil prices will remain in the range of $75-80/barrel, has become unrealistic, not long after the budget was presented," M Govinda Rao, chief economic adviser, Brickwork Ratings, said.

Revenue expenditure could shoot up from Budget Estimates, as the fertiliser subsidy bill, which was budgeted lower for 2022-23 by Rs 34,900 crore than the 2021-22 Revised Estimate, would require a significant upward revision, he said. Along with higher food subsidies, this may result in lower capital expenditure or higher fiscal deficit and borrowing.

Sustained high oil prices pose a risk for inflation as every $10 increase in oil prices lifts retail inflation by 20-25 bps, widens the current account gap by 0.3 per cent of GDP and poses an approximate 15-bp downside risk to growth, DBS Bank said in a note dated March 1. The current account deficit (CAD) is likely to widen by $14-15 billion (0.4 per cent of GDP) for every $10/barrel rise in the average price of the Indian crude basket, rating agency Icra said. "If the price averages $130/bbl in FY23, then the CAD will widen to 3.2 per cent of GDP, crossing 3 per cent for the first time in a decade," it said.

A prolonged war between Russia and Ukraine and the resultant supply disruptions could push up global crude oil prices to $185-200 per barrel, as per some industry estimates. The oil shock could have adverse effects on the economy, which is already running a high fiscal deficit, pegged at 6.4 per cent of GDP in 2022-23. This is resulting in yields on both Central and state government bonds rising sharply in the past couple of weeks, crimping their ability to borrow for the capex plans.

"The SDL (state development loans) yields show today that not only have the cut-offs increased but also the spread over G-Sec (Central government security) has increased. There has been an increase of 11-13 bps in yields on the 10 year paper of states like Gujarat, Haryana and Tamil Nadu. This also pushes up the cost of borrowings of states which still have a way to go in terms of completing their borrowing programme, unlike the centre which has no plan for any further market borrowing," Bank of Baroda chief economist Madan Sabnavis said.

Since the Union Budget also sought to push capital expenditure at state levels, rising borrowing costs and slowing growth could put a spanner in the works of this capex-led revival strategy. Some states have already indicated that they might not avail themselves of a line of credit offered by the Centre in the Budget for targeted capex programmes.