FISCAL UPDATE

23 May 2022

Government cuts excise etc. What are fiscal implications?

Centre has recently announced multiple measures to ease inflation. These include, cut in excise duty on fuel products, higher fertilizer subsidy, subsidy on gas cylinders, and cut in custom duty on some items. Earlier too, government had announced relief for PM-GKAY beneficiaries. The fiscal cost of these measures is expected to be Rs ~2.9 lakh crore. While Centre is expected to meet the gap partly via higher indirect tax revenue and nominal GDP, fiscal deficit may slip to 6.6-6.7% in FY23.

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Problem at hand: CPI inflation rose to nearly 8 year high (8.3% in May'14) to 7.8% in Apr'22 (est.: 7.5%) from 7% in Mar'22, thus surpassing RBI's mandate for the third consecutive month now. Food inflation rose further by 8.4% in Apr'22 (17-month high) from 7.7% in the previous month. Core inflation rose by 66bps to 7% in Apr'22. Depreciating rupee is also posing concern of imported inflation, apart from recuing RBI's FX reserves to stem sharp fall in INR. Rising inflationary concerns also led to out of cycle repo rate hike (+40bps) by the RBI in mid-May. It is expected that the central bank will have to hike rates by another 50-75 bps to tame inflation. However, higher rates pose risks to growth, at a time when there are fears of imminent global slowdown.

Government measures: In order to help lower the burden on consumers and keep inflation in check, Minister of Finance has announced several measures. **These include:** Rs 8/lt cut in additional excise duty on petrol; Rs 6/lt cut in additional excise duty on diesel; additional; Rs 1.1 lakh crore fertilizer subsidy (over and above Rs 1.05 lakh crore budgeted for FY23); Rs 200 subsidy per gas cylinder (upto 12 cylinders) to ~9 crore beneficiaries of PM Ujjwala Yojna; reduction in customs duty on raw materials and intermediaries for plastics products, and iron and steel. Export duty has been levied on some steel products (up 15%) and iron ore (up to 50% from 30% earlier). Import duty on ferronickel, coking coal, PCI coal has been cut from 2.5% to 0%, while the duty on coke and semi-coke has been cut from 5% to 0%. Import duty on Naphtha has been reduced to 1% from 2.5%, and on PVC to 7.5% from 10%. These measures are expected to reduce the cost of final products.

Fiscal Cost: The Finance Minister has announced that the reduction in additional excise duty on petrol and diesel will solely impact revenues of the Centre, as that duty is not shared with states. Government revenues will suffer a loss of Rs 1 lakh crore due to this. In addition, additional fertilizer subsidy will push the overall subsidy bill up to Rs 4.3 lakh crore from the budgeted Rs 3.2 lakh crore. Fertilizer subsidy will now stand at Rs 2.15 lakh crore. Cost of providing subsidy on gas cylinders will also cost the exchequer Rs 6,100 crore. Previously, on 26 Mar 2022, government had also announced extension of PM-GKAY for another 6 months from Apr-Sep'22, costing the exchequer Rs 80,000 crore.

Fiscal Deficit to rise to 6.6-6.7% of GDP: All things remaining the same, if we take into account the fiscal cost of government measures announced, then the fiscal deficit for FY23 will increase from Rs 16.6 lakh crore to Rs 19.5 lakh crore (7.5% as % of GDP) under *ceteris paribus* conditions. In the Budget nominal GDP was taken at Rs 258 lakh crore. However, some underlying assumptions of FY23 budget have changed.

- Firstly, now with higher inflation, we expect nominal GDP to be higher at 13.5-14% in FY23 compared with 11.1% assumed by the government earlier in Feb'22. This will provide an upward fillip to the denominator which will now be in the range of Rs 268-270 lakh crore.

- Higher inflation will also have an impact on Centre's indirect tax collections. Centre's indirect tax collections are estimated to be higher in on account of increased GST revenue and customs duties earned (despite the cuts announced recently on some items).

  - Based on the implied buoyancy in growth and resulting GST collections, we estimate that they would be higher by around Rs 1.2-1.4 lakh crore. Higher GST collections were witnessed in April with an all-time high for the month.

  -Customs collections too will benefit on three counts. The first is higher level of imports mainly due to steady growth in the economy which will necessitate higher non-oil imports. Second, higher commodity prices will add to the dollar value of imports. Third, a weaker rupee will increase the rupee value of imports thus leading to higher customs collections. Collections can be higher by around Rs 80,000 crore here.

- This will imply that gains on GST and customs will be in the region of Rs 2-2.2 lakh crore. The concessions given in the recent announcements along with the higher allocations amount to Rs 2.9 lakh crore, thus yielding a gap of Rs 70-80,000 crore. This will push the fiscal deficit ratio up by 0.2-0.25%.

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