

Union Budget 2022-23



Focus remains on improved spending quality

Conservative receipts lead to higher-than-expected fiscal deficit

The Union Budget 2022 was presented on 1 Feb'22 amid high expectations. Although the Economic Survey forecasted 9.2% real GDP growth in FY22, followed by 8-8.5% growth in FY23, the markets were anticipating that the government would announce measures to support weak consumption. Instead, the government continued on its course to improve the quality of its expenditure by focusing on investment growth. However, the higher-than-expected fiscal deficit, and thus, borrowings, disappointed the bond market and pushed the benchmark bond yield to over 6.8%.

- **Focus on better spending quality is encouraging:** At a time, when there were high expectations from the government to announce measures to support weak domestic consumption, the Union Budget 2022 kept revenue expenditure growth at minimal, and propelled capital expenditure (capex) strongly for the second consecutive year. While the revenue expenditure growth was revised to 2.7% in FY22RE, it is budgeted to grow only 0.9% YoY in FY23BE. Simultaneously, capex is budgeted to grow 24.5% YoY in FY23BE following 41% growth in FY22RE. The government's capital spending, thus, has more than doubled to INR7.5t in FY23BE, from INR3.4t in FY20. Since the total government expenditure is budgeted to grow just 4.6% in FY23BE, higher growth in capex indicates improved quality of spending. Total capital spending of the government is budgeted to rise to 19% of total spending, marking the highest share in 18 years from just 12-13% in the pre-COVID years.
- **Including IEBR, however, investment growth is more modest:** Although the government has budgeted a very high capex growth, a part of it is due to the reduced internal and extra-budgetary resources (IEBR) of public sector enterprises (PSEs). Including IEBR, the investment growth stands modest at just 3.3% in FY23E.
- **Extremely conservative revenue estimates for FY22RE and FY23BE....:** For the second consecutive year, the government appears to have underestimated its revenue growth in FY22RE and FY23BE. Based on provisional data available up to Dec'21 and the historical trends, our calculations suggest that revenue receipts could exceed the revised estimates by as much as INR1.7t in FY22E and further by INR2t in FY23E. However, what is perplexing is to note that the government expects INR660b from disinvestments in Feb-Mar'22 that may be difficult without the public issuance of Life Insurance Corporation (LIC). We believe LIC and other disinvestments could happen in FY23, implying that while there would be a shortfall in FY22 (v/s FY22REs), there is a possibility of over-achievement in FY23. Overall, while there could be an overshoot of INR1.2t in FY22, total receipts could exceed the targets by INR2-2.5t in FY23E.
- **...will lead to higher-than-expected fiscal deficit and market borrowings:** If so, we believe that just like in FY22, the government will have an option to either spend more or to consolidate further in FY23. Such conservative receipt estimates are the primary reason for higher-than-expected fiscal deficit and, thus, borrowings in FY22/FY23, which spooked the debt markets. Notwithstanding better nominal GDP growth, the fiscal deficit is revised upwards to 6.9% of GDP in FY22RE (at INR15.9t vis-à-vis INR15.1t in FY22BE) and pegged at 6.4% of GDP for FY23BE (at INR16.6t). The gross/net market borrowings are pegged at INR15t/INR11.2t (5.8/4.3% of GDP) for FY23, respectively.

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Market strategy

The Union Budget 2022 has been announced amid a positive backdrop of a sharp economic recovery from the pandemic lows as well as a buoyant capital market. The backdrop, however, has turned more challenging in the recent past with the US Fed and other Central Banks shifting their focuses towards containing inflation. Consequently, the prevailing easy liquidity along with the low interest regime is on the last lap now and equity markets have, naturally, turned topsy-turvy.

However, the budget presented by the Honorable Finance Minister (FM) has demonstrated continuity as it has built on the last year's budget announcements. Growth revival remained the principal theme of the budget. With this objective in mind, the government has largely continued with its focus of: a) driving capital expenditure (capex) by enhancing gross budgetary supports for roadways, railways and defense sectors, and b) propelling the manufacturing sector through PLI schemes, while transitioning the economy with an emphasis on urban planning, logistics, EV's, solar module manufacturing, river linking, water connections, etc. The FM has also focused on using PM Gati Shakti that was announced in Oct'21 to dismantle silos within the government for seamless building of infrastructure projects and improving the ease of doing business.

Resisting the temptation of populist giveaways ahead of the five state elections in Feb-Mar'22, the government has largely remained on track with a focus on long-term structural growth drivers. Fiscal deficit is expected to moderate to 6.4% in FY23 BE from 6.9% in FY22 RE. Similar to FY22, the FY23 budget numbers look conservative on revenue receipts and overall budget projections look credible. The bond markets reacted adversely to the gross market borrowings/net borrowings of INR14.9t/INR11.2t, respectively, which were above market expectations.

Overall from an equity market perspective, we believe the budget, on balance, has no unpleasant surprises while there remains some room for further capex/spending push as the government is likely to overshoot its revenue targets. While there could be some disappointments on the absence of measures to improve consumption, economic recovery in FY23 coupled with vaccination progress would continue to drive demand recovery ahead. Crude prices around USD90/bbl will present a challenge for inflation ahead and act as a risk for fiscal maths.

Given the continuity of policy focus and pronouncements, we believe markets will discount the budget and shift focus to: a) rising interest rate regime globally and consequent higher bond yields and b) corporate earnings growth that has remained resilient so far in the ongoing 3QFY22 earnings season. The forward earnings estimates for FY22/23/24 have remained stable around INR740/ INR875/INR1,000, respectively. The forthcoming RBI policy meet on 9th Feb'22 assume greater significance now with respect to the future of liquidity and interest rates. Valuations are slightly rich with Nifty trading at 20x FY23E EPS and thus the corporate earnings delivery becomes highly crucial, more so in a rising rate regime. We prefer BFSI, IT, Consumer, Telecom, Metals and Cement while we are Underweight on Auto and Energy in our model portfolio.

Top ideas – Large-caps: ICICI Bank, SBI, L&T, Axis Bank, Reliance, Bharti Airtel, Infosys, HUVV, Titan, and Hindalco.

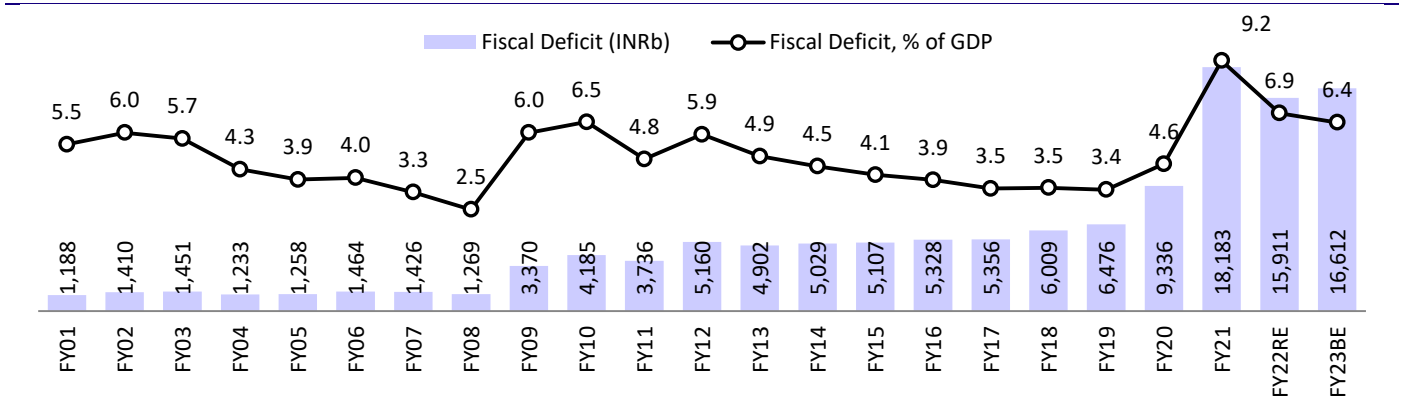
Mid-caps: Ashok Leyland, Oberoi Realty, Indian Hotels, Devyani International, Zensar Tech, Indigo Paints, ABFRL, Gujarat Gas Orient Electric, and VRL Logistics.

Higher borrowings stun the debt markets

Fiscal deficit estimated at 6.9%/6.4% of GDP in FY22/FY23, respectively

Just like last year, the Union Budget 2022 estimates appeared conservative on the receipts front but expenditure (FY22RE over FY22BE) target seemed largely in line with expectations. While the government raised its receipts estimates to only INR21.8t in FY22RE (from INR19.8t in FY22BE), the expenditure target has been revised up to INR37.7t in FY22RE (from INR34.8t in FY22BE). These numbers, therefore, suggest that the government expects a fiscal deficit of INR15.9t, which is 6.9% of GDP (assuming a nominal GDP growth of 17.6% YoY), higher than the FY22BE of INR15t (which is 6.8% of GDP). Moreover, in line with its target of reducing deficit to below 4.5% of GDP by FY26, the government pegged FY23 fiscal deficit at 6.4% of GDP (assuming nominal GDP growth of 11.1% YoY over FY22RE) (*Exhibit 1*). Both FY22/FY23 estimates are above our [expectations](#).

Exhibit 1: Trends in fiscal deficit over the past two decades



Source: Government, MOFSL

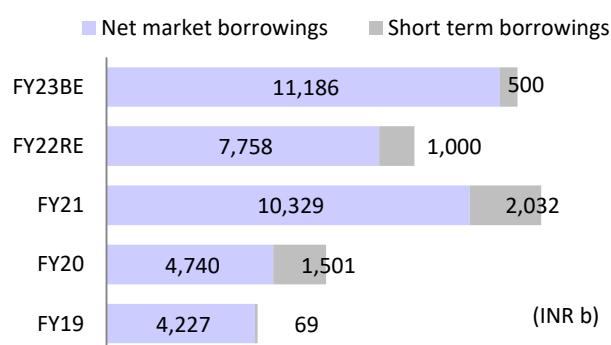
The GMBs and NMBs were kept broadly unchanged in FY22 (including INR1.59t borrowed to give loans to states in lieu of GST compensation shortfall) at INR12.1t/INR9.2t in FY22RE, respectively

The gross market borrowings (GMBs) and net market borrowings (NMBs) were kept broadly unchanged in FY22 (including INR1.59t borrowed to give loans to states in lieu of GST compensation shortfall) at INR12.1t/INR9.2t in FY22RE, respectively. With higher fiscal deficit in FY23, the government plans to increase its GMBs to INR15t next year, leading to NMBs of INR11.2t after INR3.7t worth of repayments.

The government also plans to fund a large part of its deficit by issuing securities against small savings worth INR5.9t in FY22 v/s INR4.8t in FY21. The government plans to lower it down slightly to INR4.8t in FY23. On the contrary, the government plans to issue only INR1t worth treasury bills in FY22 (up from INR500b estimated in FY22BE) and reduce it by half to INR500b in FY23 (short-term borrowings had risen to INR2t in FY21; *refer to Exhibit 2*). The additional borrowing for FY23 might impart an added pressure on bond yields.

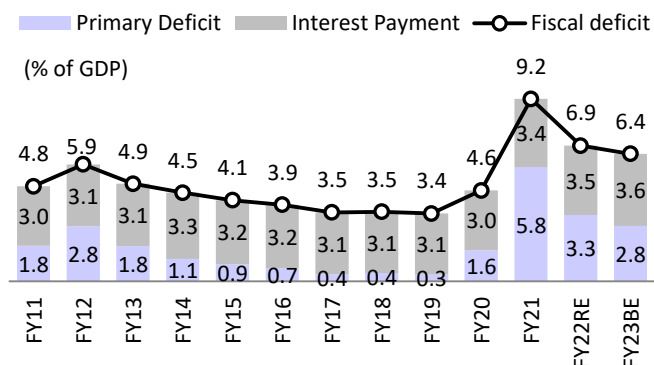
The primary deficit (fiscal deficit *excluding* interest payments), which increased to a multi-decade high of 5.8% of GDP in FY21, is estimated to reduce to ~3.3% of GDP in FY22 and further to 2.8% of GDP in FY23 (*Exhibit 3*).

Exhibit 2: NMBs to grow tremendously...



Excluding switching and buybacks

Exhibit 3: ...but primary deficit may decelerate in FY23BE



Source: Government, MOFSL

Exhibit 4: Union Budget 2022-23 in numbers

	FY20	FY21	FY22RE		FY23BE	
	INR t	INR t	INR t	% YoY	INR t	% YoY
Total Receipts	17.5	16.9	21.8	28.8	22.8	4.8
Revenue receipts	16.8	16.3	20.8	27.2	22.0	6.0
Gross Taxes	20.1	18.9	25.2	33.3	27.6	9.6
Net Taxes	13.6	14.3	17.7	23.8	19.3	9.6
Direct taxes	10.5	9.4	12.5	32.3	14.2	13.6
Corporation Taxes	5.6	4.6	6.4	38.7	7.2	13.4
Income Taxes	4.9	4.9	6.2	26.2	7.0	13.8
Indirect taxes	9.6	9.4	12.7	34.4	13.4	5.7
Customs	1.1	1.3	1.9	40.3	2.1	12.7
Excise Duties	2.4	2.5	3.9	56.5	3.4	-15.0
Goods & Services Tax (GST)	6.0	5.5	6.8	23.0	7.8	15.6
Devolution to states	6.5	6.0	7.5	25.0	8.2	9.6
Non-tax revenue	3.3	2.1	3.1	51.1	2.7	-14.1
Non-debt capital receipts	0.7	0.5	1.0	73.5	0.8	-20.7
Divestment	0.5	0.3	0.8	105.8	0.7	-16.7
Total Expenditure	26.9	35.1	37.7	7.4	39.4	4.6
Total excl. Subsidies	24.2	27.5	32.8	19.3	35.9	9.4
Revenue expenditure	23.5	30.8	31.7	2.7	31.9	0.9
Interest payments	6.1	6.8	8.1	19.7	9.4	15.6
Defense	2.1	2.2	2.3	6.3	2.3	1.5
Subsidies	2.6	7.6	4.9	-35.7	3.6	-27.1
Pensions	1.7	1.7	1.9	11.4	1.7	-9.6
Grants to states/UTs	5.3	5.7	5.6	-2.0	6.7	21.3
Non-defense Pay/allowances	2.3	3.3	1.0	-71.2	1.1	9.6
Other	3.4	3.6	8.0	120.2	7.2	-10.3
Capital expenditure	3.4	4.3	6.0	41.4	7.5	24.5
Fiscal Deficit	9.3	18.2	15.9	6.9	16.6	6.4
Revenue Deficit	6.7	14.5	10.9	4.7	9.9	3.8
Capital Deficit	2.7	3.7	5.0	2.2	6.7	2.6
Primary Deficit	3.2	11.4	7.8	3.3	7.2	2.8
Nominal GDP	203.4	197.5	232.1	17.6	258.0	11.1

Source: Union Budget documents, MOFSL

FY23 receipt estimates appear highly conservative

Following a 57.1% YoY growth in total receipts during Apr-Dec'21, the government expects total receipts to increase 28.8% YoY in FY22. Based on this, the government predicts the receipts to grow at 4.8% YoY in FY23.

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Within total receipts, the government has estimated a growth of ~24% YoY in net taxes and a massive 51.1% rise in non-tax receipts in FY22. Because of this high base, the net tax receipts are likely to grow only 9.6% YoY and non-tax receipts are actually projected to contract 14.1% YoY in FY23. Therefore, net taxes are likely to account for ~85% of total receipts, the highest in the past five decades.

Exhibit 5: Receipts expected to grow strongly this year...

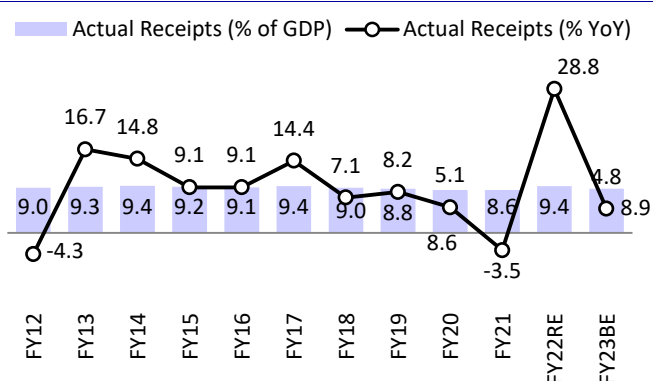
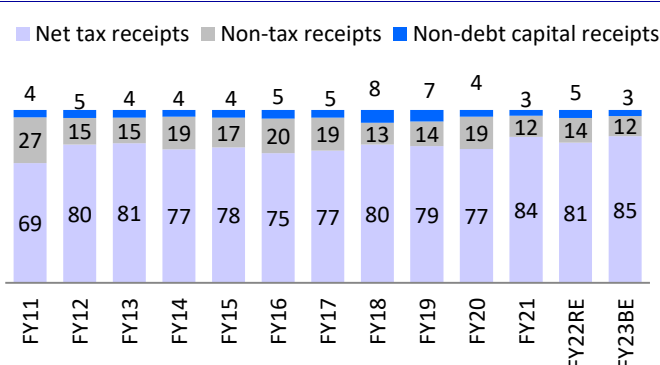


Exhibit 6: ...and taxes to account for 85% of all receipts



Source: Union Budget documents, MOFSL

Considering the fact that 89% of budgeted receipts have already been achieved in 9MFY21, a full-year target of INR21.8t implies that the government actually expects total receipts to decline 26.6% YoY in 4QFY22 (with as much as 37% decline in revenue receipts)

Conservatism on FY22 receipts implies FY23 target can be overachieved...

It is interesting to note that the government is extremely conservative on receipts for the second consecutive year. Considering the fact that 89% of budgeted receipts have already been achieved in 9MFY21, a full-year target of INR21.8t implies that the government actually expects total receipts to decline 26.6% YoY in 4QFY22 (with as much as 37% decline in revenue receipts).

On the tax front, gross taxes are likely to grow 9.6% v/s the nominal GDP growth of 11.1% for FY23, implying a tax buoyancy ratio of less than 0.9x, vis-à-vis 1.1x in the pre-COVID period (3-year / 5-year average). Based on provisional data available up to Dec'21 and the historical trends, our calculations suggest that revenue receipts could exceed revised estimates by as much as INR1.7t in FY22 and further by INR2t in FY23 (*refer to Exhibit 7*).

Gross taxes have five major components – personal income tax, corporate income tax, excise duties, customs, and GST. Notably, the government has budgeted a 15% YoY contraction in excise duty collections in FY23 on a high base of FY22 (since the government garnered additional resources due to higher taxes/duties on petrol/diesel in FY22). All other components are forecasted to grow in the range of 12-16% YoY in FY23.

Exhibit 7: Details of receipts in the Union Budget 2022-23

	FY21	FY22RE			FY22E*	FY23BE			FY23E*
	INR t	INR t	% YoY	% of GDP	INR t	INR t	% YoY	% of GDP	INR t
Total Receipts	17.0	21.8	28.8	9.4	23.0	22.8	4.8	8.9	25.4
Revenue receipts	16.3	20.8	27.7	9.0	22.5	22.0	6.0	8.5	24.0
Gross Taxes	18.9	25.2	33.3	10.8	27.8	27.6	9.6	10.7	31.4
Net Taxes	14.3	17.7	23.8	7.6	19.4	19.3	9.6	7.5	21.3
Direct taxes	9.4	12.5	32.3	5.4	14.6	14.2	13.6	5.5	16.7
Corporation Taxes	4.6	6.4	38.7	2.7	7.8	7.2	13.4	2.8	8.9
Income Taxes	4.9	6.2	26.2	2.6	6.8	7.0	13.8	2.7	7.8
Indirect taxes	9.4	12.7	34.4	5.5	13.2	13.4	5.7	5.2	14.7
Customs	1.3	1.9	40.3	0.8	1.8	2.1	12.7	0.8	2.0
Excise Duties	2.5	3.9	56.5	1.7	4.0	3.4	-15.0	1.3	4.4
Goods & Services Tax (GST)	5.5	6.8	23.0	2.9	7.2	7.8	15.6	3.0	8.1
Non-tax revenue	2.1	3.1	51.1	1.4	3.1	2.7	-14.1	1.0	2.7
Dividends from financial sector	0.6	0.5	-13.5	0.2		0.8	38.2	0.3	
Non-debt capital receipts	0.6	1.0	73.5	0.4	0.5	0.8	-20.7	0.3	1.4
Divestment	0.3	0.8	105.8	0.3	0.3	0.7	-16.7	0.3	1.2

*MOFSL estimates

Source: Union Budget documents, CGA, MOFSL

...but the disinvestment target looks confusing

The government has achieved only INR120b worth of disinvestments as of end-Jan'22. However, the full-year target has been kept at INR780b, implying that INR660b worth additional disinvestment is still expected to materialize in Feb-Mar'22. This is confusing. If the Initial Public Offering (IPO) of LIC is completed in FY22 itself, it is likely to yield higher amount of receipts; but if it does not materialize this year, then FY22 targets will be missed by a large margin.

"Towards implementation of the new Public Sector Enterprise policy, the strategic transfer of ownership of Air India has been completed. The strategic partner for NINL (Neelanchal Ispat Nigam Limited) has been selected. The public issue of the LIC is expected shortly. Others too are in the process for 2022-23," the Finance Minister said in her speech today.

Further, disinvestment target for FY23 has been kept at INR650b, which according to us is not a tall task, provided the government has lots in its pipeline.

We believe that LIC and other disinvestments could happen in FY23, which means that while there would be a shortfall of about INR500-600b in FY22 (vis-à-vis FY22RE), there is a possibility of over-achievement in FY23.

Overall, while there could be an overshoot of INR1.2t in FY22, total receipts could exceed the targets by INR2-2.5t in FY23E.

Total spending budgeted to grow just 4.6% YoY in FY23... ...the lowest in 18 years

Due to high receipts mop-up in FY22, the government has been able to raise its expenditure target to INR37.7t in FY22, a growth of 7.4% YoY

The government has been able to raise its expenditure target to INR37.7t in FY22, a growth of 7.4% YoY, due to high receipts mop-up in FY22. This also comes on the back of a very high base of 31% YoY growth in FY21 due to COVID-induced expenditure. Our calculation suggests that even if total expenditure grows only 1.5% YoY in 4QFY22, the government will be able to achieve its FY22 spending target. On the flipside, this also indicates that government support to economic growth will be negligible in the last quarter of FY22. The government expects spending to grow 4.6% YoY in FY23, which we believe is contingent on further COVID-led disruption. As a percentage of GDP, total spending might weaken to 16.2% in FY22 after a 30-year high of 17.8% in FY21. It is then expected to further decelerate to 15.3% in FY23BE.

Exhibit 8: Total spending growth budgeted to increase 7.4% in FY22RE followed by 4.6% YoY in FY23BE

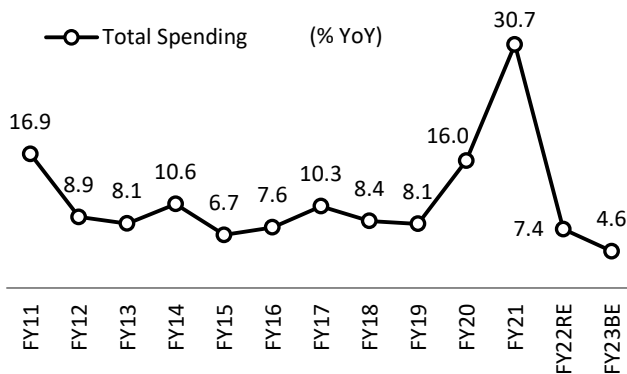
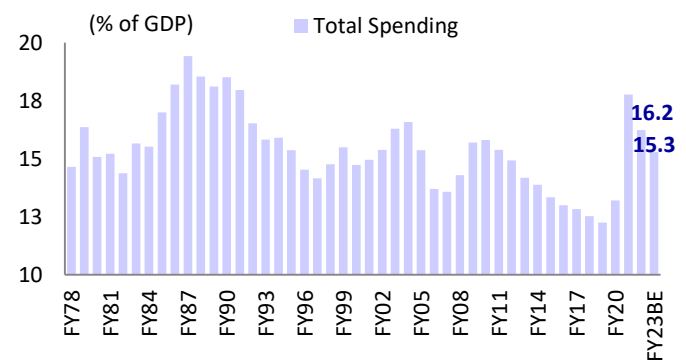


Exhibit 9: Total spending budgeted to decelerate to only 15.3% of GDP in FY23BE



Source: Government, MOFSL

High growth in FY22 total spending is expected largely on the back of capital spending, while revenue expenditure is anticipated to grow only by a modest rate

High growth in FY22 total spending is expected largely on the back of capital spending, while revenue expenditure is anticipated to grow only by a modest rate. Revenue spending is likely to grow 2.7% YoY in FY22 followed by only 0.9% YoY growth in FY23. Capital spending is estimated to have grown 41.4% YoY followed by a 24.5% growth in FY23, indicating that the share of capital spending in FY23 is likely to increase to 19%, at an 18-year high (refer to Exhibits 10, 11).

Exhibit 10: Capital spending is budgeted to rise as a percentage of total spending in FY23BE...

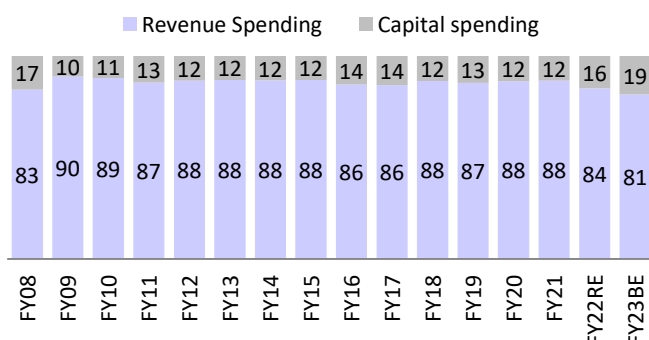
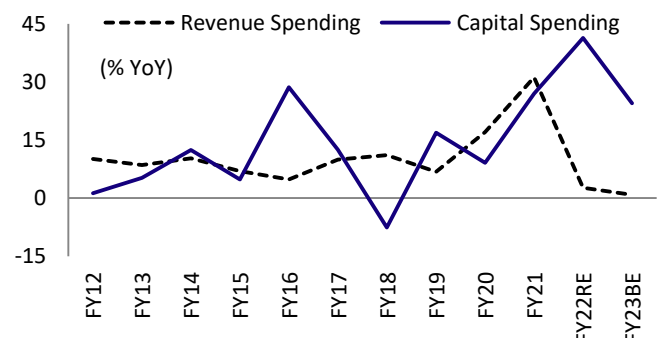


Exhibit 11: ...as capex exhibits high growth in FY23BE (albeit slower than FY22RE)



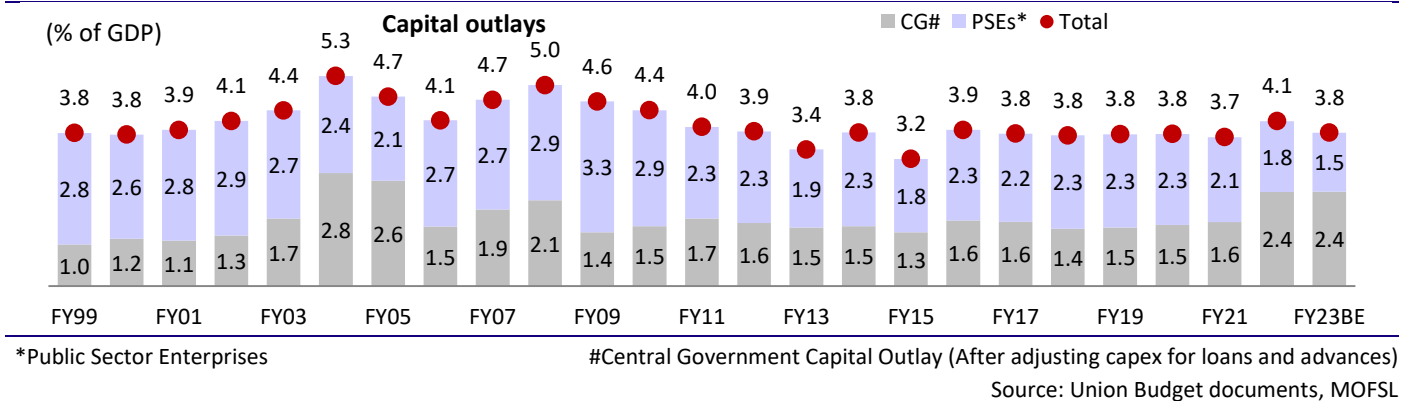
Source: Union Budget documents, MOFSL

Total government capex as a percentage of GDP is expected to reduce to 3.8% in FY23 from 4.1% in FY22

Actual capex projected to grow only 3.3% YoY in FY23

Although the central government has targeted a growth of 24.5% YoY in capital spending in FY23, the same for Central Public Sector Enterprises (PSEs) is expected to contract next year. This indicates a growth of only 3.3% YoY in FY23 for the combined capital spending (government + PSEs), which is very low. As a percentage of GDP, while PSEs' capex is likely to reduce to 26 year low of 1.5% that of the government is expected to remain unchanged at 2.4% in FY23. Therefore, the total government capex, as a percentage of GDP, is projected to reduce to 3.8% in FY23 similar to the pre-FY22 period and lower than 4.1% in FY22 (refer to Exhibit 12).

Exhibit 12: While the Center capex as % of GDP is expected to remain flat in FY23, that of CPSEs might reduce



Rural spending by the central government is expected to decline 6.4% YoY in FY23BE following just 3.4% YoY growth in FY22RE

A few other noticeable points in government spending estimates:

- Due to the unprecedented COVID-19 pandemic, the government had rolled out high amount of food subsidy to reach the lower strata of the society. Consequently, food subsidy in FY21 rose a sharp 143% YoY to INR5.4t. Now that the program has ended, food subsidy has been brought down to only INR2.9t in FY22RE followed by INR2.1t in FY23BE.
- Due to large amount of COVID-induced fiscal expansion, the government's debt burden increased massively. Naturally, its interest burden also increased. Interest payment in FY23 has been estimated at INR9.4t v/s INR8.1t in FY22RE, INR6.8t in FY21 and only INR6.1t in FY20.
- Rural spending by the central government is expected to decline 6.4% YoY in FY23BE, following just 3.4% YoY growth in FY22RE. As a percentage of total expenditure, rural spending is assumed to have decreased to 11.2% in FY23, from 12.6% in FY22RE (Exhibits 13, 14).

Exhibit 13: Rural spending is budgeted to fall...

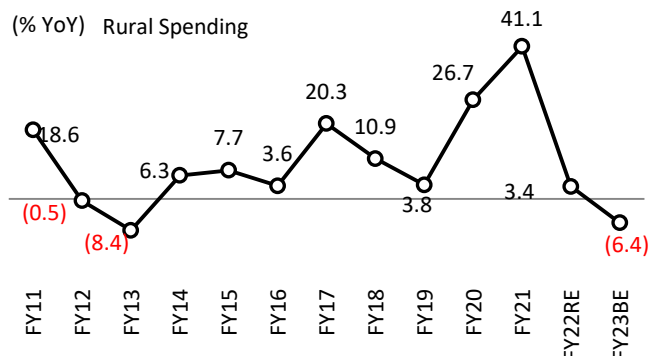
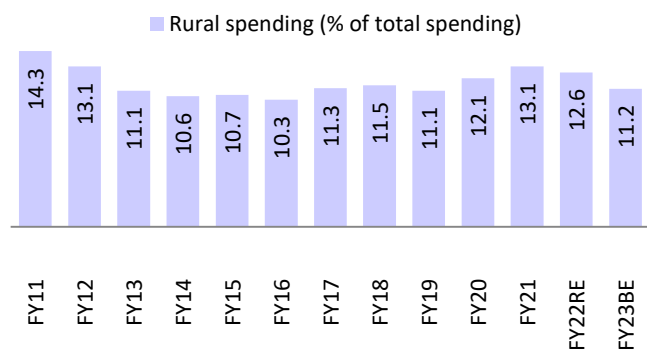


Exhibit 14: ...leading to a lower share in total spend in FY23



Source: Union Budget documents, MOFSL

Spending quality improved at the cost of short-term economic growth

Contrary to high expectations to support weak consumption growth, the government once again focused on improving the quality of its spending, at the cost of short-term economic growth

Overall, contrary to high expectations to support weak consumption growth, the government once again focused on improving the quality of its spending, at the cost of short-term economic growth. The capital spending of the government is budgeted to more than double to INR7.5t in FY23BE, from INR3.4t just three years ago in FY20. Consequently, the share of capital spending is expected to increase to 19% of total spending in FY23BE, marking the highest rate in 18 years.

However, a part of this higher budgeted capital spending is also because of reduced PSEs spending. Including IEBC of PSEs, the combined investment spending is expected to grow modestly at just 3.3% YoY in FY23.

Our calculations suggest that not only the government could over-achieve its FY23 receipt targets by INR2-2.5t, but there could be an excess receipts of INR1.2t in FY22 also. If so, it would be interesting to see if the government uses extra receipts to increase its spending and support economic activity or it reduces its fiscal deficit and borrowings. We believe there is a high likelihood that just like in FY22, the actual receipt growth will turn out to be significantly better in FY23.

Notwithstanding better nominal GDP growth, the fiscal deficit is revised upwards to 6.9% of GDP in FY22RE (INR15.9t vis-à-vis INR15.1t in FY22BE) and pegged at 6.4% of GDP for FY23BE (INR16.6t).

Because of such conservatism in receipts, the fiscal deficit and market borrowings are pegged at much higher levels for FY22RE and FY23BE. Notwithstanding better nominal GDP growth, the fiscal deficit is revised upwards to 6.9% of GDP in FY22RE (INR15.9t vis-à-vis INR15.1t in FY22BE) and pegged at 6.4% of GDP for FY23BE (INR16.6t). The gross/net market borrowings are pegged at INR15t/11.2t (5.8/4.3% of GDP) for FY23, respectively. It is not surprising that the debt market was spooked by the Union Budget 2022. However, there is a high likelihood that over a period of time, if state borrowings are not very high, bond yields could soften after few weeks.

**Agri****Budget Impact: Positive****Sector Stance: Positive**

The Union Budget 2022 has reflected the government's focus on increasing irrigation infrastructure. The key announcements influencing the Agri sector, or farmers, are:

Area	Key proposal	Impact
Fertilizer subsidy reduced 25% to INR1,052b (over FY22 Revised allocation)	❖ Overall budget allocation for Fertilizer Subsidy was cut by 25% to INR1,052b (Urea lower by ~17% to INR632b and Complex Fertilizer lower by 35% to INR420b). We believe the government will increase subsidy allocation as per the requirement and on assessing the raw material scenario during the year. The government had revised Fertilizer Subsidy in 2021-22 by 76% over budgeted subsidy allocation to INR1,401b (Urea higher by 29% to INR759b and Complex Fertilizer higher by 209% to INR642b, over budgeted estimates)	Negative
Increased allocation under water resource development dept. by 5% to INR190b (over FY22 revised estimates)	❖ The government has increased expenditure on the totally centrally-funded schemes under Department of Water Resources, River Development and Ganga Rejuvenation by 5% to INR190bn v/s revised estimates for 2021-22.	Positive
Focus on irrigation infrastructure	❖ Government has finalized draft DPRs of five river links: Damanganga-Pinjal, Par-Tapi- Narmada, Godavari-Krishna, Krishna-Pennar and Pennar-Cauvery. The Center will provide support for the implementation of the project once a consensus among the beneficiary states is reached. ❖ The government will implement an estimated INR446bn Ken-Betwa Link Project that will provide irrigation benefits to 9.08 lakh hectare of farmers' lands, drinking water supply for 62 lakh people, 103 MW of Hydro, and 27 MW of solar power.	Positive
Focus on increasing domestic production of oilseeds	❖ The government is focusing to implement a rationalized and comprehensive scheme to increase domestic production of oilseeds and reduce dependence on imports.	Positive
Focus on startups for agriculture and rural enterprises to drive agriculture sector	❖ The government is focusing on a fund with blended capital, raised under the co-investment model and it will be facilitated through NABARD. It will finance startups for agriculture and rural enterprises across the value chain. The activities for these startups will include, inter alia, support for FPOs, machinery for farmers on rental basis at farm level, and technology including IT-based support.	Positive

Outlook and recommendations

For the Agriculture sector, the Budget focused on: i) increasing allocation towards the irrigation infrastructure, ii) startups for agriculture and rural enterprises to drive the sector, and iii) lower dependency on import in agriculture produce. The government's focus on improving irrigation infrastructure by linking canals with rivers, groundwater well-based systems, tanks, and other rainwater harvesting projects for agricultural activities would increase agriculture produce. The future plan of the government, with its objective of increasing farmers' income, is likely to benefit the Agrochemical and Fertilizer companies.



Autos

Budget Impact: Negative

Sector Stance: Positive

The Union Budget 2022 continues to support electrification with the proposition to formulate the Battery Swapping Policy. Furthermore, it plans to boost clean mobility in public buses through the Public-Private Partnership (PPP) model. However, a reduction in the allocation towards the rural markets may hurt rural-focused segments such as 2Ws and Tractors. Key announcements directly influencing the sector are:

At a glance

Area	Key proposal	Impact
Battery Swapping	❖ Considering the space constraint in the urban market, the Battery Swapping Policy and inter-operability standards would be formulated to promote the use of clean mobility in the urban markets. The private sector would be encouraged to develop business models for 'Battery' or 'Energy-as-a-Service'.	Positive
New scheme for public bus transport services	❖ A new scheme would be launched at an expense of INR180b to support the augmentation of public bus transport services. The scheme would facilitate the deployment of innovative PPP models to enable private sector players to finance, acquire, operate, and maintain over 20,000 buses.	Positive
Extension of concessional tax schemes for new companies	❖ The government has extended the commencement date for manufacturing for new companies eligible for the concessional tax rate of 15% (u/s 115BAB) by a year to 31 st Mar'24. This would prove beneficial for many OEMs that are demerging their EV businesses into separate companies (such as TTMT, BJAUT, and TVSL).	Positive
Outlay for rural schemes	❖ Lower rural outlay under MGNREGA (-25%), food subsidy (-30%), and fertilizer subsidy (-25%) would impact rural-focused segments such as 2Ws and Tractors.	Negative
Customs duty reduction on Rhodium	❖ The customs duty on Rhodium was reduced from 12.5% to 2.5%. This is a small positive as rhodium consumption has gone up (under BS-6) and costs have also increased exponentially in the last couple of years.	Positive

Outlook and recommendations

The Budget 2022 has reduced the outlay for the rural markets, which has the potential to adversely influence demand for Autos, particularly 2Ws and Tractors, which are already witnessing decline. Our sector outlook is positive as we are in the early phase of recovery after three years of witnessing a weak demand-supply environment across segments. We prefer 4Ws over 2Ws on the back of strong demand and offer a stable competitive environment. We expect the CV cycle to maintain the momentum. We prefer companies with a) higher visibility in terms of demand recovery, b) a strong competitive positioning, c) margin drivers, and d) balance sheet strength. **MSIL** and **AL** are our top OEM picks. Among the auto component stocks, we prefer **BHFC** and **APTY**.



Capital Goods/Infra

Budget Impact: Neutral

Sector Stance: Positive

Capex spending trend unaffected by the pandemic – Defense key beneficiary; Roads outlay flat YoY

At a glance

Area	Key proposal	Impact
Roads	❖ While gross budgetary support rose 55% YoY to INR1.9t in FY23BE, the funding via IEBR has been pegged at around zero. Thus, the total capex outlay was flattish YoY at INR1.9t during FY23BE.	Neutral
Railways	❖ The sector has witnessed a 14% growth on the overall capex outlay, but this also includes equity infusion for High Speed Rail and other PPP projects. <u>Adjusted for the same, the like-for-like growth stood at 6.5% only.</u>	Neutral
Defense	❖ Defense capex spending increased 9.7% to INR1.52t. Importantly, 68% of the capital procurement budget will be earmarked for domestic industry in FY23BE v/s 58% in FY22RE. <u>This implies the capital procurement budget for the domestic industry will register a 29% YoY growth to reach INR1t.</u>	Positive
Others	❖ Allocations for the Metro project are almost flat at INR191b in FY23BE (v/s INR190b in FY22RE).	Neutral

Outlook and recommendations

- **Capital Goods / Infrastructure:** Overall, capex growth was unable to suggest a big impetus on infrastructure spending, but it was in line with our expectation of decent growth. Roads capex remained flattish, while Railways witnessed satisfactory growth. Defense capex continued to be focused on import substitution and was a key positive.
- **Our top pick:** L&T is our preferred play on overall capex in the country; while, BEL is our preferred play on defense capex, led by import substitution. Within the Roads segment, we continue to prefer GR Infra and KNR Constructions.



Cement

Budget Impact: Neutral

Sector Stance: Positive

There is no direct announcement for the Cement sector in Union Budget 2022, though, the allocation on Housing schemes, Roads, etc., have been raised marginally on a higher base of last year.

There appears to be some changes on customs duty on coal and lignite. However, the customs tariff structure has been simplified and the effective basic customs duty (including applicable cess) remains unchanged.

At a glance

Area	Key proposal	Impact
Allocation for Housing schemes	❖ Allocation to Housing schemes (PMAY-Gramin and PMAY-Urban) stood at INR480b, up 1.3% YoY (up 17.7% YoY in FY22E) and the target is to complete construction of 8m houses. This will continue to boost Cement consumption.	Neutral
Allocation for Roads	❖ Allocation for Roads (including IEBR) stood at INR1,877b, up 1% YoY (up 20.8% YoY in FY22E). Allocation for Pradhan Mantri Gram Sadak Yojana stood at INR190b, up 36% YoY.	Neutral

Outlook and recommendations

- **Cement:** We remain positive on the sector as we expect demand to improve going forward, led by the government's thrust on Infrastructure spending and a pick-up in demand from the Real Estate sector. Cement demand is expected to outpace clinker capacity additions over FY21-24E. This should lead to an improvement in clinker utilization and profitability for the industry. We expect clinker utilization, excluding South India, to be over 90% in the January to March period of FY22-24E. This will boost the pricing power of manufacturers over that period. UTCCEM is our top pick, followed by ACC and DALBHARA in the largecap space. We also prefer Grasim Industries due to: 1) improvement in VSF demand in domestic markets, 2) focus on backward integration, which will help higher chlorine usage, 3) capacity expansion plans, and 4) its foray into the Paints business.



Specialty Chemicals

Budget Impact: Positive

Sector Stance: Positive

Through the Union Budget 2022, the government has tried to focus on import substitution, thereby reducing import bill. The government has facilitated domestic companies by imposing customs duties on key raw materials. The key announcements influencing the chemicals sector are:

At a glance

Area	Key proposal	Impact
Changes in customs duties	<ul style="list-style-type: none"> ❖ BCD exemption has been prescribed on “Crude glycerin for use in manufacture of soaps” – this will now attract 7.5% duty ❖ BCD on “Acetic acid” has been decreased from 7.5% to 5% ❖ BCD on “Methyl Alcohol” has been decreased from 5% to 2.5% ❖ Concessional BCD rate of 5% is prescribed on goods required for renovation, modernization or maintenance of a fertilizer plant ❖ BCD rate has been prescribed on machinery for effluent treatment plants of the handloom sector ❖ Concessional BCD rate of 5% has been prescribed on C-block compressors and crankshafts used in manufacture of refrigerator compressors – this will now attract 7.5% duty 	Positive

Outlook and recommendation

The aforementioned changes in the customs duties would be beneficial to companies such as Atul Ltd, Alkyl Amines and Clean Science. Moreover, the entire domestic ecosystem would benefit from the higher and cheaper availability of raw materials/intermediates, thereby aiding the chemicals space.

**Consumer****Budget Impact: Negative****Sector Stance: Neutral**

While there was no material announcement in the Union Budget 2022 that would significantly impact any of the stocks in our Consumer universe (positively or negatively), the lack of any major initiative to boost slowing rural demand is perceived as a dampener. In fact, lower allocations towards food subsidies, and fertilizer subsidies (both urea-based and complex) as well as a 25% lower MNREGA allocation are all sentimental downers. However, we believe that the government could increase its allocations towards subsidies and MNREGA during the year, based on the prevalent ongoing economic scenario and this would prevent any material decline in rural disposable incomes. However, given the steep commodity inflation level, rural purchasing power will be affected in the interim. The lack of additional GST or cess on cigarettes and marginal reductions in the import duties for diamonds, gemstones, and cocoa beans are seen as minor positives for ITC, TTAN, and NEST.

At a glance

Area	Key proposal	Impact
GST + cess on cigarettes	❖ There was no increase in GST or cess on cigarettes – a temporary relief for ITC. In the past, the absence of such an announcement during the Budget would be met with exultation. However, the positive impact may be short lived as a GST increase on cigarettes could be part of any subsequent GST Council meets.	Marginally Positive
Import duty on sawn diamonds/ polished diamonds and gemstones	❖ There was a minor reduction of 2.5% in the basic customs duty (BCD) on polished diamonds and other gemstones while sawn diamonds are now exempt from BCD. This is marginally positive for TTAN as the move will help reduce the company's procurement costs.	Marginally Positive
BCD reduction on Cocoa beans	❖ The BCD on Cocoa beans has been decreased to 15% from 30%, which is a major raw material for chocolates. This is marginally positive for NEST as chocolates and confectionaries accounted for ~10% of NEST's CY20 sales.	Marginally Positive
BCD reduction on Coffee brewing and vending machines	❖ The BCD on coffee roasting, brewing and vending machines, has been reduced to 5% from 10%. This is slightly positive for NEST and HUVR's B2B business, which provides coffee vending machines to retailers.	Marginally Positive

Outlook and recommendation

In the absence of any consumption stimulus despite the ongoing weakness in rural demand, recovery in sales and earnings growth for staples companies will take more time than expected. Eventual absorption of steep raw material-led price hikes and stabilization of material costs will be the key monitorables. Despite relatively cheaper multiples of staples, our preference continues to be discretionaries such as JUBI and TTAN, both of which have: a) a strong visibility on topline and earnings growth (from near-term and medium-term perspectives) as well as (b) relatively less benign margin pressures. Among staples we like GCPL, Dabur and BRIT.



Financials

Budget Impact: Positive

Sector Stance: Overweight

The Union Budget 2022 announcements for BFSI were limited and positive overall. The government recommendations were as follows: (i) it extended the ECLGS scheme by a year and increased the cover by an additional INR500b; (ii) the Credit Guarantee Trust Scheme for MSME was upsized; (iii) it was proposed that the post office be linked with the core banking system and digital banking units be set up to increase reach; and (iv) the introduction of digital currency (INR) was proposed. The government further announced some operational measures with regard to the IBC code and other regulatory frameworks.

At a glance

Area	Key proposal	Impact
Extension of ECLGS Scheme	❖ The ECLGS scheme was extended up to Mar'23E v/s Mar'22 earlier. Furthermore, the guarantee cover was increased by INR500b to INR5t. The additional outlay is earmarked exclusively for hospitality and related enterprises.	Positive
Credit Guarantee Trust for MSME to be revamped	❖ The Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) scheme was upsized, facilitating additional credit of INR2t for MSMEs.	Positive
Post offices to be linked with core banking system	❖ To boost financial inclusion, 100% of the 1.5 lakh post offices would be brought on to the core banking system, enabling financial inclusion and access to accounts through net banking, mobile banking, ATMs, and online fund transfers between post office accounts and bank accounts.	Positive
Amendments in IBC for cross-border resolution	❖ The necessary amendments would be carried out in the IBC code to enhance the efficacy of the resolution process and facilitate cross-border insolvency resolution.	Positive
IRDAI framework for surety bonds	❖ The IRDAI provided the framework for the issuance of surety bonds by insurance companies, which could be used as substitutes for bank guarantees.	Neutral
Introduction of digital rupee	❖ The government proposed to introduce the digital rupee using blockchain and other technologies – to be issued by the RBI from FY23. This would further boost the digital economy and enable a more efficient and cheaper currency management system.	Neutral
Affordable housing	❖ The eligibility period for the claim of additional deduction of interest of INR150k paid towards loans taken for the purchase of an affordable house was retained as 31 st Mar'22 (not extended under the budget). ❖ INR480b (INR280b for urban and INR200b for rural) was allocated towards 8m houses, to be completed for the identified eligible beneficiaries of the PMAY scheme.	Neutral
Ayushman Bharat Digital Mission	❖ An open platform would be rolled out for the National Digital Health Ecosystem consisting of the digital registries of health providers and health facilities, unique health identities, consent frameworks, and universal access to health facilities. Albeit a long-term move, this would help health insurers better price their products and improve their claim ratios.	Positive
NPS deduction for state government employees	❖ The NPS deduction for state government employees was increased to 14%, in line with that for central government employees. UTI AMC is among the largest managers of this fund and would thus benefit from this change.	Positive
Impact of higher yields	❖ PSU banks, AMCs, and insurance companies have a large quantum of investments in debt instruments. The hardening of yields would result in MTM losses on the portfolio, leading to sharp decline in investment income.	Negative

Outlook and recommendations

The extension of the ECLGS scheme, along with the revamping of the CGTMSE scheme, would provide further impetus to the MSME sector – which has borne the brunt of the pandemic. The linking of post offices with the core banking system and setting up of digital banking units would aid in financial inclusion and expanding reach.

The government further announced the introduction of the digital rupee – guidelines on this would be issued by the RBI in due course and would be a key monitorable. The thrust on infrastructure spending and higher government capex is a positive for CV financiers.

Higher fiscal deficit projections have adversely impacted bond yields and could drive higher MTM provisions for banks (mainly PSUs) on their investment portfolios as well as lead to higher borrowing costs for NBFCs. We maintain our OW stance on the sectors. Top ideas: ICICIBC, SBIN, AXSB, SBI LIFE, AUBANK, MUTHOOT, and ANGELONE.



Logistics

Budget Impact: Positive

Sector Stance: Positive

With introduction of multi-modal logistics parks, volumes and turnaround times to improve

At a glance

Area	Key proposal	Impact
Logistics	❖ Contracts for the establishment of multi-modal logistics parks at four locations via the Public-Private Partnership (PPP) model would be awarded during 2022–23E.	Positive
	❖ 100 PM Gati Shakti cargo terminals for multi-modal logistics facilities would be developed during the next three years.	

Outlook and recommendations

- **Logistics:** The setup of multi-modal logistics parks and associated infrastructure would ensure faster turnaround times and higher volumes. It would also improve operational efficiency. **Our top picks: VRL Logistics and Transport Corporation** are our preferred play in the Logistics sector.



Metals

Budget Impact: Neutral

Sector Stance: Positive

The continued thrust on infrastructure spending is positive for the sector. The sector did not witness any significant budget proposal that would have impacted the stocks, but the overall emphasis on capital expenditure by both Central and State Governments should boost demand for metals.

At a glance

Product	Key proposal	Impact
Steel scrap	❖ Import duty on steel scrap (incl. stainless steel) was maintained at 0% for one more year. This was reduced from 2.5% last year to support the MSME, which was hit by COVID-19. It is mildly positive for the sector, and will not materially influence the earnings for companies under over coverage.	Neutral
Certain steel products	❖ Anti-dumping duties (ADDs) on certain steel products were suspended in the last budget for a period of eight months. This suspension was extended by an additional four months later on. However, in the 2022 Union Budget, the ADDs have been revoked altogether. The products impacted are: a) straight-length bars and rods of alloy-steel from China, b) high-speed steel of non-cobalt grade from Brazil, China, and Germany and c) flat-rolled steel products (plated or coated with alloys of zinc or aluminum - Galvalume) from China, Korea RP, and Vietnam. The Finance Minister highlighted that due to high steel prices, the duties were no longer needed. This is mildly negative for the major steel companies that produce value-added flat steel. However, since the duty was already suspended from last year, we do not expect any incremental impact on the earnings.	Neutral
Coal	❖ The standard tariff rate on coal has been reduced to 5% from 10%. However, the effective duty on coal remains at 2.5%, which comprises 1% BCD and 1.5% Agricultural and Infrastructure Development Cess. Hence, there is no change in the effective duty.	Neutral

Outlook and recommendations

- **Steel:** Infrastructure contributes ~60% of the total domestic steel demand with construction at ~20%, and automobile at ~8%. The domestic steel demand has bounced back strongly post-COVID led by pent up demand. 3QFY22 steel consumption, at 25.5mt, was up 14% QoQ while 9MFY22 demand at 70.8mt was 21% higher YoY. 4QFY22 is likely to be better than 3Q, as we expect demand to improve after Omicron subsides.
- Revocation of duties, which were already suspended for the last one year when the pent up demand was strong, is unlikely to have any incrementally negative impact on either demand or pricing. China is concerned about exporting steel while keeping carbon emission at home contained, thereby making it more difficult to attain its carbon reduction targets. Hence, we anticipate steel imports to ebb gradually. We maintain our positive view on metals with JSPL being our top pick in ferrous and Hindalco in the non-ferrous domain.



Oil and Gas

Budget Impact: Neutral

Sector Stance: Positive

Through the Union Budget 2022, the government has tried to focus on the greener alternative for auto fuels. Accordingly, an additional excise duty of INR2/lit has been levied on unblended petrol and diesel. There has only been a marginal decrease in petroleum subsidy, while the divestment target for the year has been revised down. The key announcements influencing the Oil and Gas sector are:

At a glance

Area	Key proposal	Impact
Petroleum subsidy	❖ Petroleum subsidy at INR58b in BE FY23 v/s INR65b in RE FY22	Neutral
Divestment target	❖ Disinvestment targets at INR780b in FY22 RE and INR650b in FY23 BE	Negative
Promotion of blended fuel	❖ An additional Basic Excise Duty of INR2/lit has been imposed on petrol and diesel, intended to be sold to retail consumers without blending. This would be levied with effect from 1st Oct'22	Neutral
Changes in customs duties	❖ Basic Customs Duty (BCD) rate of 5% has been prescribed on 'Kerosene imported by IOCL, HPCL, BPCL and IBP for ultimate sale through the PDS' ❖ Concessional BCD rate of 5% has been prescribed on kits required for the conversion of petrol-/diesel-driven vehicles into CNG ❖ Concessional BCD rate of 5% has been prescribed on goods required for setting up of crude petroleum refinery ❖ BCD has been prescribed on parts and raw materials for manufacture of goods required for off-shore oil exploration	Negative

Outlook and recommendation

Demand for blended fuel will improve in line with the stated aim of 20% ethanol blending by 2025. However, the increase in excise duty would not have any impact on the profitability of the OMCs (IOCL, BPCL, and HPCL). Capex of upstream and downstream companies would increase (as stated above) amid the increase in the BCD. Removal of concessional benefit on the CNG kits would bear an impact on the CGD companies (IGL, MAHGL and GUJGA), which enjoyed a high number of CNG conversions during the pandemic.



Real Estate

Budget Impact: Neutral

Sector Stance: Positive

In the Union Budget 2022, the government has decided to terminate the tax and interest deduction benefits for affordable housing (AFH) projects as it did not extend the benefits for projects registered or home loan availed after 31st Mar'22. The key announcements influencing the real estate sector are:

At a glance

Area	Key proposal	Impact
Interest deduction benefit on AFH	❖ The government did not extend the additional tax benefit (of INR150,000) on interest paid in AFH loans; hence, only the loans availed before 31 st Mar'22 will enjoy the above benefit	Neutral
Tax holiday for developers of AFH	❖ Tax holiday for AFH projects is only applicable for projects registered until 31 st Mar'22; no extension has been provided.	Negative

Outlook and recommendations

While much was anticipated on the real estate sector, there was overall a very little mention about the sector in the budget. Besides, the government did not extend the benefits for new AFH projects (Tax holiday) and AFH loans (additional interest deduction). **That said we do not foresee any negative impact on listed real estate space** as (1) the classification cap of INR4.5m for AFH units and (2) the recent increase in commodity prices have made AFH projects unviable for most of the top-7 cities. **Hence, the listed players have limited exposure to the AFH projects.**



Telecom

Budget Impact: Neutral

Sector Stance: Positive

Telecom receipt budget: Prepayments of deferred liability by the telcos support FY22 RE

At a glance

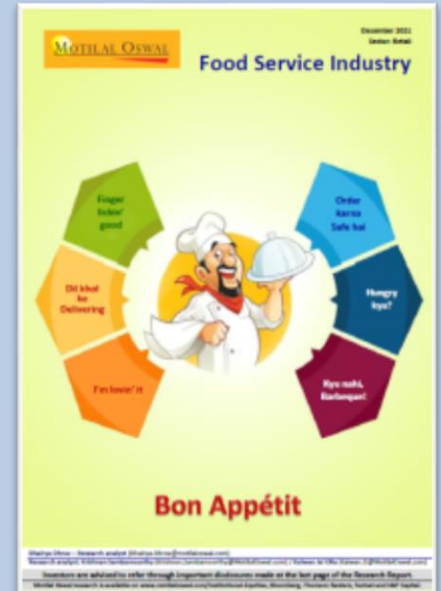
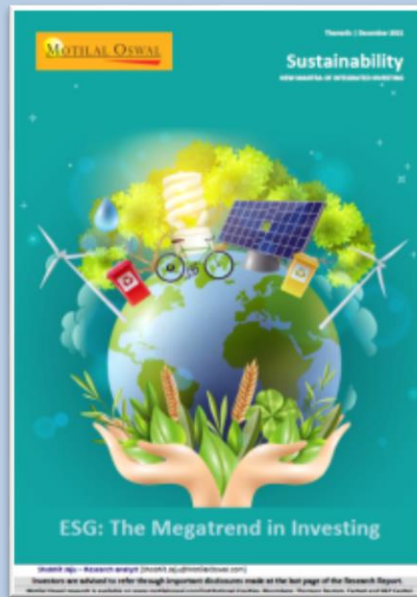
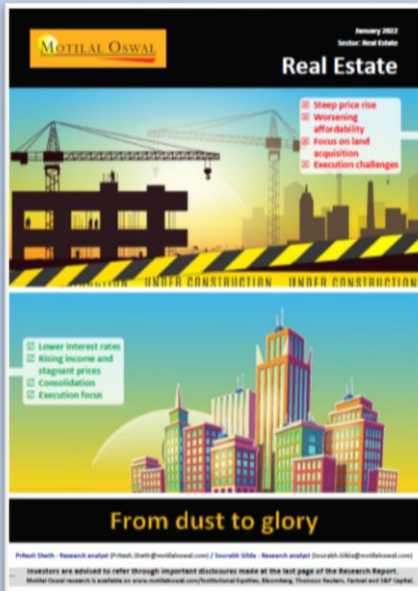
Area	Key proposal	Impact
Telecom receipts accounting for auction	<ul style="list-style-type: none"> ❖ FY22 RE benefit from deferred spectrum prepayments: Telecom receipts in FY22 (BE) were expected to increase to INR540b from INR455b in FY21, primarily led by the 5G auction expectation as per our understanding. However, despite the delay in 5G auction, FY22 RE has increased to INR720b from INR540b (FY22 BE), backed by INR463b received from Telcos towards prepayment of deferred spectrum liabilities. ❖ FY23 factors in ~INR270b from 5G spectrum: The telecom receipts are expected to reduce to INR528b in FY23 v/s INR720b FY22 BE. Adjusting for the recurring ~INR260b license and SUC fee, the rest of the ~INR270b is budgeted toward 5G auction as indicated by the Finance Minister. Assuming about 35%/50% of upfront spectrum payment, the government's estimated auction outlay would be INR520b/810b, respectively. 	Neutral
Focus on make in India for sourcing telecom equipment	<ul style="list-style-type: none"> ❖ Scheme for design-led manufacturing to build 5G ecosystem to be launched as part of product linked incentive (PLI). This will push telecom equipment sourcing and exports, which are being eyed by RJio and Indian telecom equipment manufacturers. 	Positive
Pushing for fiber penetration in the country	<ul style="list-style-type: none"> ❖ PPP model instead of EPC contracts: Bharatnet project contracts for optical fiber networks that are so far awarded as EPC contracts by government to cable manufacturers and EPC companies will now be handed out under PPP model with targets to complete it by FY25. This could push telcos to intensify fiber penetration under government scheme. ❖ Rural Broadband push: 5% of annual telecom collection under USO fund (INR2.3b) will be allocated to improve access in rural areas and promote R&D. 	Positive

Outlook and recommendations

The domestic manufacturing of devices will be propelled by: a) design-led manufacturing to build a 5G ecosystem as part of PLI, b) duty concessions given to parts of transformers of mobile phone chargers and mobile camera lens and c) certain other items. Further, rollout of 5G mobile services within 2022-23 by private telecom providers would also be a positive driver for the sector. **Bharti Airtel** remains our top pick in the sector.

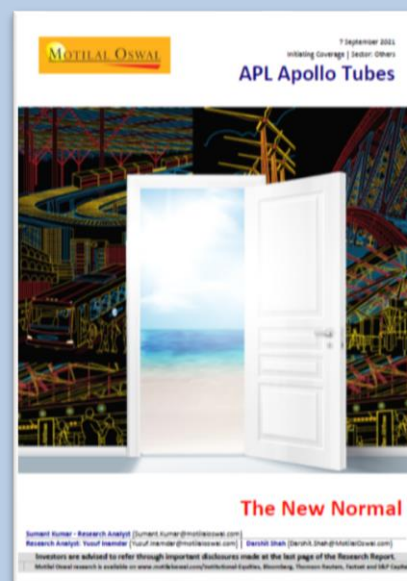
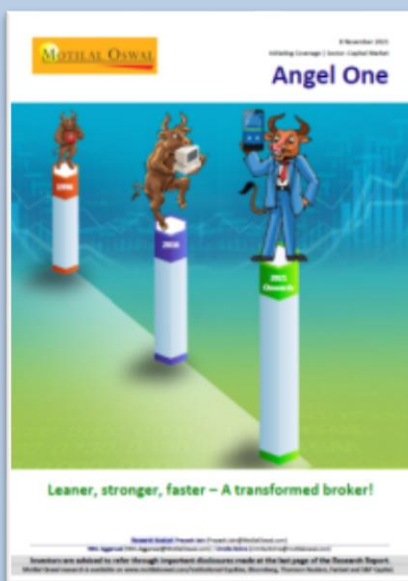
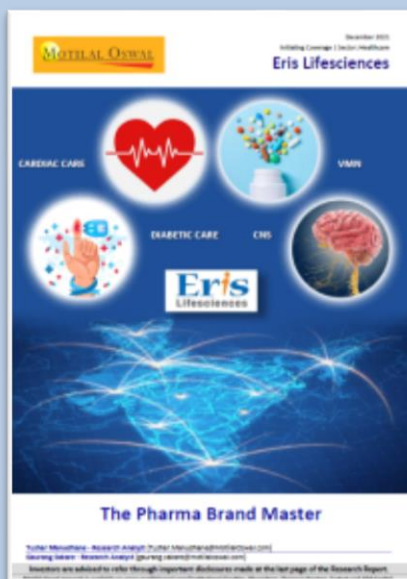
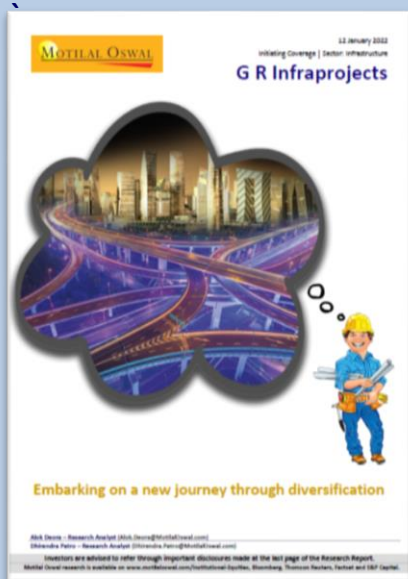
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