

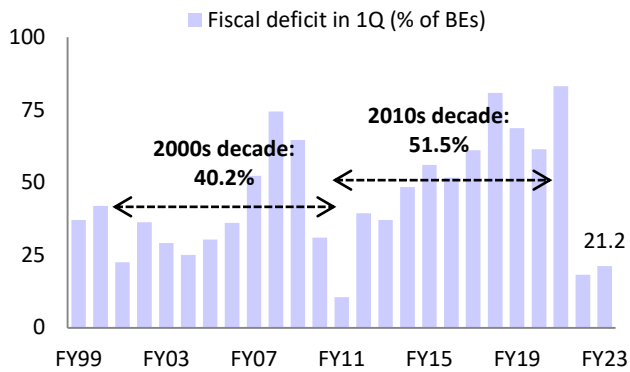
## Has the government shifted its fiscal deficit strategy?

A lower deficit in the first quarter is a result of conservatism in receipts, rather than lesser spending

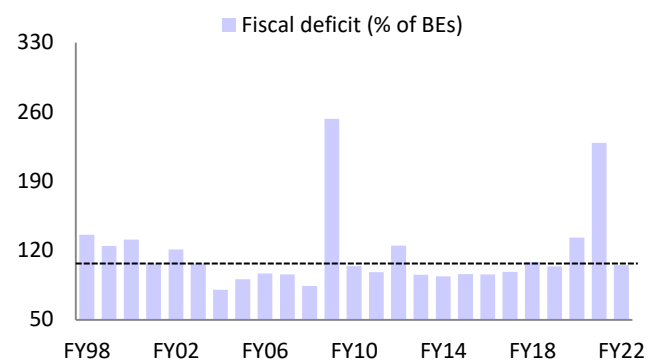
- In the good old days, there used to be a continuous pattern in Union government finances – the fiscal deficit in the first quarter (1Q) of the fiscal would be so high that there was a continuous debate on whether the government will be able to meet its deficit target for the fiscal or not (*refer Exhibit 1*). The fiscal deficit of the Union government averaged 40% of budget estimates (BEs) in the first quarter in the 2000s decade, while it averaged over 50% of BEs in the 2010s decade (up to FY20).
- Due to the COVID-pandemic, the fiscal deficit stood exceptionally high at 83.2% of BEs in 1QFY21. However, the fiscal deficit for the Union government was just 18.2% of BEs in 1QFY22 and remained very low at 21.2% of BEs in 1QFY23. Barring 1QFY11 (the fiscal immediately after the Great Financial Crisis), a fiscal deficit of ~20% of BEs in 1Q is unusually lower and less than half of its long-run average of 45% in the past quarter of a century.
- At the same time, it is equally important to note that while the fiscal deficit used to be very high in 1Q, the Union government managed to contain its annual deficit around its target in majority of the fiscals (*refer Exhibit 2*). In the past two decades, the deficit for the Union government was lower than that budgeted in 11 fiscals, within 110% of BEs in another five fiscals, and much higher than its target in the remaining four fiscals, which were led by extreme circumstances (FY09, FY12, FY20, and FY21).
- It means that while there were many higher deficits in 1Q, the Union government managed a much lower deficit (as a percentage of BEs) in the final or fourth quarter of the year (4Q). This was more true for the 2010s decade (or since FY14), as fiscal deficit averaged less than 10% of BEs in the 4Q (as compared to an average of 40% of BEs in the 4Q in the 2000s decade, similar to the 1Q).
- The monthly data on states is available for the past decade, and an analysis of the combined fiscal accounts indicate that the trends are similar – fiscal deficit in 1QFY22 and 1QFY23 was much lower than that in preceding fiscal, while it increased in 4Q (v/s 1Q, *refer Exhibit 3*).
- This raises the question is there a shift in the Union government's fiscal deficit strategy to back-loaded now (*refer Exhibit 4*) from being front-loaded in the pre-COVID era. This assumes importance because if this is the new thought out strategy, it implies that: 1) there will be larger borrowings in the 4Q (probably in the form of short-term bills), 2) unless this becomes the widely accepted norm, this could create more uncertainty in the debt market, and 3) it may imply that the government will spend more in 4Q.
- In order to understand the validity of these implications, it is important to gauge the primary cause behind the lower deficit in 1Q and higher deficit in 4Q after the lifting of COVID-related restrictions. Is this something temporary or more permanent in nature?
- Fiscal deficit can rise due to two factors: lower receipts and/or higher spending. A lower deficit in 1QFY22 and 1QFY23 appears to be a result of higher receipts. Total receipts were 26-28% of BEs in 1QFY22 and 1QFY23, more than double the average collection of 13% of BEs during the past two decades (*refer Exhibit 5*). In contrast, total spending was ~24% of BEs in 1QFY22 and 1QFY23, lower than in the previous five fiscals (when it was 26-30% of BEs in 1Q), but higher than its long-run average of ~23% of BEs in 1Q (*refer Exhibit 6*).
- The primary factor, thus, responsible for the lower/higher deficit in 1Q/4Q seems to be a change in the preparations of BEs. Unlike ambitious targets in the pre-COVID era, the Union government was widely believed to be realistic-to-conservative in its receipt forecasts in the FY22 and FY23 budgets, leading to very high collections (as a percentage of BEs) in 1Q. Since the government continued to spend almost as much as in the prior fiscals, the fiscal deficit shrunk in 1Q.
- As the government grows more confident in achieving higher receipts towards the end of the fiscal (say in 4Q), it faces two options – to spend more and keep the deficit unchanged or reduce its fiscal deficit. In FY22, the government decided to spend more. FY23 may be no different. The sudden reduction in fiscal deficit in 1Q seems more a result of receipt conservatism, rather than any change in its spending strategy. It is very likely that the BEs will move towards optimism sooner than later. If so, this trend in the fiscal deficit will prove to be temporary.



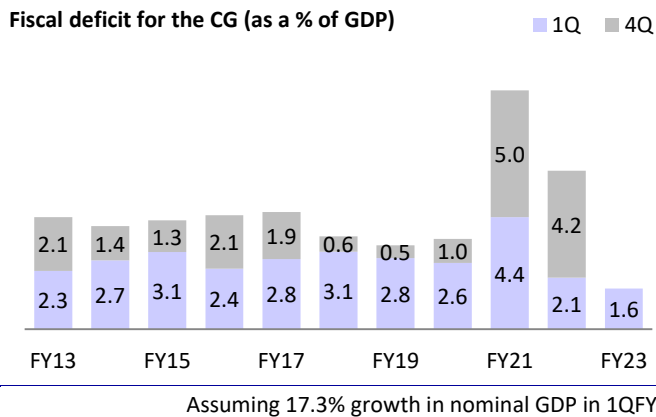
**Exhibit 1: The fiscal deficit in the first quarter averaged over 50% of BEs in the 2010s decade v/s ~20% of BEs in FY22/FY23**



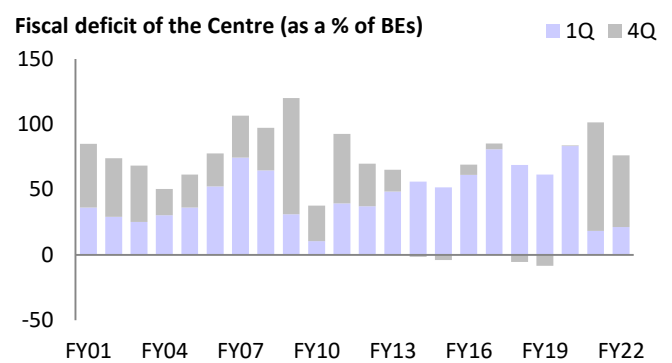
**Exhibit 2: However, the Union Government has managed to keep its deficit within target in most years**



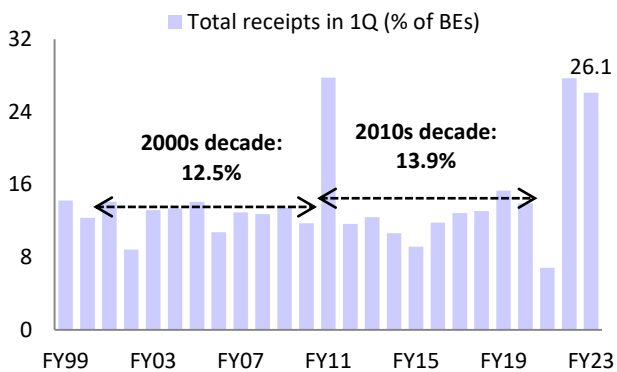
**Exhibit 3: The same trend is notable for the combined general government (GG)**



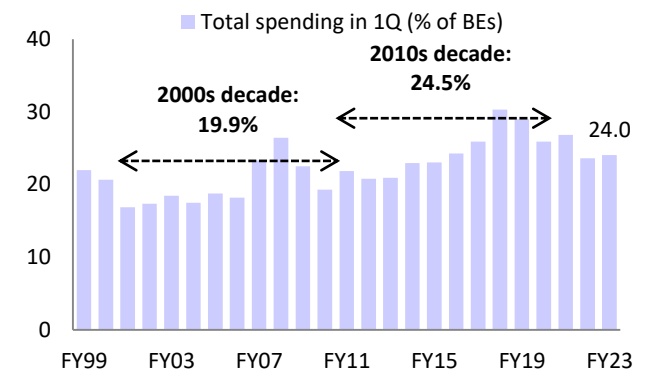
**Exhibit 4: A lower deficit in the first quarter matches with a higher fourth quarter deficit, unlike the 2010s decade**



**Exhibit 5: Total receipts in 1QFY22 and 1QFY23 were more than double its long-run average...**



**Exhibit 6: ...while total spending (~24% of BEs) was similar to the 2010s decade**



Source: CAG, CGA, CEIC, MOFSL

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