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Capital Formation Gets Much-needed Push from the Govt

Expert Take

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In the background of the economic and humanitarian challenges created by the pandemic, this budget emphatically signals a strong focus on investment-led growth. This approach of a strongly expansionary fiscal policy is welcome and required.

The government has made a big shift in favour of capital expenditure and a significantly higher allocation to health, marking a qualitative improvement in government expenditure. Overall capital expenditure is budgeted to increase by 26% y-o-y over the RE of FY21 which itself had increased by 31% y-o-y over FY20. In fact, government capex as a percentage of GDP has risen to the highest level in 17 years, giving a much-needed push to capital formation which has been declining in the country.

In real estate, the tax holiday for affordable housing projects and tax deduction for interest on housing loans have been extended. The push to sectors with a high multiplier on growth is commendable.

The question then is how this spend will be financed. Not only has the government indicated that the fiscal deficit for FY22 would be a significant 6.8% but it has also mentioned a glide path that would mean the expansionary fiscal policy would be multi-year and continue till FY25-26.

We believe that with interest rates low and global policy opinion in favour of countercyclical fiscal policies, this was an opportune time to expand the fiscal. Moreover, with no major increase in taxes, clearly, there is a view that buoyancy in tax revenues through growth will meet some of this funding need. But, there are more innovative plans as well laid out in the budget.

For one, there is the creation of a DFI for infrastructure financing which satisfies the need to provide long term financing, especially after both IDBI and ICICI converted to commercial banks. In another major initiative, the ARC and AMC model to clean the bad book of banks is very positive and should help in declogging the financial system and give a strong impetus to credit growth, which would be required to fund the economy.

Furthermore, the National Monetisation Pipeline of brownfield infrastructure assets and Asset Monetisation dashboard are excellent initiatives to monetise operating public infrastructure. The government has also budgeted a sum for divestment at ₹1.75 lakh crore. The plan to privatise two public sector banks and one general insurance company is also a radical and positive move to raise resources and improve capital allocation in the economy.

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We can expect growth in REITs and InvITs to finance some of the monetisations and removing withholding tax on dividends here is a positive signal to foreign investors. There will however be some amount that would have to be funded by market borrowings. The impact of this on interest rates and crowding out of the private sector is going to be dependent on the RBI and how much we are able to tap the immense liquidity available globally.

India is indeed unique in giving such a strong push for capex and the supply side in these unprecedented times. Rather than only work on targeted redistribution, we believe this budget puts sustainable, inclusive growth as the clear focus of government policy and should lay the foundation to the 7-8% growth trajectory this nation aspires for.

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