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FY23 BUDGET PREVIEW

20 January 2022

Trade-off between growth and consolidation

- **Given an improving Covid-19 situation, expect a path towards normalisation of deficit targets**
- **Focus likely to be on manufacturing, rural and urban infrastructure, agriculture, healthcare and digital education**
- **FY23 Union Budget, though important for the economy, is unlikely to be a significant market-moving event near term, in our view**

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Last two budgets were growth-oriented: Last year's union budget had a twin focus on kick-starting the capex cycle and improving health infrastructure amid a slowdown in private capex. The large capex outlay during the FY21 and FY22 budgets pegged fiscal deficits at 9.5% and 6.8% respectively. We also observed recurring underlying themes related to infrastructure, local manufacturing, ease of doing business, and ease of living as envisioned in the 'minimum government, maximum governance' strategy.

FY23 budget likely to juggle growth and consolidation: Given the low incidence of hospitalisation in the third Covid wave, we believe the government will likely feel more confident in normalising deficit targets. However, the focus on ease of doing business, improving healthcare, reforming agriculture and augmenting digitisation will likely continue. We provide a list of industry expectations from the FY23 budget (fig 1) – we also expect allocation of resources for online rural education, further rationalisation of customs duty framework as also indicated in the FY22 budget and more sops for affordable housing (vs. the industry's demand for a blanket increase in tax deduction on home loan interest from Rs 200,000 to Rs 500,000).

Sectors likely to attract the spotlight: We expect a sustained spotlight on infrastructure, including roads. Given the government's emphasis on ease of living, we anticipate further greenfield and brownfield expansion of the metro network. Healthcare and agriculture will remain at the fore. We see an increasing thrust on clean energy and renewables but with the underlying intention of increasing domestic capacity. Given impending state elections, an increase in personal tax rate looks unlikely, which will be neutral-to-positive for consumption sectors.

Short-term market reaction unpredictable: We analysed Nifty returns over the last 10 years for a period starting a week before budget day and ending a week after (Fig 2). There were just three instances of movement greater than 5% during this period (two upmoves and one decline), but in all three cases, we noted directionally similar movements in the S&P500 index too. We, therefore, believe a short-term speculative position on the basis of a likely budget outcome is best avoided.

Returns from 1W pre- to 1W post-budget date

Budget date	Nifty returns (%)	S&P500 returns (%)
01-Feb-21	6.85	3.63
01-Feb-20	(0.17)	2.59
05-Jul-19	(2.38)	1.20
01-Feb-19	3.83	2.35
01-Feb-18	(5.87)	(6.02)
01-Feb-17	1.47	(0.16)
29-Feb-16	5.29	4.10
28-Feb-15	2.09	(0.41)
10-Jul-14	(1.64)	(0.42)
17-Feb-14	1.53	0.91
28-Feb-13	(0.54)	1.71
16-Mar-12	(2.45)	1.58
28-Feb-11	1.27	0.43

Source: BOBCAPS Research, Bloomberg

Industry expectations

Fig 1 – FY23 Union Budget: Sector-wise expectations

Industry	Expectation
General Corporate	• Reduction in personal income tax rate to boost consumption • Tax incentive for Covid-related expenses • Incentives for employment-generating sectors such as hospitality, tours & travels, and textiles • Excise duty cut on fuels • Custom duty rationalisation, particularly for chemicals • Extension of support to SME sectors including incremental funding support
Auto	• Incentives for setting up EV infrastructure/ecosystem • Fame II scheme (direct incentives to buyers of EVs) has been extended to FY24; expect steps to ensure budgeted funds are used
Consumer Durables	• Incremental incentives for semiconductor sector • Energy-saving norms could be announced which will aid sales of higher ASP products
FMCG	• Incentives for climate-friendly packaging material
Healthcare	• Interest subsidies, lower GST on clinical trials and research activities, and restoration of weighted tax deduction u/s 35(2AB) to encourage innovation and R&D • Reduced GST on critical medicines, healthcare products and services • Increased allocation for the healthcare sector – across the entire infrastructure chain, specifically for immunisation • Incentives for medical cold chain infrastructure • Development of domestic medical device industry to reduce import dependence • Higher allocation towards Production Linked Incentive (PLI) schemes for healthcare sector to encourage capacity expansion of sensitive APIs, complex excipients, drug intermediates, biopharmaceuticals and medical devices • Increased government spending on genetic research • Creation of an effective commercial ecosystem for innovation and research
Infrastructure	• Incentives for investment in infrastructure sector • Continuing high budgetary allocation for capital expenditure (Rs 4.4tn and Rs 5.5tn in FY21 & FY22 budget respectively)
Logistics	• Tax incentives to set up shipping lines • Incentives for local manufacturing of containers • Incentives for warehousing infrastructure • Announcement of West South and East South Dedicated Freight Corridor (DFC) after completion the East and West DFC in FY23 • Visibility on divestment plan for Container Corporation of India
Metals & Mining	• Reduction/rationalisation of duties on raw materials. e.g. (a) waiver of coal cess (Rs 400/t) or refund of input tax credit under GST, (b) reduction of basic customs duty and cess on coking coal, SS scrap and nickel as domestic availability is low • To provide protection to domestic industry by raising customs duty from 7.5% to 10% on primary aluminium products and from 7.5-10% to 10-12.5% on downstream products • Correction of inverted duty structure on critical raw materials including pet coke, caustic soda, aluminium fluoride, alumina, etc. for aluminium industry value chain • Nil duty on import of copper concentrate. Industry has been lobbying for this for 4-5 years • Increase in duty for scrap for responsible recycling and restrictions on import of low-grade copper scrap

Industry	Expectation
Oil & Gas	• Roadmap for inclusion of petroleum products under GST regime • Removal of 2.5% import duty on LNG in line with crude oil; withdrawal of GST on import freight for LNG cargo • Improve viability of incremental investments in pre-NELP aging fields by rationalising royalty and cess. Clarification that royalty payment to government does not attract service tax. Tapering of royalty rate to bring it in line with rate applicable on crude production in NELP blocks • Rationalisation or exemption of duties on capital goods for oil & gas pipelines • Biofuels – mechanism for encouraging private participation; some form of capital grants or lower interest rates to offset high upfront capital costs • Compressed Biogas (CBG) – Clarification to exempt from VAT/excise duty on sale after blending with natural gas/compressed natural gas as biogas already attracts lower GST slab • ATF – Levy of specific duty instead of ad-valorem duties
Power	• Possible roadmap on key reforms such as the Electricity Amendment Bill • Distribution infrastructure development allocation as part of the Rs 3tn scheme announced earlier or additional related plans
Real Estate	• Income tax deduction for interest on home loan to be increased from Rs 200,000 to Rs 500,000 • Framework for resolution of stalled projects • Template for a standard home buyer's agreement • Continuation of existing incentives for affordable housing along with incremental incentive to increase the pace of construction
Renewables	• Tax incentives and credit guarantees for users of renewable power and hydrogen • Incentives for renewable equipment suppliers including for setting up rooftop solar (which has lagged utility scale investments)

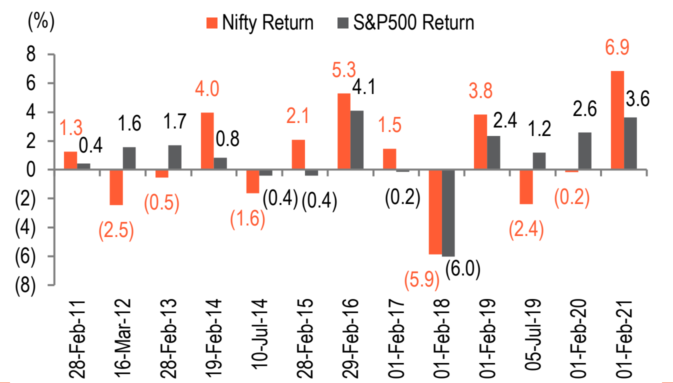
Source: BOBCAPS Research, Bloomberg

Stock market performance pre- and post-budget

We have analysed Nifty returns over the last 10 years for a period starting a week before budget day and ending a week after the budget. We then compared these to S&P500 performance for the same period (fig 2). On average over the last decade, the Nifty delivered returns of just 0.71% as against 0.88% for the S&P500.

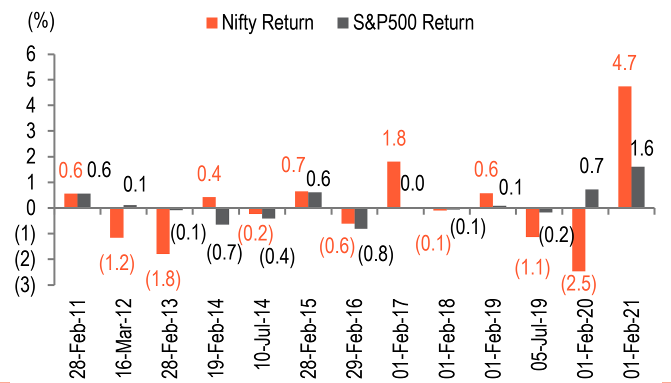
If we simply confine ourselves to the budget day (fig 3), the 10-year average Nifty return is a mere 0.1%. This underscores that budget-related moves, if any, tend to cancel each other out over a period.

Fig 2 – Returns from 1W pre- to 1W post-budget day



Source: BOBCAPS Research, Bloomberg

Fig 3 – Returns from 1D prior to close of budget day



Source: BOBCAPS Research, Bloomberg

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BUY – Expected return >+15%

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Note: Recommendation structure changed with effect from 21 June 2021

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