HDFC MUTUAL FUND
BHAROSA APNO KA

Union Budget 2021-22 – India means Business

The backdrop of the Union Budget 2021-22 was particularly challenging. Even before Covid-19, India's macroeconomic conditions were weak with growth slowing, high inflation and somewhat average fiscal & external sector conditions. The problems were aggravated with significant disruption in economic activity due to lockdowns, weakness in global trade, impact on incomes & jobs, etc. Consequently, Indian GDP contracted by ~24% in Q1FY21 and is expected to contract by 7.7% (Source: MOSPI) in FY21, a first in 40 years. However, India's external sector was a silver lining and the current account is likely to be in surplus in FY21 supported by lower oil prices and imports contracting more than exports. The adverse impact of tough economic conditions on capital and financial markets was contained to a large extent with fiscal stimulus, aggressive monetary easing and regulatory forbearance.

Given this grim background, the expectations from government and Union Budget were high to revive growth and sentiments. The need of the hour was to prioritise growth over fiscal prudence, encourage private investments, kick start investments in infrastructure and revive the animal spirits in the economy. Fortunately, the budget didn't disappoint which is also evident from a fairly broad based rally in the stock markets with NIFTY 50 registering one of the highest single day gains in past two decades. In a nutshell, budget pushes for capital formation driven growth and focusses on supply side reforms to stimulate investment cycle and boost sustainable growth. Given this backdrop, the relaxation of medium term fiscal deficit targets is also a step in right direction, in our opinion.

A close study of the current budget, together with policy actions of last few years, suggests that the following 4 strategic objectives are being pursued by the Government

1. Strong focus on Aatma Nirbhar Bharat and Domestic Manufacturing
2. Accelerate Infrastructure development
3. Privatisation of PSUs as part of principle of Minimum government, Maximum Governance
4. Stability in and Simplicity of tax structure

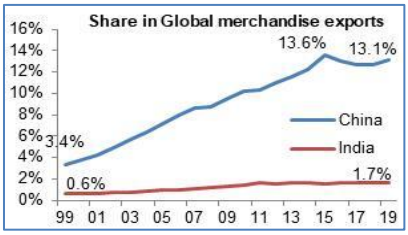
While this budget nicely maintains continuity of aforesaid policy objectives, it makes a clear break from fiscal consolidation given the changed environment and needs.

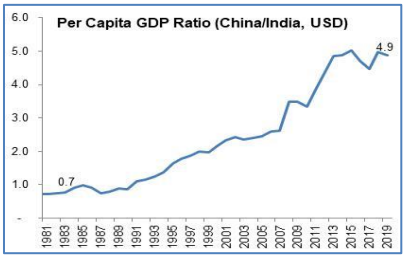
Apart from above, there is continued focus on healthcare, rural and social causes. For the purpose of this commentary, we have focussed on the aforesaid 4 strategic objectives only.

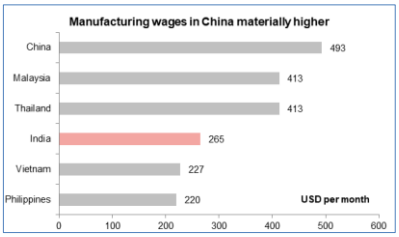
Theme 1: Focus on Atmanirbhar Bharat and Domestic Manufacturing

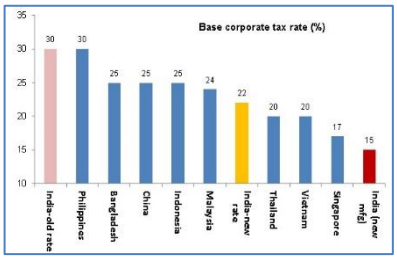
As we have been highlighting in the past, India lagged China and missed the opportunity to establish itself in the global manufacturing supply chain during early 2000s. On the other hand, China's share of global merchandise trade rose to ~13% as compared to 1.7% of India by 2019. Interestingly, over the last few years, China's share has started to moderate after years of successive gains driven by rising wages and environment compliance costs. This shift is likely to accelerate as supply chain disruption due to Covid-19 and rising trade tension between US & China nudges companies to increasingly follow China plus One strategy. This environment provides a unique second chance to India to establish itself in the global supply chain and to boost local manufacturing.

Recognising this opportunity, Indian government has been taking aggressive steps like reducing its corporate tax rates for new units, launching PLI schemes for multiple sectors, raising tariff and non-tariff barriers (refer Annex 3), rationalizing labour laws, etc. The pace of measures has accelerated after the recent border standoff with China. India's many advantages like competitive wage costs, large skilled and English speaking population, large domestic market, stable political regime, etc. also provide an edge.









Sources: Kotak Institutional Equities, JM Financials, Bloomberg, JETRO, World Bank

This budget takes few additional steps to support this objective. These are

- Increase in custom duties on various products (refer the table below)

Sr. No	Particulars	FY21	FY22
1	Inputs, parts or sub-parts for manufacture of specified parts of mobile phones, including: (1) Printed Circuit Board Assembly (PCBA)(2) Camera module (3) Connectors [To apply with effect from 01.04.2021]	0	2.50%
2	Printed Circuit Board Assembly [PCBA] and Moulded Plastic, for manufacture of charger or adapter	10%	15%
3	Inputs and parts [other than PCBA and moulded plastic of mobile charger	Nil	10%
4	Inputs, Parts and Sub-parts [other than PCBA and Li-ion Cell] for manufacture of Lithium-ion battery and battery pack [w.e.f. 01.04.2021]	0	2.50%
5	Compressor of Refrigerator/Air Conditioner	12.50%	15%
6	Specified insulated wires and cables	7.50%	10%
7	Specific parts of transformer such as Bobbins, brackets, wires, etc.	Nil	Applicable rate
8	Inputs and parts of LED lights or fixtures including LED Lamps	5%	10%
9	Solar Inverters	5%	20%
10	Solar lanterns or solar lamps	5%	15%
Source: Budget documents			

- Proposal to set up 7 Mega textile parks over next 3 years to improve export competitiveness.
- Steps taken to boost infrastructure and logistic facilities– refer Theme 2 for details
- Additional funding for skill development program

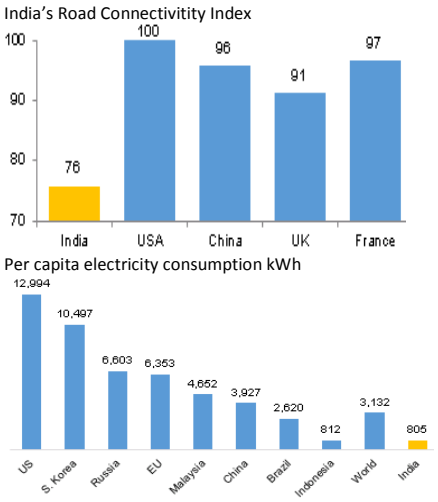
For more on opportunity of global manufacturing and steps by government, please refer slides 45-49 of our Yearbook 2021 available on www.hdfcfund.com

Theme 2: Boosting Infrastructure and Logistics

It is no secret that India's weak infrastructure and higher logistic costs are a handicap in its manufacturing competitiveness. Infrastructure spends not only improves competitiveness but also has a multiplier effect on productivity and creates jobs.

Recognising this, a series of steps have been taken in last few years including income tax exemptions for investment income of Sovereign wealth funds, abolition of dividend distribution tax, launch of National Infrastructure pipeline, housing for all, innovative model for road developments, etc.

Further, the current external environment of ample global liquidity and low interest rates is conducive for attracting long term capital at competitive rates. India can be a natural destination for this capital due to its large economy, stable political regime, attractive yields, strong long term growth prospects, etc.



Sources: World Bank, WEF Global Competitiveness Report, Transport Competitiveness Report, World Development Indicators-World Bank, IR Yearbook 2018

This budget carries forward this vision and announced following steps towards achieving these objective

- Setting up of Development Financial Institution: A Development Finance Institution (DFI) with initial capital of INR 200 bn is proposed to be set up to fund infrastructure projects. The institution will target to have a lending portfolio of INR 5 trillion over 3 years. This step should address, to a certain extent, the need for long term capital for infrastructure projects.
- Improving access to finance for Infrastructure Investment: Given the importance of funding in infrastructure, government has taken following steps to improve access to debt
    - Allowed the Debt financing of REITs/INVITs by FPIs; till now FPIs were only allowed to buy from secondary market. This improves access to long term funding at a relatively cheaper cost.
    - Infrastructure Debt Funds (IDFs) are now eligible to raise funds by issuing tax efficient Zero Coupon Bonds.
- Building a National Monetisation Pipeline: Government announced its intentions to launch National Monetisation Pipeline with potential brown field projects including NHAI toll roads, power transmission assets, gas/product pipelines, warehouses, etc. of Central Public Sector Enterprises (CPSEs), Further, it intends to also monetize railway stations, dedicated freight corridors for O&M, airports for O&M, etc. These steps are important as it releases capital for building up of further infrastructure.
- Jal Jeevan Mission: Government has launched Jal Jeevan Mission, under Ministry of Jal Shakti, which aims to ensure access of piped water for every household in India. The estimate spending on this is ~INR 2.9 trillion spread over 5 years.
- Privatisation of airports for Operations and maintenance has started with 6 airports already handed over and more are planned in medium term.

Government's focus on infrastructure is also evident from proposed capex of 2.5% of GDP in FY22, compared to an average spend of 1.8% in past 5 years.

For more on India's infrastructure and logistics issues & steps taken so far, please refer slide 50 - 53 of our Yearbook 2021 available on www.hdfcfund.com.

Theme 3: Push for Privatisation and Strategic Sale of PSUs

Government has been vocal about its vision of Minimum Government, Maximum Governance over the past few years. Pursuing the same, in its Aatm Nirbhar package plan announced in May 2020, government announced that it will divest/exit non-strategic businesses and will only maintain presence in strategic sectors. The Honourable Finance Minister reiterated the Government's intention in her budget speech by saying ***"We have kept four areas that are strategic where bare minimum CPSEs will be maintained and rest privatized. In the remaining sectors all CPSEs will be privatized."***

Pursuant to above, Cabinet has approved the policy of strategic disinvestment of public sector enterprises in which it has identified following 4 sectors as strategic

1) Atomic energy, Space and Defence
2) Transport and Telecommunications
3) Power, Petroleum, Coal and other minerals and
4) Banking, Insurance and financial services

In line with its objectives to privatise PSUs, government announced following measures

- Target to complete divestments of BPCL, Air India, Shipping Corporation of India, Container Corporation of India, IDBI Bank, BEML, Pawan Hans, Neelachal Ispat Nigam limited among others in FY22
- IPO of Life Insurance Corporation is also aimed to be completed in FY22 and requisite amendments required in law will be tabled in this budget session itself.
- Proposal to privatize two more Public Sector Banks and one General Insurance company in FY22
- NITI Aayog will also work out next list of CPSEs to be taken up for strategic disinvestments in due course.
- With a view to monetise non-core assets, it also announced creation of a Special Purpose Vehicle in the form of a company to monetize non-core assets largely consisting of surplus land of government Ministries/Departments and Public Sector Enterprises

Strategic divestments as against market sales through Offer for Sale / Exchange Traded Funds (ETFs) has following advantages

1) Strategic sale does not result in supply of additional shares in the secondary market;
2) Value realisation is, generally, higher
3) Strategic sale results in open offers at higher prices, thus improving the valuation of PSUs and encourages long term investors
4) Encourages strategic foreign investors to invest in India, thus improving FDI flows

While government divestment target of INR 1.75 lakh crore for FY22 appears ambitious, couple of big ticket divestments like BPCL (Value of Government Stake based on CMP is ~INR 45,000 crores), IDBI Bank (~INR 13,000 crores), etc. should bring it closer to the target. Also, in our opinion, successful completion of few strategic sales is more relevant than the amount raised. This should instil confidence in the market about government's intention & ability and is likely to have a positive impact on valuations of other PSUs.

Theme 4: Stable Tax structure – No news is good news

A stable and simple tax regime is supportive of investments and capital flows. Over the past few years, Government has made concerted efforts to simplify the tax structure and administration for better compliance. Introduction of Goods & Services Tax (GST), faceless interactions, phasing out of outdated exemptions and deductions, option of alternative tax regime, E-filing, etc. are aimed towards ease of doing business, encouraging private investments, reducing fear of tax authorities and reducing tax litigations.

This budget stands out as it has no major tax changes apart from small tweaks in import duties, etc. and this is a welcome development. The process of simplification was, however, carried forward in this budget. Following table highlights the major steps taken to simplify tax structure in recent past and in this budget

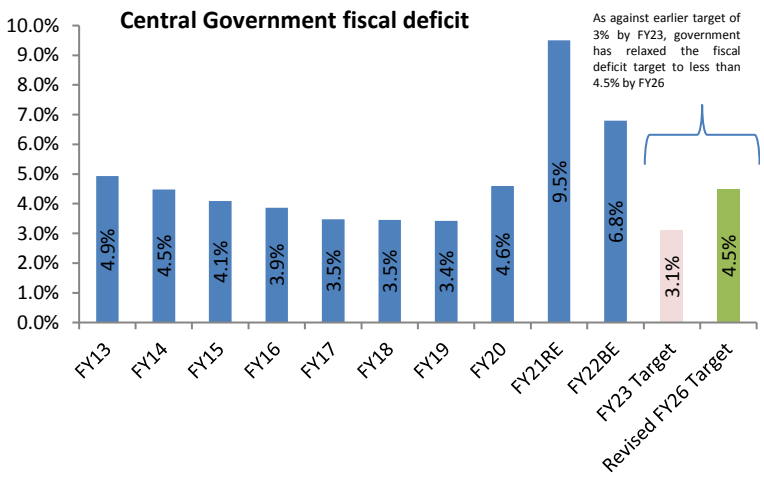
	Steps taken so far	Steps in budget 2021-22
Indirect taxes	• Introduced GST, a single indirect tax across India, subsuming more than 17 taxes • Rationalization of tax rates in GST • Simplification and reduction in no. of returns (refer table below) • Dispute resolution scheme "Sabka Vishwas"	• Custom duty rationalization – review of 400 old and outdated exemptions, Rationalisation of custom duty on gold and silver as well as raw material inputs to man-made textile • Discontinuation of anti-dumping duty and countervailing duty on certain items • Agriculture Infrastructure and Development Cess on small number of items – Diesel and petrol by offsetting earlier additional cess
Corporate taxes	• Phasing out of exemptions and deductions • Reduction of tax rates from 30% to 22%/15% • E-filing of returns, refunds and assessment • Dispute resolution scheme "Vivaad se Vishwas" • Faceless appeals • Abolishing dividend distribution tax	• Tax incentives for IFSC • Launching MCA version 3.0 – compliance management to be simplified • Reduction in time limit to re-open the assessment from 6 years to 3 years
Personal taxes	• E-filing of returns, refunds and assessment • Reduction in tax rates for individuals opting to forego exemptions/deductions. • Option to individuals to choose between two regimes • Plan to phase out exemptions and deductions • Faceless appeals	• Persons above age of 75, who have only pension and interest income, are exempt from filing returns. The paying bank will deduct the necessary tax on their income. • Dividend payment to REIT/InvIT to be exempted from TDS • Increase in limit for tax audit for persons who carry out 95% of their transactions digitally • Reducing time limit for reopening of income tax assessment • Relaxation to NRIs for income of retirement • Details of capital gains and interest income and dividend will be pre-filled. • Constitution of a Dispute Resolution Committee for small tax payers • Income Tax Appellate Tribunal to be made faceless

Higher Fiscal Deficit – A clear break from the past

Over the last six years, government has walked on the path of fiscal prudence. However, given the backdrop of slowing growth, weak private investments, lockdown, etc. an effective fiscal intervention was required to revive growth.

While the slippage in fiscal deficit in FY21 was inevitable given the disruption in economic activity due to lockdown, Government's intent of prioritising growth over fiscal deficit is clear in the higher budgeted fiscal deficit of 6.8% in FY22 and also relaxing the target of bringing down fiscal deficit to less than 4.5% by FY26 (earlier target of ~3% by FY23).

Revised estimates (RE) of fiscal deficit for FY21 is 9.5% of GDP in FY21, one of the highest in past 50 years, driven by lower revenue collections and higher spending. Further, FY22 budgeted fiscal deficit is estimated to be 6.8%, significantly higher than market expectations. For details of fiscal calculations, please refer Annex 1.



FD (% of GDP)	2018	2019	2020E	2021E
United States	5.8	6.3	18.7	8.7
Euro Area	0.5	0.6	10.1	5..0
Japan	2.5	3.3	14.2	6.4
UK	2.2	2.1	16.5	9.2
China	4.7	6.3	11.9	11.8
India*	5.9	7.8	14.3	10.8

Source: IMF, Kotak Institutional Equities
*General Government Fiscal deficit (Centre+ State) 2018/2019/2020/2021 for India represents FY19/FY20/FY21RE/FY22BE

Source: Kotak Institutional Equities;

The rise in fiscal deficit is primarily on account of 3 factors

- Off budget subsidy payments and dues in food and fertilizer heads have been brought into budget, signalling transparency and timely clearance of dues. This alone constitutes ~2% of GDP. With practise of NSSF giving loans to Food Corporation of India (FCI) discontinued going forward, the trend is likely to continue.
- Estimated capital spends in FY21 and FY22 is likely to be ~2.3% and 2.5% of GDP respectively as against average 1.7% in past 5 years. RBI study suggests that growth multiplier of capital expenditure is higher than revenue expenditure. Thus, Government is spending where it matters and it should bear the fruit over medium to long term, in our opinion.
- As against earlier practise, revenue projections, especially tax projections, have been made conservatively despite a strong real and nominal growth recovery expected in FY22

We believe that like there are good and bad carbs, there is good and bad fiscal deficit. The good fiscal deficit is due to higher capital spending while bad fiscal deficit is due to higher revenue spending. Good fiscal deficit can trigger a virtuous cycle of growth, jobs, tax collections and can ultimately result in lowering fiscal deficit.

Driven by higher fiscal deficit, India's sovereign debt to GDP is likely to rise in near term. However, same can moderate if the growth revives over time. Reactions by international rating agencies will be interesting to watch in this regard. S&P commented that "While we currently see no material effect from the budget on India's key credit factors, the economy's brightening growth prospects will be critical to maintaining the sustainability of India's public finances, with general government debt likely to hover at more than 90% of GDP over the next few years".

The reaction of bond markets was expectedly negative and Gsec yields increased by 10-20 bps. However, some comfort can be derived from the fact that credit demand is weak and system is flush with liquidity. Thus, financing the high fiscal deficit may not be a major challenge at least in FY22. Further, we believe that fiscal consolidation beyond FY22 will be guided by growth, pick up in private sector investments, credit demand growth, etc.

For detailed comment on fiscal numbers, please refer Annex 1.

Other Budget highlights

- The budget announced a levy of Agriculture Infrastructure and Development Cess (AIDC) on a small number of items. Some of the products are - Auto fuels (Petrol and Diesel) on excise front, imported items like gold, silver, alcoholic beverages, etc.

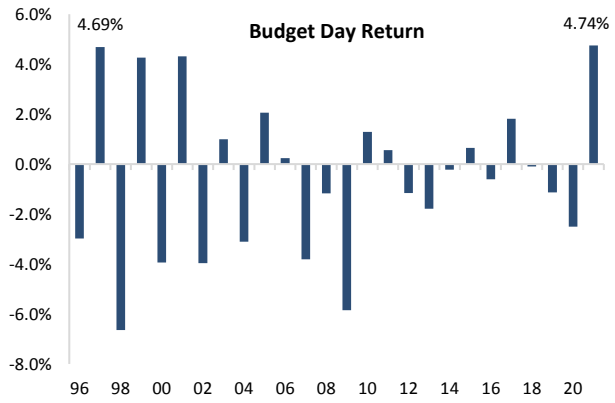
  This change is not likely to additionally burden consumers as AIDC is offset by reduction in rates of excise/custom duties as clarified by Honorable Finance Minister. In a sense, AIDC is largely reclassification of part of existing taxes like custom and excise duties with an additional label to achieve following key purposes.

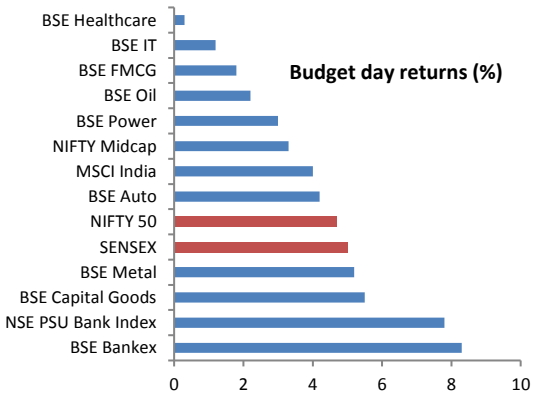
  - First, directing tax resources to be spent for specific purpose. The focus of AID Cess spending is towards improving agricultural infrastructure to enable higher and efficient production, as well as conservation and processing of agriculture output.
  - Further, this will give more funds in hand of the central govt, as AID Cess will effectively reduce the share of states from centrally collected taxes. This is because; excise and custom duties are ultimately being shared with the states whereas Cess is not shared with the states.
- ULIPs taken on or after Feb. 1, the maturity proceeds of policies with an annual premium of more than INR 2.5 lakh will be taxable on par with equity-linked mutual fund schemes. Individuals holding multiple ULIPs with an aggregate premium in excess of INR 2.5 lakh will have to pay tax on the proceeds.

In conclusion, while FY22 maintains continuity around the 4 key priorities – focus on domestic manufacturing, infrastructure development, privatisation of PSUs and stable & simplified tax structure – it makes a clear beak from the path of fiscal consolidation. We strongly feel that given the challenges posed by Covid-19, lockdowns, etc. relaxing fiscal deficit targets for few years was the need of the hour. This was also corroborated by the movement in the stock market with Nifty 50 / Sensex ending the budget day ~5% from previous close.

Equity Markets Outlook

Equity markets reacted very positively to the Budget. NIFTY50 recorded its best performance in over 2 decades on the budget day indicating the credibility, quality and appropriateness of the Budget. This is a pro-growth, pro investment budget and the same was also reflected in the single day sectoral distribution of returns.

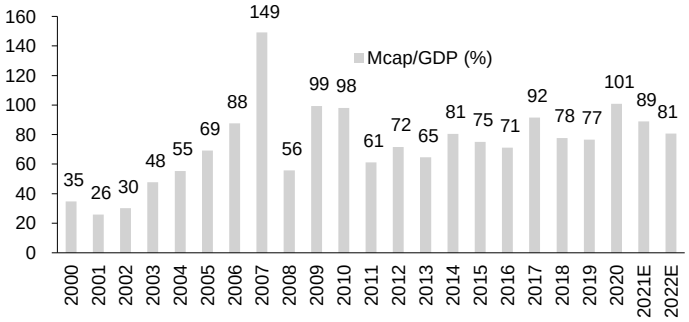




Source: Bloomberg

The budget rally on the back of a strong recovery in the markets despite Covid, lockdown and the economic challenges has been confusing for some. The answer to this lies in the limited impact on the Discounted Cash Flow (DCF) valuation of a business of the fall / loss in one year's profits. Besides, sharply lower cost of capital has a higher positive impact on DCF. *For a simple explanation and illustration on this, refer slide 57 of HDFC MF Yearbook 2021 available on www.hdfcfund.com.*

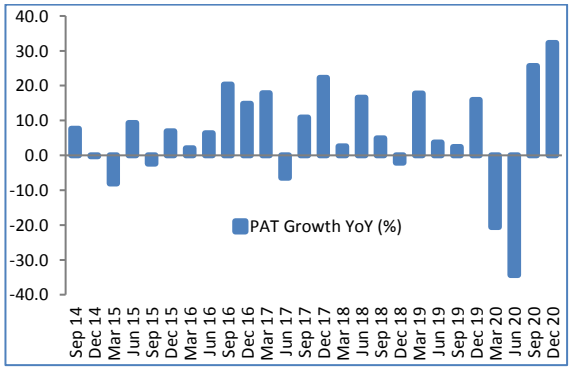
Reasonable valuations: Despite the current rally, Indian market capitalization is currently ~81% of GDP (based on CY 2022 GDP), which is reasonable especially in the context of lower cost of capital. At its bottom in March 2020, it had fallen close to 48% *(based on CY21 GDP).*



Source: Kotak Institutional Equities, Bloomberg, Market cap to GDP as on 31st Jan, 2021

Even at current levels, 10 year & 15 year NIFTY50 returns of 10% & 11% CAGR respectively, have marginally lagged nominal GDP growth of 12% & 13% CAGR respectively over same periods^. This is also indicative of reasonable valuations. (^ Returns as on 31st Jan, 2021, GDP CAGR is calculated based on FY20 Nominal GDP)

Earnings Revival: Stock markets have also drawn strength from the unexpected strong results. Q3FY21 has turned out to be one of the best earnings season in last 6 years (since Sep 14) so far with PAT growth of 32% (Source: Motilal Oswal Financial Services limited, universe of 102 companies covered by MOFSL that have declared result till 29th Jan 2021). This has resulted in broad based earnings upgrade. Interestingly, NIFTY 50 earnings in FY21 are also expected to grow at healthy pace, beating most earlier estimates post the outbreak of pandemic (Source: Kotak Institutional Equities).



Source: MOFSL

Driven by strong economic recovery, lower costs, sharply falling provision costs in banks, improved outlook for IT, pharma, higher commodity prices etc., NIFTY50 is expected to deliver significant earnings CAGR between FY20 & FY23E (Kotak Institutional Equities estimates) vs earnings growth of 4% CAGR between FY14 & FY20.

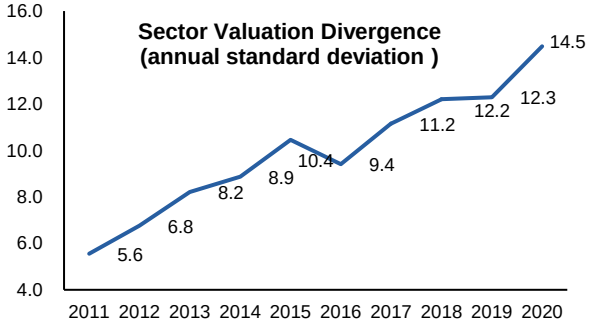
Polarised Markets: An interesting aspect of the markets in recent years has been the polarized nature of the returns with top 5 stocks contributing bulk of returns.

In the past, it has been observed that such a phase of polarised returns is followed by broader markets outperforming NIFTY 50 (Refer adjacent table and chart below). *While this is seen from historical data, the same may or may not sustain in future.*

Polarised market returns are also visible in divergence in sector valuations as reflected in rising standard deviation amongst the valuation multiples across sectors over the past few years.

CY	NIFTY50 Returns	Top 5 contributors
2005	39.1	48.9
2006	46.2	45.8
2007	57.1	47.7
2008	(51.2)	n.a.
2009	77.9	38.1
2010	19.5	53.5
2011	(23.6)	n.a.
2012	29.9	49.8
2013	8.5	102.3
2014	33.4	38.8
2015	(2.8)	n.a.
2016	4.5	72.8
2017	30.3	48.4
2018	4.6	152.2
2019	13.5	81.3
2020	16.1	81.7

n.a. – not applicable



For the graphs above, the X-axis represents calendar year; Source: Bloomberg, Kotak Institutional Equities

The polarised returns have resulted in significant divergence in valuations across sectors compared to their long term average. The same has been presented in the table below

Sector Valuations P/E#	Auto	Consumer staples*	Consumer Discretionary	Oil and gas	Cement	IT services	Pharma	Private Banks P/B	Metals and mining	Tobacco	PSU Banks P/B	Electric utilities
Valuation multiple	28.3	53.2	65.2	14.9	28.7	26.1	26.0	2.6	8.3	16.0	0.8	6.8
10Y Average Valuations	15.6	38.9	41.8	11.0	21.6	17.7	22.1	2.5	10.3	24.3	1.1	11.2
Premium / (discount)^	81%	37%	56%	36%	33%	48%	17%	3%	-20%	-34%	-30%	-39%
# - as on 31 January 2021. *ex tobacco; ^to Long term (LT) average												

Source: Kotak Insti Equities. Stocks are part of Kotak Institutional Equities universe. Automobile and Oil & Gas valuations are high due to one company. Excluding these, the multiples are 25x for Auto & 7.6x for Oil & Gas vs 10 year average multiple of 18x & 9x respectively.

For our view on sectoral impact of budget, please refer Annex 2.

Finally, the Government's focus on strategic divestments as against ETFs / OFS earlier should also have a favourable impact on equity markets, in general and PSUs in particular.

To summarise, Union Budget 2021-22, is clearly a growth oriented budget and has improved the outlook for equities, especially for investment related sectors. Continued improvement in economic activity and improving growth outlook, strong earnings, reasonable valuations especially in view of the low cost of capital etc. are supportive of positive outlook of equities over the medium to long term. Investors' exposure to equities should be guided by their tolerance for volatility and their ability to hold for medium to long term. Significant rise in spread of COVID-19, unwinding of expansionary fiscal and monetary stimulus globally, sharp rise in crude oil prices, higher than expected NPAs post the moratorium, escalation of border tension between India and China and/or trade tension between US and China, etc. are key risks in the near term.

For more on our view on Equities, please refer slide 54 to 68 of our Yearbook 2021 available on www.hdfcfund.com

Debt Markets Outlook

FY21 has been a difficult year for government finances with revenue shrinking due to disruption in economic activities and the need to maintain spending momentum to cushion the impact of Covid-19 induced slowdown. Hence, the gross market borrowings program was raised to INR 12 trillion during the year as compared to INR 7.8 trillion estimated in budget. While widening of deficit was a given, revised estimate of FY21 fiscal deficit at 9.5% of GDP was significantly higher than market estimations (~7%). However, one should be mindful that a significant portion of this is due to higher transfer to FCI (1.6%), which was expected to be carried forward to next year.

Government also announced additional borrowing of INR 800 bn for FY21 which was not anticipated by market. Further, the FY22 fiscal deficit estimate of 6.8% is also much higher than market expectations. These resulted in Gsec yields rising by 10 to 20 bps across the board on the day of budget.

Going forward, the sharp increase in budgeted fiscal deficit, relaxation in glide path of fiscal consolidation and large supply of market borrowings is expected to likely to keep upward pressure on yields. Further, high near term inflation and signs of broad based improvement in economic activity can also push yields higher.

However, as has been the case over the past year or so, we believe RBI will continue to use conventional and unconventional tools going forward as well, thus, limiting the increase in Gsec yields. Currently much of the policy actions and stance is based on the view that the economic recovery is uneven and nascent. Further, we derive comfort from the fact that RBI seems to be committed towards maintaining ample liquidity within the system. Also, rangebound oil prices, comfortable outlook on Balance of Payment, low global rates and easy liquidity by major central banks also bode well for yields in India.

In view of above, we expect yields to trade with upward bias though the upside should be limited. The risk to this view is that the fiscal deficit turns out to be lower than anticipated either due to lower expenditure or better than expected tax collections along with lower inflation from Q2FY22 onwards. On the flip side, if the inflation surprises on the upside on a sustained basis, the yields can inch up further.

Annexures

Annex 1: A brief snapshot of fiscal position

Government finance Summary (INR bn)	FY20A	2021RE	2022BE		FY21RE/ FY20A	FY22BE / FY21RE
Gross tax collection	20,101	19,003	22,171		-5.5%	16.7%
Total Direct Tax	10,554	9,108	11,151		-13.7%	22.4%
Personal Income tax	4,927	4,590	5,610		-6.8%	22.2%
Corporate Tax	5,569	4,460	5,470		-19.9%	22.6%
Total Indirect Tax	9,547	9,895	11,020		3.6%	11.4%
GST	5,988	5,151	6,300		-14.0%	22.3%
Custom duties	1,093	1,120	1,360		2.5%	21.4%
Excise duties	2,406	3,610	3,350		50.0%	-7.2%
Service tax & other taxes	60	14	10		-76.8%	-28.6%
Less: State shares & Others	6,532	5,548	6,717		-15.1%	21.1%
Net Tax collection	13,569	13,455	15,454		-0.8%	14.9%
Non- Tax Revenue	3,272	2,107	2,430		-35.6%	15.4%
Total Revenue Receipts	16,841	15,562	17,884		-7.6%	14.9%
Total Capital Receipts	686	465	1,880		-32.2%	304.3%
Divestments	503	320	1,750		-36.4%	446.9%
Total Receipts	17,527	16,027	19,764			
Total Revenue Expenditures	23,506	30,111	29,290		28.1%	-2.7%
Interest payments	6,121	6,929	8,097		13.2%	16.9%
Others	17,385	23,182	21,193		33.3%	-8.6%
Total Capital Expenditures	3,357	4,392	5,542		30.8%	26.2%
Total expenditure	26,863	34,503	34,832		28.4%	1.0%
Revenue Deficit	6,665	14,550	11,406			
Gross Fiscal Deficit	9,337	18,477	15,068			
Revenue Deficit as % of GDP	3.3%	7.5%	5.1%			
Fiscal Deficit as % of GDP	4.6%	9.5%	6.8%			

Sources: CMIE, Budget documents, Kotak Institutional Equities. RE – Revised estimates, BE – Budgeted Estimates, FY20A – Financial year 2020 Actual

At the onset, we would like to mention that this year's budget numbers are relatively realistic and credible. Our observations for FY21 and FY22 estimates are:

- **FY21RE:** Given the reported numbers so far, the FY21RE numbers appear to be realistic and achievable. While spending is assumed to be significantly higher than done till now, a substantial portion is on account of transfer of FCI liability to its own government book. Further, additional amount to be released on account of fertilisers' subsidy can be achieved. Excluding aforesaid, the fiscal deficit would have stood at ~7.5% of GDP which is reasonable in our view.
- **FY22BE:** Based on this high base, the FY22 growth estimates seem reasonable though, contrary to earlier budget, there is risk is that actual fiscal deficit might turn out to be lower than anticipated.

Assumptions	Remarks
Nominal GDP : 14.4%	• Government has assumed tax buoyancy of ~1.2x for gross tax revenue which appears reasonable. • Further, given the low base, corporate & personal income tax revenue assumptions appear reasonable and expected growth recovery. • Growth in GST collections seems conservative and can surprise on upside • Growth in non-tax revenue also seems conservative given the likelihood of spectrum auction happening in FY22. • Divestment target seems ambitious but could be within reach on back of planned strategic disinvestments of Bharat Petroleum Corporation limited, Air India, Container corporation, stake sale in Life Insurance Corporation of India (LIC), IDBI Bank, etc.
Corporation Tax : 22.6%	
Personal Taxes : 22.2%	
Excise: -7.2%	
GST : 22.3%	
Non-tax revenue – 15.4%	
Disinvestments: 447%	
Revenue Expenditure: -2.7%	• Given the high base due to booking of FCI and Fertiliser subsidy in its own book in FY21, Revenue expenditure assumptions seems reasonable and are likely to moderate in FY22.
Capex: 26.2%	• Given the thrust on infrastructure, capex spending is also assumed to rise sharply and can turn out to be lower.

Annex 2: Sectoral Impact

Sectors	Budget proposals	Impact on sectors
Auto	▪ Voluntary scrappage policy for more than 15 years old commercial vehicle and 20 years' older passenger vehicle through fitment tests. Total M&HCV sold older than 15yrs have been ~17.5lac vehicles and mostly not more than ~10% of those vehicles would be in use. ▪ Allocation of INR 1.8 bn for 20,000 new buses for urban transportation ▪ Higher allocation of roads, railways and Infrastructure ▪ Customer duty hike on few auto components like Ignition, wiring set, safety glass and screws etc. ▪ Lowering of import duty on steel	**Neutral:** Some positive for CV companies and broadly neutral for all other segment players Lowering of import duty on steel may too have negligible impact on gross margin as price changes should be immaterial because of this No allocation increase of FAME II for Electric Vehicles
Banks	▪ **Stressed Asset Resolution**: An Asset Reconstruction Co. and Asset Management Co. would be set up to consolidate and take over the existing stressed debt of Public banks ▪ **Stressed Asset Resolution:** National Company Law Tribunal (NCLT) framework will be strengthened, e-Courts system will be implemented and alternate methods of debt resolution and special framework for Micro, Small & Medium Enterprises (MSMEs) will be introduced. ▪ **Deposit insurance:** Last year, Government raised the limit from INR 0.1 mn to INR 0.5mn – now it plans to offer access to depositors of its fund in a time bound manner ▪ **PSU bank recapitalization of INR 200 bn** ▪ **Privatisation of 2 more PSU banks** ▪ **Support to tea workers in Assam / West Bengal** ▪ **Tax Neutrality of conversion of Urban Cooperative Bank (UCB) into a Small Finance Bank (SFB)**	**Positive**: Would help in cleaning up of balance sheet of PSU banks and thus free up the capital for lending. (Reduction in ageing provision for Non-performing assets (NPA)) **Positive**: Faster resolution of stress asset is positive for the banking system **Positive:** This would increase the confidence in the banking system **Positive:** For PSU banks **Positive**: For the sector, as long term capital would be available **Positive**: For banks and NBFC- MFI with exposure to Assam & West Bengal **Positive**: As competition in the space will increase
Cement and building materials	▪ Focus on rural economy, affordable housing and infra continues with increase in allocation ▪ Tax benefit for affordable housing projects extended till Mar-22	**Positive:** This can aid demand from housing and infrastructure sector
Consumer	▪ Cigarettes- No increase in National Calamity Contingent Duty (NCCD) ▪ Gold and Silver- Basic Custom duty will come down from 12.5% to effectively 10.0% (Basic Customs duty at 7.5% and Agri Infra and Development cess at 2.5%) ▪ Palm oil imports- Basic Custom duty will go up by 5% from 27.5% earlier to now effectively at 32.5% (Basic Customs duty at 15% and Agri Infra and Development cess at 17.5%) ▪ Alcoholic Beverages (Alcobev)- Basic Custom duty remains at 150% effectively same as earlier rate (Basic Customs duty at 50% and Agri Infra and Development cess at 100%) - Neutral for Alcobev companies.	**Positive**: it will benefit Cigarette companies as this will help in cigarette volume recovery. **Positive**: It will benefit organized Jewellery companies as this will boost volume. **Neutral to negative:** Minor negative for Soap manufacturing companies as this is will increase input cost. **Neutral**: Alcobev companies will not have impact as effective duty remains same.

Sectors	Budget proposals	Impact on sectors
	▪ Import duty on Compressors for refrigerator and ACs increased from 12% to 15%	**Positive**: It will benefit the domestic industry.
Defense	▪ Revised expenditure has been increased by 18.3% from BE for FY21 and maintained at that level for FY22.	**Positive:** Outlay has increased; it should lead to higher order book for defense companies.
Education	▪ 15,000 schools to be strengthened under the New Education Policy (NEP). ▪ 100 new Sainik Schools to be set-up ▪ Central University to be set up in Ladakh ▪ 750 Eklavya model residential schools to be set-up in tribal areas. ▪ Revamp of post matric scholarship scheme – INR 35,219 crore allotted for 6 years.	**Positive:** over a long term for publishing companies.
Fertilizers	▪ Total fertiliser subsidy allocation raised to INR 1.34 trillion for FY21 to help liquidate the backlog. Subsidy allocation for FY22 pegged at INR 795bn (+11% vs FY21 BE). ▪ FY22 Subsidy allocation for Urea increased by 23% vs FY21 BE while for NPK is reduced by 11.7% vs FY21 BE	**Neutral**: Overdue Subsidy outstanding will be liquidated.
Healthcare	▪ Ayushman Bharat allocation at INR 64 bn ▪ Healthcare expenditure budget increased by ~10% YoY to INR 713 bn ▪ Pradhan Mantri Atmanirbhar Swasth Bharat Yojana: A new centrally sponsored scheme with an outlay of INR 642 bn over the next 6 years has been launched to develop capacities of primary, secondary and tertiary care health systems, strengthen existing national institutions, and create new institutions.	**Neutral**: Ayushman Bharat is making treatment available to the "bottom of the Pyramid". Allocation is similar to last year, though FY21 utilization as per revised budget is only Rs31 bn given COVID-19 impact on hospitalizations. **Positive**. Increase in healthcare budget is positive for the healthcare sector, including pharmaceuticals as well, as it should help drive increased diagnosis and treatment rates
Infrastructure	▪ Roads: (a) Total outlay increased from INR 1.57trn to INR 1.73trn (+10% yoy), (b) gross budgetary support increased from INR 921 bn to INR 1.08trn (+18% yoy), (c) NHAI outlay increased from INR 1.14trn in FY21 RE to INR 1.22trn, (d) allocation for Pradhan Mantri Gram Sadak Yojna is up 9% yoy to INR 150bn vs FY21 RE. Plan to award another 8500km or road projects by Mar-22 ▪ Railways: Capex increased by 34% to INR 2,149bn vs INR 1,608bn in FY21 BE. ▪ Urban Development: Increase in allocation for metro projects by 172% to INR 233bn (vs FY21 RE) while Smartcity and AMRUT increased significantly from INR 100bn to INR 138bn ▪ **Jal Jeevan Mission (Urban):** It aims at universal water supply in all 4,378 Urban Local Bodies with 2.86 crores household tap connections, as well as liquid waste management in 500 AMRUT cities. It will be implemented over 5 years, with an outlay of INR 2.87 trn. Allocation increased significantly to INR 500bn (+354% yoy) vs INR 110bn in FY21 RE ▪ To set up Development financial institution with initial equity outlay of INR 200bn and targets to have lending portfolio of INR5trn in 3 years ▪ Allows funding of infrastructure projects by issuance of Zero Coupon Bonds by notified infrastructure Debt funds. ▪ To launch National Monetisation Pipeline with potential brown field projects including NHAI toll roads, power transmission assets of CPSE, gas/product pipelines of CPSEs, railways would	**Positive:** Strong traction in road sector awarding to continue. **Positive:** Higher capex will aid demand for industrial and EPC companies. Also, steel companies will benefit from higher demand for rails led by new lines, track renewals **Positive:** Higher capex in Urban development to aid demand for EPC companies **Positive:** Higher allocation for Mission to drive water infrastructure capex and aid demand for EPC companies **Positive:** It will bring incremental funding source for infrastructure projects. **Positive:** Monetisation of brownfield operational projects to help incremental resources by Govt/agencies for funding future projects.

Sectors	Budget proposals	Impact on sectors
	monetize dedicated freight corridors for O&M, airports for O&M, warehouse of CPSE etc ▪ Budget proposes to allocate INR 2 trn to states and autonomous bodies for capex. Central government would also work out specific mechanisms to nudge States to spend more on infrastructure ▪ Dedicated freight corridor: Western / Eastern DFCs to be commissioned by Jun-22. In future, plan to undertake three DFCs 1) East Coast (Kharagpur to Vijaywada), 2) East West (Bhuswal-Kharagpur-Dankuni) and North- South (Itarsi to Vijaywada).	
Insurance & Capital market	▪ New ULIP policies with ticket size of INR 0.25m or more will be subject to LTCG like Mutual Funds. ▪ **Insurance sector FDI limit hiked from 49% to 74%** ▪ **Rationalisation of SEBI Act, Depositories act, Securities contract act & Government securities act into one.** ▪ Proposal for creating a permanent institutional framework for creating liquidity in the bond market	**Negative**: Likely to impact the flows of large ticket ULIP for Insurance companies. **Positive:** This would provide long term capital to the sector **Positive:** Simplification of structure would increase the ease of doing business for capital market participants. **Positive:** For development of bonds markets.
IT Services	▪ No major announcement directly impacting the sector	No immediate / major impact **Neutral to Positive:** Aggressive fiscal deficit and borrowing targets might eventually be inflationary and result in a weak INR over time. A weak INR is positive for the sector.
Metals	▪ Basic custom duty on (a) flat steel products reduced to 7.5% from 12.5%, and (b) on long steel products reduced to 7.5% from 10% ▪ Basic custom duty on steel scrap exempt till March 2022 (earlier 2.5%). • Basic custom duty on copper scrap reduced to 2.5% from 5%.	**Negative:** Impact will be only marginally negative as large amount of steel imports in India is from South Korea, Japan which already attract zero import duty due to Free Trade Agreement. **Negative:** This can result in moderate price correction in secondary long steel products which can then impact primary long product prices. **Negative:** It can result in lower copper prices in India and can have modest impact on earnings of copper smelters who use copper concentrates as input material.
NBFCs & HFCs	▪ Applicability of SARFAESI Act to smaller NBFC. ▪ Tax incentives for Affordable Housing and Affordable Rental Housing Project, to continue for one more year	**Positive:** Would bring NBFC sector at par with banks**.** **Positive:** for Banks and HFC's
Oil & gas	▪ Imposition of Agriculture Infrastructure and Development Cess (AIDC) on Petrol and Diesel ▪ LPG DBTL subsidy provision for FY22 at INR 140bn – a YoY decline of 45% ▪ Basis Custom duty on Naphtha reduced from 4% to 2.5% ▪ Monetisation of Oil & Gas pipelines of GAIL through InvIT route ▪ BPCL divestment process to be completed in FY22 ▪ Proposal to appoint an Independent Transmission System Operator (TSO) for the management of common carrier capacity of gas pipelines.	**Neutral:** Overall levies are unchanged. **Positive:** It covers FY22 subsidy. Positive for upstream companies. **Negative:** Marginal impact on refineries as it will lower their realizations **Positive:** Possible value unlocking as well as more funds for capex which could increase dividend capability. **Positive:** Time bound successful strategic divestment of BPCL to increase confidence in overall divestment program **Positive:** Will broaden the gas market and could be precursor to complete deregulation of the sector in future.
Pharmaceuticals	▪ Pneumococcal vaccine to be introduced under Universal Immunization Programme (UIP) across the country.	**Positive**: With an annual birth cohort of 24 mn, and US$6/child pricing, addition to UIP should create a US$150 mn market opportunity over time.

Sectors	Budget proposals	Impact on sectors
	▪ INR 350 bn allocation for Covid-19 vaccination ▪ Jan Aushadhi allocation maintained: Budgetary allocation for Jan Aushadhi stable at INR 0.65bn for FY22.	**Positive**. Govt. is pushing to cover 300 mn high-risk population in the first phase, which given Rs200/dose pricing should take up Rs120 bn. Assuming Rs50-100 bn for supporting vaccination, the amount implies coverage of 600 mn population. This is positive for Indian vaccine manufacturers. **Neutral**. Jan Aushadhi is a small part of the market and do not pose a significant threat to the private players**.**
Power	▪ Measures to promote competition in electricity distribution sector ▪ An INR 3 lakh crore scheme, spread over five years, linked to performance, to improve distribution infrastructure spending, smart metering, feed separation etc. ▪ Equity infusion of 1,000 crore in Solar Energy Corporation of India Ltd. (SECI) ▪ Increase in duty on solar invertors by 15%	**Positive:** Financial support to public electricity distribution companies will help improve their performance and financial health. Measures to promote competition will open new private sector investment opportunities and drive efficiency. The budget proposals are in positive direction. Support to Make-in-India through PLI schemes will encourage manufacturing and drive electricity demand growth.
Real Estate	▪ Extension of date for allowance of INR 1.5 lakh extra deduction for housing loans taken for affordable homes by another one year. ▪ Tax holiday for developers of affordable housing has been extended by another year ▪ Debt financing of REITs/InvITs by FPIs will be enabled ▪ TDS on dividend announced by Special Purpose Vehicles (SPVs) to the REIT will now be exempt. ▪ Differential between circle rates and agreement value allowed has been hiked from 10% to 20%.	**Positive**: Affordable housing remains focused area for government. Lower interest rate to drive housing demand. Asset monetisation through REIT/InvITs will become easier and attractive.
Telecom	▪ Receipt from communication services hiked from INR 337bn in FY21 to INR 540 bn	**Neutral:** Such steep hike is factoring proceeds from spectrum auction as well AGR dues which are widely known.

Note: INR 1 bn = INR 1 billion = INR 100 crore; 1 trn = INR 1 trillion = INR 100,000 crore. EPC – Engineering, Procurement & Construction; CV – Commercial vehicles; EV – Electric vehicles; M&HCV – Medium & Heavy Commercial Vehicles, FAME - Faster Adoption and Manufacturing of (Hybrid &) Electric Vehicles, REIT = Real Estate Investment Trust, InvIT – Infrastructure Investment Trust, AGR – Adjusted Gross Revenues

Annex 3: Changes in import duties over the past 5 years

Sr. No	Particulars	FY17	FY18	FY19	FY20	FY21
1	Mobile handset	10%	15%	20%	20%	20%
2	Charger/ Adapter	15%	15%	15%	20%	20%
3	Battery Pack	15%	15%	15%	15%	15%
4	Headphones and earphones	15%	15%	15%	15%	15%
5	Smart Meters	-	15%	15%	15%	15%
6	Mechanics, Die Cut Parts, Microphone and Receiver, Key Pad, and USB Cable	-	10%	10%	10%	10%
7	Smart watches / wearable devices	-	10%	20%	20%	20%
8	LCD/LED/OLED panels and other parts of LCD/LED/OLED TV	-	10%	15%	15%	15%
9	Digital Video Recorder (DVR) and Network Video Recorder (NVR)	-	10%	15%	20%	20%
10	CCTV camera and IP camera	-	10%	15%	20%	20%
11	Set Top Box for Television	-	10%	20%	20%	20%
12	Microwave Ovens	-	10%	20%	20%	20%
13	Light Emitting Diode (LED) Lamps	-	10%	20%	20%	20%
14	Printed Circuit Board Assembly	-	-	10%	10%	20%
15	Camera Module and Connectors	-	-	10%	10%	10%
16	Vibrator Motor / Ringer	-	-	Nil	10%	10%
17	Display Assembly	-	-	Nil	10%	10%
18	Touch Panel/ Cover Glass Assembly	-	-	Nil	10%	10%
19	Fingerprint readers/ scanner	-	-	Nil	15%	15%
20	Indoor and outdoor unit of split –system air conditioner	-	-	10%	20%	20%
21	Loudspeaker	-	-	10%	15%	15%
22	Optical Fibres, optical fibre bundles and cables	-	-	10%	15%	15%
23	Capital goods used for manufacturing of specified electronic items, namely- (i) Cathode Ray tubes; (ii) CD/CD-R/DVD/DVD-R; (iii) Deflection components, CRT monitors/CTVs; (iv) Plasma Display Panel	-	-	Nil	10%	10%
24	Charger/Power adapter for CCTV camera/IP camera/DVR/NVR	-	-	Nil	15%	15%
25	Specified electronic items like plugs, sockets, switches, connectors, relays	-	-	Nil	10%	10%
26	Compressor of Refrigerator and Air conditioner	-	-	-	10%	12.5%
27	Static Converters	-	-	-	15%	20%
28	Dip bridge rectifier	-	-	-	10%	20%
29	Populated, loaded or stuffed printed circuit boards	-	-	-	10%	20%
30	Open Cell for television set	-	-	-	15%	Nil/5%

Source: Budget documents, Elara Capital

Views expressed herein are as of February 1, 2021, based on the Budget proposals presented by the Honorable Finance Minister in the Parliament on February 01, 2021. The Budget proposals may change or may be different at the time the Budget is passed by the Parliament and notified by the Government. The information is for general purposes only and is not a complete disclosure of every material fact of Indian Budget. For a detailed study, please refer to the budget documents available on www.indiabudget.gov.in . The views involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied herein. Views are subject to change without notice. Stocks/Sectors referred herein are illustrative and Schemes of HDFC Mutual Fund may or may not have any present or future positions in these stocks /sectors. The information is based on information already available in publicly accessible media. The same should not be construed as an investment advice or a research report or a recommendation by HDFC Mutual Fund/HDFC Asset Management Company Limited (HDFC AMC) to buy or sell the stock or any other security covered under the respective sector/s. HDFC Mutual Fund/HDFC AMC is not indicating or guaranteeing returns on any investments. Readers should seek professional advice before taking any investment related decisions and alone shall be responsible. No part of this document shall be duplicated, copied or distributed in whole or in part in any form without prior written consent of HDFC Mutual Fund / HDFC AMC.

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