Investments by CPSEs budgeted to stagnate in FY19

Share of central capex to fall below 4% of GDP

One of the biggest misses in the Union Budget 2018-19 was the central government's capital spending, which was revised down sharply for FY18 – from budgeted growth of ~11% to a decline of ~4% – and budgeted to grow only ~10% in FY19. While gross taxes are budgeted to cross 12% of GDP for the first time in history, capital spending is budgeted at 1.6% of GDP – the lowest on record. What is more worrying is that investments by central public sector enterprises (CPSEs) is budgeted to grow only 0.3% in FY19, following ~21% growth in the past three years. As a percentage of GDP, the investments by the public sector (central government + CPSEs) are budgeted at 3.8% in FY19, down from 4% in FY18 and 4.9% a decade ago. Barring Railways, Coal & Telecommunication, most PSEs – especially Power, Civil Aviation and Shipping – are budgeted to witness a decline in capital spending in FY19. Overall, as we argued last year, public investments reached their limits in FY17 and their share in total investments is set to fall in FY19. The entire onus to revive the investment cycle and offset softening consumption now lies on the private sector, which holds the key for 7% real GDP growth next year.

While the government has budgeted all-time high (gross) tax receipts of 12.1% of GDP, capital spending is budgeted at all-time low of 1.6% of GDP

Last week, in its **Union Budget 2018-19**, the government did a commendable job of resisting calls for free cash incentives to the farm sector, universal minimum/basic income (UMI/UBI) or a generally inflationary stimulus. It promised to keep minimum support prices (MSPs) of kharif crops at least at 1.5x of the production cost and to launch the flagship National Health Protection Scheme covering 500m people. Yet, following 11.4% growth in revenue spending (excluding GST compensation cess) in FY18RE, the government has budgeted a growth of only 9% in FY19BE. Thus, while there were some shades of populism in the budget speech, this was not seen in the budget allocation. One of the biggest misses, however, was the sharp downward revision in capital spending for FY18 – from a budgeted growth of 10.7% to a decline of 4%. Consequently, the share of capital spending, which was budgeted to increase to 14.4% of total spending, was only 12.3% in FY18. For FY19, while the government has budgeted all-time high (gross) tax receipts of 12.1% of GDP, capital spending is budgeted at an all-time low of 1.6% of GDP *(Exhibit 1)*. The government has budgeted a growth of ~10% in capital spending for FY19 – on a base of a decline of 4%, keeping it at 12.3% of total spending *(Exhibit 2)*.

Exhibit 1: Capex is budgeted at all-time low when gross taxes are budgeted at all-time high (% of GDP)

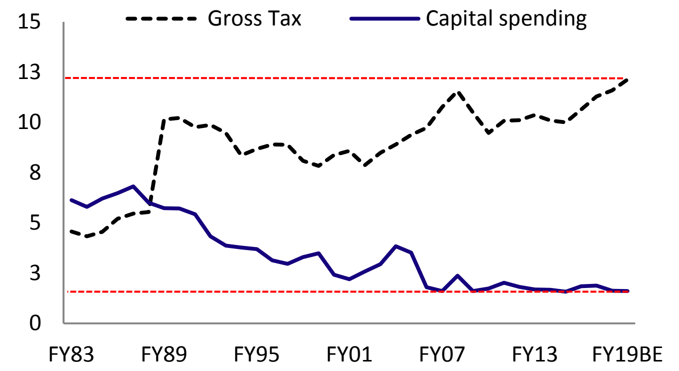
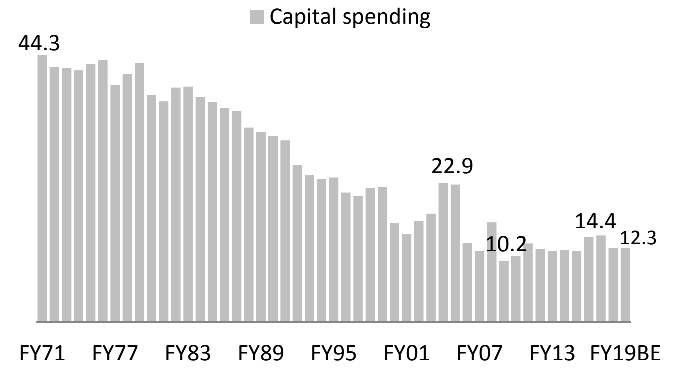


Exhibit 2: Share of capital spending has fallen consistently and most recently also (% of total spending)



Source: Union Budgets (UB), Central Statistics Office (CSO), MoSL

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CPSEs have budgeted a growth of only 0.3% in their investments for FY19BE, following an average growth of 21.4% in the past three years

Investments by central PSEs to be stagnant in FY19BE…: It is generally believed that while the center has reduced its capital spending, the central public sector enterprises (CPSEs) are doing the heavy lifting. This is, however, far from the truth. An analysis of investments by CPSEs (excluding budgetary support) reveals that they have budgeted a growth of only 0.3% YoY for FY19BE, following an average growth of 21.4% in the past three years *(Exhibit 3)*. Consequently, while central government capex is kept broadly unchanged at 1.6% of GDP for FY19BE, CPSEs' capex is budgeted to fall from 2.4% in FY18RE to 2.2% next year. The combined investments of the center and CPSEs are budgeted to fall from 4.0% of GDP to 3.8% in FY19 *(Exhibit 4)*.

Exhibit 3: Capex by CPSEs budgeted to stagnate in FY19…

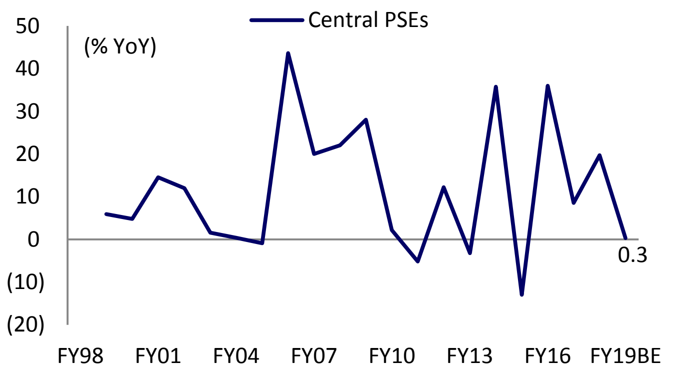
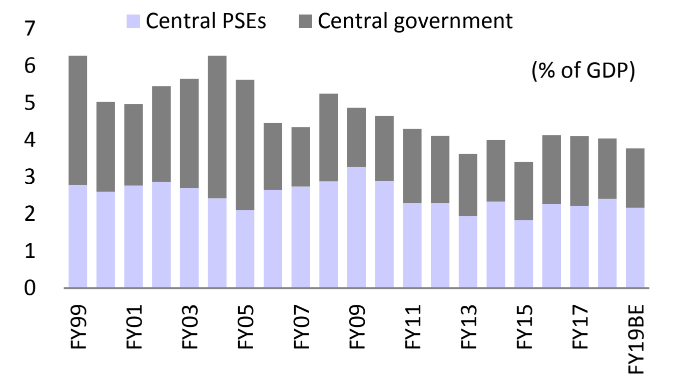


Exhibit 4: …bringing down total capex to 3.8% of GDP



Source: UB documents, CSO, CEIC, MoSL

Budgetary support to CPSEs in FY18RE was the lowest in almost a decade, while their reliance on bonds market increased sharply

…due to budgeted decline in Power, Civil Aviation and Atomic Energy: Five ministries – namely Railways, Petroleum & Natural Gas (P&NG), Power, Road Transport & highways (RT&H) and Department of Telecom – account for about four-fifth of total investments by CPSEs *(Exhibit 5)*. A look at the financing of their investments reveals that budgetary support in FY18RE was the lowest in almost a decade, while their reliance on bonds market increased sharply *(Exhibit 6)*. For FY19BE, CPSEs are budgeted to receive INR1.11t of budgetary support, 8.6% higher than INR1.03t in FY18RE. It will account for ~21.5% of total investments by CPSEs. The remaining financing will be raised through their internal resources (32%), bonds market (30.8%) and other sources (15.7%) such as suppliers' credit or external commercial borrowings (ECBs).

Exhibit 5: Key ministries in size of investments (% of total)

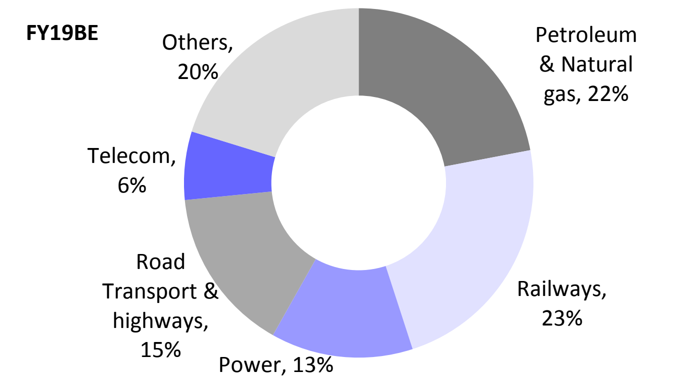
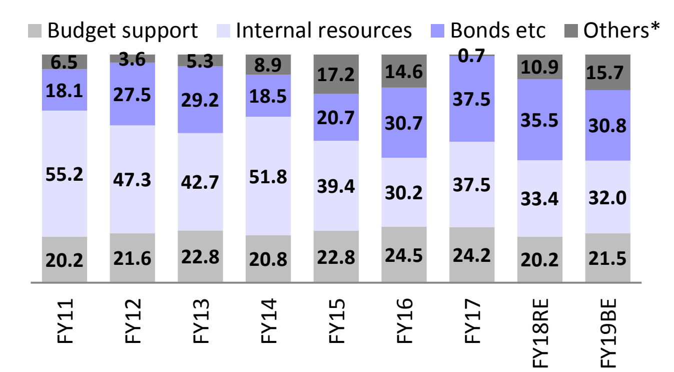


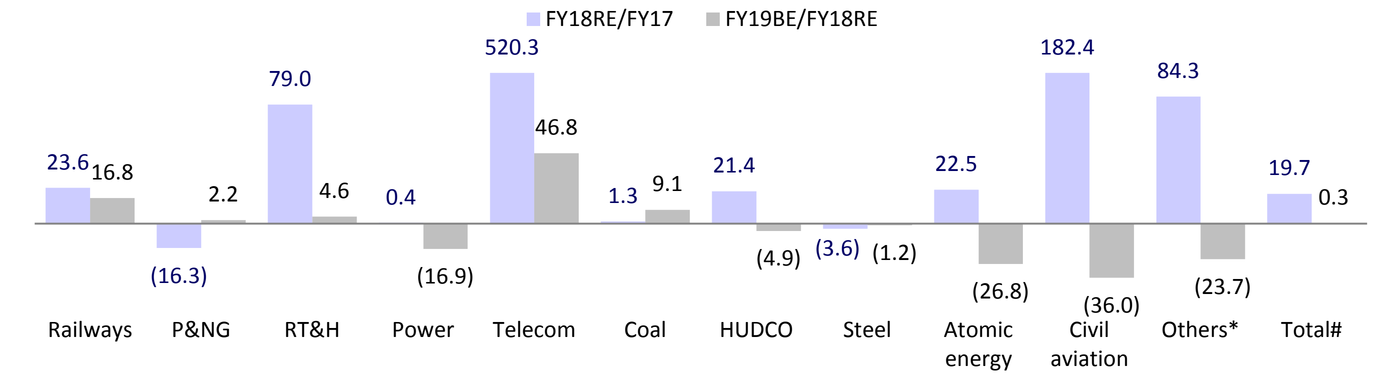
Exhibit 6: Key sources of financing investments (% of total)



* ECBs, suppliers' credit etc
Source: UB documents, CSO, CEIC, MoSL

A look at ministry-wise investments (excluding budgetary support) confirms that barring Railways, Coal & Telecom, investments are budgeted to decline for most ministries in FY19BE *(Exhibit 7)*. Large ministries such as Ministry of P&NG have also budgeted a small growth on the base of significant decline last year.

Exhibit 7: Ministry-wise change in investments (% YoY)



* Others total INR317b in FY19BE

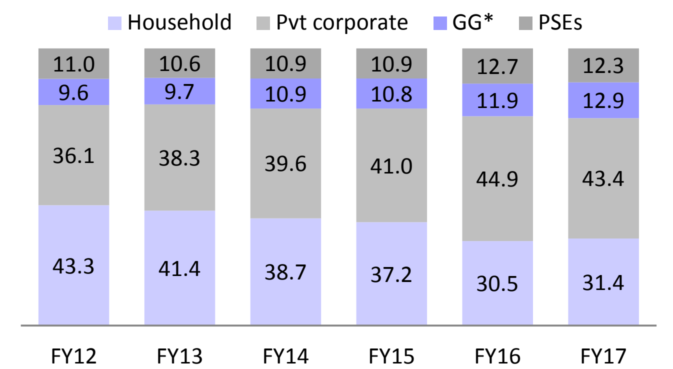
Source: UB documents, CEIC, MoSL

\# Excluding investments by Food Corporation of India (FCI)

We believe that public-sector-driven-investments-growth in the economy peaked out in FY17 and the share of public sector is set to fall in FY18/FY19

Public investments peaked in FY17; set to fall in FY18/FY19: The Central Statistics Office (CSO) recently released National Accounts statistics for 2016-17, which confirm that the share of public sector (central government + states + PSEs) has increased from ~20% in total investments in FY12/FY13 to more than 25% in FY17 *(Exhibit 8)*. As **discussed** last year, we believe that the public sector share in total investments peaked in FY17. In the ongoing FY18, while the central government has budgeted a decline of 4% in capex, **states** have also witnessed a sharp decline of ~14% in their capital spending in the first eight months of the year (up to November 2017). Although CPSEs have budgeted higher investment growth in FY18RE, it is unlikely to offset the fall in investments by general government (GG, center + state governments). For FY19, combined investments of the center and CPSEs are budgeted to grow only ~4% against the average growth of 17.3% in the past three years. We, thus, believe that public-sector-driven-investments-growth in the economy peaked out in FY17 and the share of public sector in total investments has probably fallen in FY18 and is set to fall further in FY19. A comparison of the share of the public sector in total investments in India vis-à-vis other economies shows that it is at the higher end for India *(Exhibit 9)*.

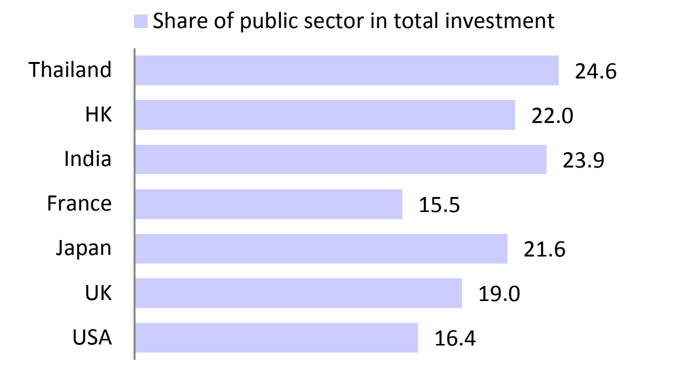
Exhibit 8: Share of various institutions in investments# (%)



\# GFCF + inventories

* Centre + States

Exhibit 9: Share of public sector in different economies (%)



Average of the last three years

Source: CSO, CEIC, MoSL

Will private sector maintain its 1HFY18 performance in FY19?

Fiscal policy reaching its limits did not come as a surprise to us. What, however, is more important to note is that non-government investments (corporate + households) have grown sharply in 1HFY18 – at least partly on account of favorable base. Our **estimates** suggest that investments of the general government (center + states) declined for the first time in 11 quarters in 2QFY18; however, real investments of the private sector grew 10.5% YoY in 2QFY18 and a strong 8.8% YoY in 1HFY18 *(Exhibit 10-11)*.

Exhibit 10: Private capex picked up in 2QFY18, while fiscal capex# declined for the first time in 11 quarters (%)

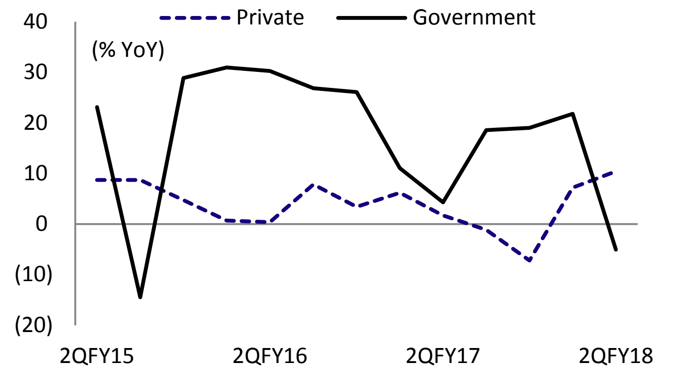
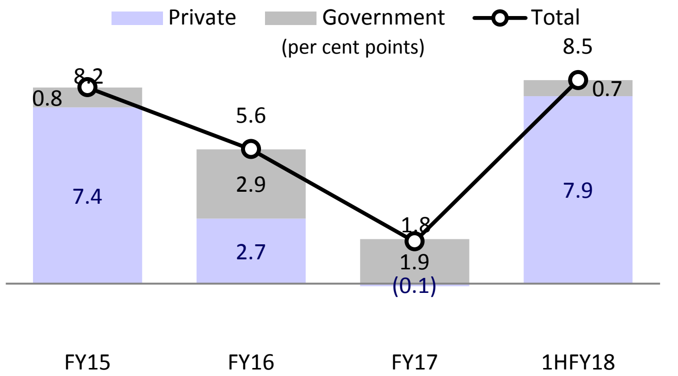


Exhibit 11: Contribution of private and fiscal investments in total investments



Source: CSO, CAG, CGA, RBI, CEIC, MoSL

With consumption growth slowing, investments will have to grow much faster to support real GDP growth in FY19

With consumption growth – private and fiscal – slowing, investments will have to grow much faster to support real GDP growth in FY19. As the central capex (central government + CPSEs) is budgeted to grow only 4.2% in FY19 – half of ~9% growth in FY18RE and less than one-fourth of average growth of 17.3% in the past three years, private investments will have to witness a strong revival to help real GDP growth touch 7% in FY19.

Overall, while real GDP growth may improve next year, touching 7% growth still appears a tall task

Households may push real estate investment in FY19, boosting construction activities. The corporate sector may also invest more. However, whether they will be able to offset the slowdown in consumption and fiscal investments is something to watch out for in FY19. Overall, while real GDP growth may improve next year, touching 7% growth still appears a tall task.

N O T E S

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