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NOT STICKING TO MANDATED FISCAL RULES IN CURRENT CRISIS IS GOOD ECONOMICS

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The COVID-19 is likely to impact India's fiscal numbers in FY20 though it might be too early to say, possibly in FY21. However, it will be completely foolhardy to stick to any mandated fiscal rules in times of current crisis that is now threatening to rip apart the entire global financial ecosystem. Globally, state loans, income subsidies and tax deferrals are the most common fiscal packages being offered. In India the number of active cases have risen to 151 with 14 fresh cases in single day. When we analyze the occurrence of active cases in seven most affected countries apart from China, in the second week, the number of cases jumps almost 7 times compared to the first week. In some countries like Iran and Spain even the active cases rose to 13 times in the second week compared to the first week. Though India has already taken plethora of steps to prevent the spread of COVID-19, all eyes are now on the rise in active cases in the current week and next as this determines the extent of our preparedness.

Meanwhile, based on current tax revenue trends, additional expenditure rationalization of Rs 1.2 lakh crores might be required in the current fiscal, if India has to stick to mandated 3.8% fiscal deficit. Even COVID-19 will have an impact on GDP through Trade, Hotels, Transport, Communication & Services sub-segment and this will have pressures on fiscal deficit as a % of GDP. In FY21, nominal GDP growth is at 10% and every 10 bps slippage in nominal GDP numbers in FY21 will push up fiscal deficit by roughly 1 basis point. **We are already estimating that the impact of a 5% inoperability shock could be 90 basis point on GDP from Trade, Hotel and Transport and Transport, Storage and Communication segment, that could be spread over FY20 and FY21, with a larger impact in FY21. The Government has already announced an additional borrowing through short term papers in FY20.**

If we look at the historical trend in Brent crude oil prices and its relationship with excise duty collection and retail prices, the data suggests post-GST, excise duty on petro products now contributes 85-90% of overall excise duty collection of Centre. In 2019-20 (Apr-Dec), total excise collection on petro products for 9 months is close to Rs 1.5 lakh crore. If the same run rate continues for FY20, then there could be shortfall of at least Rs 14,000 crore. Ideally, as per our estimates, a $1 dollar change in crude prices results in 50 paisa change in retail prices. Based on such trends, the fall in crude oil prices from $50/barrel to less than $30/barrel could potentially lower the petrol and diesel prices by Rs 10-12 /litre from their present prices assuming excise had stayed at the previous level. However the rise in excise duty of Rs 3 on petrol and diesel prices by Center may lead to maximum cut of Rs 4.25 paisa on petrol and Rs 3.75 paisa on diesel from the current level. **We thus expect the Government may further limit such fall in retail prices and thereby increase the excise more.**

However, extraordinary times call for extraordinary measures and out of box thinking! We thus strongly recommend that the increased excise revenue from oil should not be used for bridging the fiscal gap and pleasing the markets; rather sound economics demands it must be used as a fiscal package for income support to the people working in the unorganized sector who are already facing the brunt of loss of jobs. Additionally, RBI should come out with a comprehensive forbearance scheme for sectors that are being negatively impacted and are staring at job losses like Aviation, Textiles, Hotels, Automobiles and even Food Processing!

FISCAL ARITHMETIC OF FY20

- As per a written reply given by the Finance Ministry in Rajya Sabha, total direct tax collections till 10 Mar'2020 stand at Rs 8.63 lakh crore as against the revised estimate of Rs 11.70 lakh crore, implying a shortfall of Rs 3.06 lakh crore to be collected in remaining 20 days of this fiscal.
- However, if we look at the past year data during the last month the Government collected around 26% of the cumulated amount collected till Feb'19. Thus assuming that the Government collects around 22% of the amount collected so far in the remaining days, the direct tax shortfall would amount to Rs 1.2 lakh crore.
- Looking at the indirect tax collection, the actual amount collected by 29 Feb'20 is Rs 8.75 lakh crore (FY20 RE of Rs 9.86 lakh crore), implying a shortfall of Rs 1.11 lakh crore from the RE. However, assuming that the Government collects 12% of the amount collected so far in Mar'20 (based on the past year trend), the shortfall in case of indirect tax collection comes to Rs 6000 crore.
- Taking into account the surplus on account of AGR dues (Rs 30000 crore, assuming only this much is received by the Government), excise duty increase (Rs 2000 crore) and expenditure rationalization of Rs 1.20 lakh crore, the new fiscal deficit comes to Rs 7.79 lakh crore (3.83% of revised GDP as per 2nd advanced estimate.
- Even COVID-19 will have an impact on GDP through Trade, Hotels, Transport, Communication & Services related GDP. As the March month is severely affected by travel and transport curbs, we believe that Q4 nominal GDP may impart a 1.4% decline in FY20 GDP. Thus, considering the impact of COVID-19 on GDP, the new fiscal deficit will be 3.88% of GDP.
- Apart from fiscal measures we believe that Government may think of unconventional fiscal measures like tax moratoriums, payment extensions on social charges, loan guarantees and wage subsidies for workers who cannot work or move to part-time roles if COVID-19 in India reaches to third or fourth stages.

Fiscal Deficit Estimate (Rs crore)	
Tax Revenue Shortfall	125000
Shortfall in Disinvestment receipts	40000
Surplus on account of AGR dues	30000
Surplus on account of Excise Duty cut	2000
Total Revenue loss (A)	**133000**
Expenditure rationalisation (B)	**120000**
Fiscal Deficit FY20 RE (C)	766846
New Fiscal Deficit for FY20 = C+A-B	779846
GDP (2nd Advanced)	20384759
New Fiscal Deficit (% of GDP)	**3.83%**
GDP after adjusting for COVID-19 impact	20106959
Revised Fiscal Deficit (% of GDP)	**3.88%**
Source: SBI Research	

Unconventional measures taken by European nations to fight COVID-19					
Measures	**Germany**	**France**	**Italy**	**UK**	**Spain**
State loans or credit guarantees for companies	✓	✓	✓	✓	✓
Income subsidies for affected workers	✓	✓	✓	✕	✓
Tax deferrals	✓	✓	✕	✓	✓
Social security deferrals or subsidies	✓	✓	✕	✕	✓
Debt repayment holidays	✕	✕	✓	✓	✓
Fiscal Stimilus	-	-	€25 billion	£30 billion	€200 billion
Memo: COVID-19					
Number of Active Cases	9919	7730	31506	1950	13716
Source: SBI Research					

OIL PRICE TRENDS

- The most unexpected development in the global economy has been the sudden emergence of price war between the OPEC and the non-OPEC members of the oil producing countries. The Saudi offer to reduce price and increase the production when the demand negating impact of COVID-19 is still uncertain has taken markets by surprise. The oil prices have corrected sharply by 25%.
- What triggered the price war is unclear. However the markets largely missed the brewing discontent and this transpired the steep fall. Low levels of oil price may be good story in part, but it also has con side: high financial market volatility, abrupt corrections in inflation and impact on Government finances.
- Unless there is some truce coming, oil price is expected to stay low. With no signs of slowdown in spread of COVID-19, an increase in oil supply will keep the prices depressed.

IMPACT ON RETAIL PRICES IN INDIA

- Global crude oil plummeted to as low as $31.02 a barrel from $50 per barrel few days back and is presently hovering around $27/barrel. If the same holds for a long period in FY21 then it will be a bonanza to both Government and consumers. We expect oil to stay at low levels at least in the first half of FY21.
- This will reduce the import bill of India and therefore the current account deficit by a big margin. However, with deregulation, petrol and diesel prices across the country, the question arises whether the benefit of decline in crude oil prices will be transmitted to consumer or not and if yes, then how much?
- The Government has increased taxes on petrol and diesel by Rs 3 per litre each, a move that may fetch it an additional revenue of around Rs 40,000 crore in a year.
- If we look at the historical trend in Brent crude oil prices and its relationship with excise duty collection and retail prices, the data suggests post GST, excise duty on petro products now contributes 85-90% of overall excise duty collection of Centre with the invent of GST. In 2019-20 (Apr-Dec), total excise collection on petro products for 9 months is only Rs.1,47974 crore with a monthly run rate of Rs 16,441 crore. If the same run rate continues for FY20, then there could be shortfall of at least Rs 14,000 crore.
- We estimate Centre's projection for excise duty on petro products to be approximately Rs 2.40 lakh crore for FY21. The additional excise duty on petrol and diesel by Rs 3 which augment revenue of Rs 40,000 crore will give room to increase its spending on the most vulnerable sector such as informal sector to counter the impact of COVID-19.
- Our own estimate shows, a $10 increase in crude oil prices, on an average leads to Rs 5 rise in retail fuel prices and vice versa. In other words, a $1 dollar change in crude prices, results in a change in 50 paisa in retail prices. However, this does not happen always as declining tax revenue of both Centre and States are countered through imposition of higher VAT/ Excise duty as is being done now. The rest of falling crude prices either goes to Government kitty or oil companies kitty which indirectly comes to Government through dividend tax.
- The break up in retail prices of petrol and diesel suggests that the Centre charges a fixed excise duty of Rs 22.98 per litre on petrol and Rs 18.83 per litre on diesel. Apart from this, there are transportation costs, commission costs and other charges which on aggregate contribute Rs 10 in petrol and Rs 13 in diesel. On top of these, the state tax/VAT is levied along with additional cess that ranges around Rs 15-20 in petrol and Rs 10-15 in diesel.
- **We estimate that the fall in crude oil prices from $50/barrel to $35/ barrel (average for FY21) could potentially lower the petrol and diesel prices by Rs 10/litre from their present prices assuming excise had stayed at the previous level. However the rise in excise duty of Rs 3 on petrol and diesel prices by Center may lead to maximum cut of 4.25 paisa on petrol and 3.75 paisa on diesel from the current level. We expect the Government may further limit such fall in retail prices and thereby increase the excise even more.**

Brent Crude oil prices and its Impact on Excise Duty

Excise Duty on Petro Products (Rs Crore)					Average Price in Delhi	
Year	Brent Crude oil Price ($)	Excise Duty on Petro Products (Rs Crore	Union Excise Duty (Rs Crore)	Share	Petrol	Diesel
2014-15	84.16	99,068	1,88,128	53%	66.37	53.37
2015-16	46.17	1,78,477	2,88,073	62%	61.58	47.00
2016-17	47.56	2,42,691	3,81,756	64%	64.60	53.24
2017-18	56.43	2,29,716	2,58,834	89%	68.08	57.47
2018-19	69.88	2,14,369	2,31,045	93%	75.37	68.22
2019-20	63.13	1,97,300	2,48,012	80%	72.81	65.92
2020-21	55.34	2,40,300	2,67,000	90%		

Note: The excise duty on petrol increased 142% and diesel by 429% since 2014. On April 1, 2014, the excise duty on diesel was only Rs 3.56 per litre, and on petrol, it was Rs 9.48 per litre. Since 2014, duties were revised 11 times upwards and 2 times downwards.

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