Optimistic India budget jars with revenue reality

Staking his credibility on meeting a deficit-cutting target, Finance Minister P. Chidambaram is likely to be forced to scale back spending in the upcoming fiscal year after delivering a budget that makes aggressive revenue assumptions.

Cutting expenditure would pit Chidambaram against the Congress party's urge to ramp up populist spending ahead of elections due in 2014, and risks exacerbating a dramatic slowdown in Asia's third-largest economy.

Instead of slashing spending, as had been expected, Thursday's budget for the financial year starting next month bets on an increase in revenue to fund a 16 percent rise in expenditure and trim the fiscal deficit to 4.8 percent of GDP.

For that to happen, India's sputtering economy must accelerate to roughly 6.5 to 7 percent growth from the current fiscal year's expected 5 percent -- a decade-low and a disappointment for a country that not long ago aspired to double-digit expansion.

The budget also assumes that India will manage to sell about $10 billion worth of government stakes in companies and generate $7.5 billion in revenue from the battered telecoms sector.

It also envisions capping subsidies at 2 percent of GDP, from 2.6 percent this year, a limit that rating agency Standard & Poor's warned could be breached.

Keeping a lid on spending, however, is where Chidambaram may be able to deliver.

Against the populist leanings of his party, Chidambaram has managed to curb expenditure in the final months of the current year, putting the fiscal deficit on track to fall to 5.2 percent, better than its revised 5.3 percent target.

However, austerity comes at a price. The December quarter's stunningly weak growth of 4.5 percent underscores the risk of cutting back on government spending, and some economists expect growth to lag 5 percent for another quarter or more.

"Chidambaram has kept some room to cut spending by having a bigger allocation to plan expenditure," said Barclays economist Siddhartha Sanyal.

So-called plan expenditure refers mostly to capital spending that can have a multiplier effect, which is needed to help grow the economy but is politically easier to delay than subsidies.

"So, if he falls short in revenues, he can cut some of the plan expenditure, but that will again hurt growth," Sanyal said.

SAVE NOW, SPEND LATER?

One way Chidambaram could reach his deficit target even if revenue falls short is to hold back on spending in the first half of the fiscal year before ramping up outlays in the run-up to parliamentary elections due by May 2014.

In the current year, Chidambaram slashed plan expenditure by nearly 18 percent to 4.3 trillion rupees and raised non-plan expenditure, which is consumption-based spending, by 317 billion rupees over budget estimates to 10 trillion rupees.

That has allowed him to narrow the current year's fiscal deficit to near an original 5.1 percent target that had anticipated economic growth of 7.6 percent, which in hindsight proved highly optimistic.

Trimming the deficit helps fend off the threat that India becomes the first of the BRIC economies to have its credit rating downgraded to "junk", something Chidambaram would be loath to see happen on his watch.

His new budget will prove similarly malleable.

"It has enough flexibility to deal with both upside and downside risks, as past experience has shown," Dipak Dasgupta, principal economic advisor in the finance ministry, told Reuters.

TOUGH TARGETS

That flexibility will be necessary, because the budget makes optimistic assumptions.

Undaunted by repeated failure to meet targets for unloading its stakes in companies, India plans to sell 540 billion rupees worth of shares in the fiscal year starting in April, including 400 billion rupees worth of shares in state firms, compared with a reduced target of 240 billion rupees this fiscal year.

That equity sales target is equivalent to two-thirds of the total $15 billion raised by firms in 2012. It comes as investors are being asked to digest $2-$3 billion in shares in numerous firms as controlling shareholders trim their holdings to comply with a 75 percent cap that takes effect on June 30.

"The target, 400 billion, looks very ambitious to me," said Taina Erajuuri, a Helsinki-based portfolio manager at FIM India.

"It's very hard to sell in this kind of market conditions. The market is going to be very volatile, the rupee will continue to be very weak," she said.

Similarly, the budget assumes 408.5 billion rupees from licences and other revenue from the debt-strapped telecoms sector, a target analysts say looks tough.

Goldman Sachs, HSBC and local ratings agency Crisil expect India to miss its fiscal deficit target, saying 5 percent of GDP is more likely.

"They'll have revenue shortfalls and they'll make up for it by squeezing expenditure," said Jahangir Aziz, economist at JPMorgan, who expects full-year economic growth of about 5.6-5.7 percent in the upcoming fiscal year.

(Reuters.com)