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INDIA INSIGHTS

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India Budget 2021

A Bold Growth Supportive Budget

The Indian Government announced its Budget for the financial year 2021 -22 on 1st February 2021. This budget is unequivocally countercyclical in its stance providing the required impetus to fuel economic growth. The Government has defined its priorities right with a focus on infrastructure spending, asset monetization, privatization of state-owned companies and incentivizing foreign investment.

At the same time, the budget is also credible as far as various underlying economic assumptions are concerned. The fiscal deficit target of 6.8% for FY 2022 is reasonable and acknowledges the changed global economic landscape. The medium-term glide path of bringing it down to 4.5% of the GDP by FY2026 is realistic and creates the fiscal space for more growth-enhancing measures.

Some of the key measures announced in the budget are as follows -

- **Scaling up investments on healthcare and infrastructure:**
    - The budget has recognized the need of the hour to improve the healthcare infrastructure in India. Towards this end, outlay for health has been raised from INR 945 bn (~USD 13.5 bn) in fiscal year 2021 to INR 2.23 trn (~USD 32 bn) in the next fiscal (2022). The government has committed ~USD 4.8 bn to India's Covid vaccination programme, the world's largest drive with over 1.3 bn people being vaccinated.
    - Capital spending has been stepped up from INR 4.39 trn (~ USD 63 bn) in FY21 to INR 5.45 trn (~ USD 78 bn) in FY22. The boost to infrastructure expenditure would also help increase demand in core industries such as cement, steel, power and heavy duty machinery, as well as demand for construction equipment, including commercial vehicles.
    - There is a big thrust on monetization of operational infrastructure assets of the government like roads, airports, transmission towers. The finance minister in its budget announced the intention to monetize INR 1 tn (~ USD 13 bn) of NHAI highway assets over the next four years. Similarly, there is a plan for railways to monetize dedicated freight corridor assets for operations and maintenance, after commissioning. Other core assets forming part of monetization plan include oil and gas pipelines of GAIL, IOCL and HPCL, airports in Tier II and Tier III cities, rail infrastructure, warehouses and sports stadiums.
    - Impetus to Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs):
        - Payment of dividends to InvITs and REITs has been exempted from Tax Deduction at Source (TDS).
        - Enabling debt financing by Foreign Portfolio Investors (FPIs) to these vehicles thus providing the flexibility to raise debt capital at lower cost

- Other initiatives include creation of an infrastructure focused Development Financial Institution with a capital base of INR 200 bn (~ USD 3 bn), and permitting zero coupon bond issuance by Infrastructure Debt Funds to fund infra projects.

- **Measures to reform the banking sector:**
  - Proposal of setting up of a 'Bad Bank': The idea is to take over the existing stressed debt of banks and dispose off the assets to Alternative Investment Fund (AIFs) and other potential investors, for value realization.
  - Two public sector banks are expected to be privatized – which would expedite the long-awaited reforms in the banking sector.

- **Boost to demand for affordable housing:**
  - Extension of tax holiday for affordable housing by one more year: This may encourage more developers to invest in this sector.
  - As per industry expert Jones Lang LaSalle (JLL), nearly one-third of the newly launched projects across the top seven markets in India catered to affordable housing in 2020 and this share is only expected to increase.

Impact on the economy and our strategies

The economic situation in India has been improving quite rapidly since Sep-20. Various high frequency indicators are showing a strong rebound. Goods and Services Tax (GST) collections, which is a key indicator of economic activity has been rising steadily for the past 4 months. GST collections for the months of Dec-20 and Jan-21 have been amongst the highest monthly collections over the last three years. Earlier this month, India also witnessed the highest daily electricity consumption. Manufacturing PMI is indicating an expansionary trend for the past four months now. Companies in core sectors like metals, cement, auto and real estate continue to witness strong growth and higher EBIDTA margins. In 2021, as per estimates of various agencies, India is expected to be one of the fastest growing emerging economy with real GDP growth estimated at 9 – 10%. The measures announced in the budget are expected to provide a further boost to economic activity and help towards propelling India to become a USD 5tn economy over the next 6 – 7 years.

We also believe that the budget would have a positive impact on our private debt and infrastructure yield strategies.

- Our performing credit strategy provides bespoke funding to operating and holding companies for growth. We believe that India currently provides an annual investment opportunity of USD 4-5bn for such structured credit investments. As economic growth picks up steam, we expect more companies to seek this type of funding over the medium term. On the supply side, banks continue to be regulatorily constrained. Other traditional vehicles like NBFCs / open ended mutual funds suffer from

ALM mismatches. Thus, alternative vehicles like ours that can provide long term patient capital to corporates will benefit from this increasing demand for capital.

- Residential real estate is witnessing a revival in the past three months through a combination of decadal low mortgage rates, all-time best affordability and reduction in stamp duties. An economic recovery with stable job prospects would act as a catalyst for this trend. In our assessment, there is likely to be higher demand for residential projects which are completed or are showing visible progress in construction. We expect this trend to continue over the next 1 – 2 years till the economic recovery picks up steam. Thus, completion financing in projects that have low execution risk and a proven product remains an attractive investment proposition. We foresee a market opportunity of INR 3-4 bn in this space. Priority over cash flows from the underlying projects helps further mitigate risk in these investments.

- Our existing distressed credit investments would also benefit from the faster economic revival. We believe that the future investment opportunity in stressed credit would continue to remain very large. The RBI is expecting NPAs of 13.5% in the banking system and around 6.8% with NBFCs by Sep-21 as per the latest financial stability report released in Jan-21. While the mechanics around the creation of a bad bank need to be seen, it would provide an opportunity for distressed investors to take a consolidated exposure in large corporate loans rather than acquiring such loans from multiple banks. This should improve the transaction efficiency for such transactions.

- As far as infrastructure yield strategy is concerned, the government has announced its plans to monetize its infrastructure assets to manage the fiscal deficit. This along with the monetization of infrastructure assets by developers for deleveraging will continue to provide attractive investment opportunity for our infrastructure yield strategy.

- Instruments like InvITs and REITs have been gaining popularity in India. These trusts have attracted capital upwards of INR 2 tn (~ USD 26 bn) so far and the potential for such investments continues to be high. The tax incentives announced for and enabling of debt investment from FPIs into these vehicles would stimulate further investments by offshore investors.

All in all, we believe that this is a very positive budget which will unlock further growth in the Indian economy and encourage long-term global capital.

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