

## Indian Budget 2018-2019: Populist, yet long-term positive

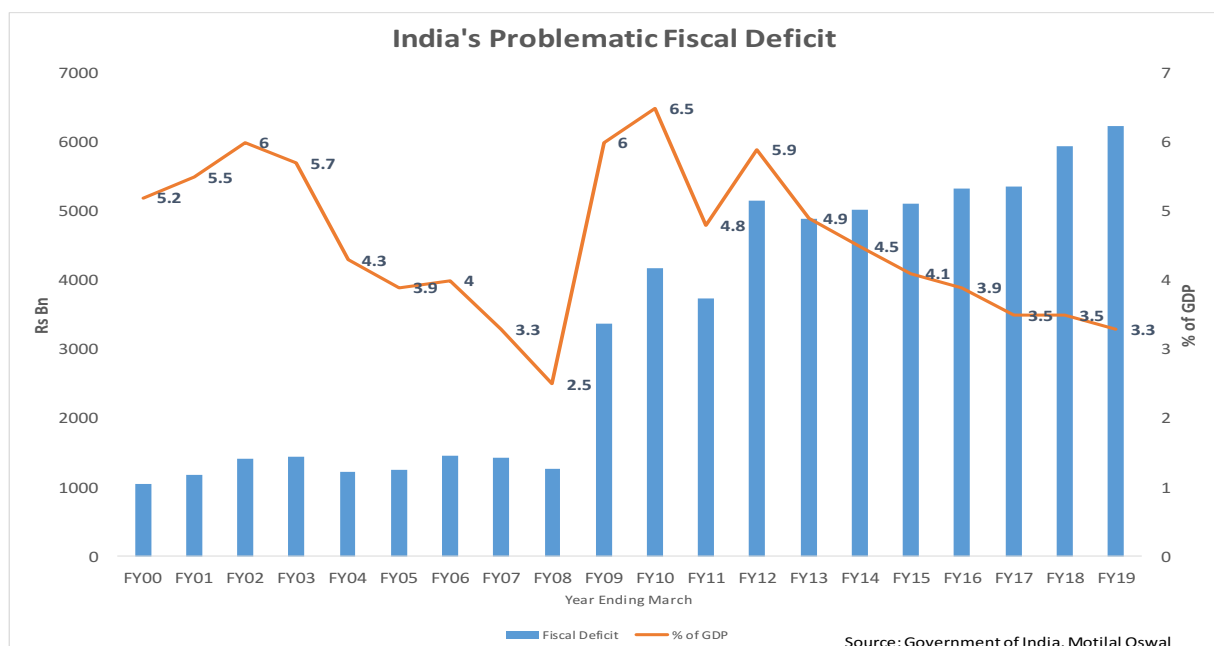
The Government of India announced its Budget for FY19 (March year end in India) on February 1, 2018. Given the rural dissent, observed during the Gujarat Elections (farmers and rural population in Gujarat voted against PM Modi's party, the BJP) and a spate of state elections in 2018 and national election in 2019, expectations were that the government would take a populist approach in its budget proposals and hand out many freebies to farmers and the rural population.

The concern surrounded the issue of whether populism would lead to fiscal indiscretion in a country where bringing the budget deficit under control has been difficult. As per expectations, the government did adopt a populist approach, though it maintained its focus on infrastructure build and reforms. On

the positive side, it refrained from any big bang distribution of free cash incentives or farm loan waivers.

This means that the fiscal deficit target of 3% in FY19 (Budgeted target 3.3% in FY19) will get pushed out further to 2022. The Budget also assumes a sharp increase in indirect tax collections and GST receipts, which if for some reason is not achievable may will increase the fiscal deficit for FY19.

The other thing to watch out for is rising oil prices as the Government provides subsidies to insulate the impact this can have on the economy, particularly from an inflationary standpoint. This alongside the flagship National Health Protection Scheme could add another Rs.500-750bn to the deficit.



### The Positives:

On the positive side of the ledger, the budget tabled focussed on rural economy development, targeting specifically sectors such as agriculture, healthcare and education.

In terms of the rural sector, an allocation of US\$224bn has been made for the upcoming year. This is focused on setting selling prices of crops at 50% above cost for farmers – called MSP or minimum support price. Whilst this is extremely positive for farmers and the rural

economy, it is likely to be somewhat inflationary.

A **national healthcare scheme** was also announced to support 100m poor families. Additionally, for the less wealthy, free gas connections will be provided to 80 million households as well as electricity to 40 million households. This also is part of a thematic to have everyone housed by 2022 (Housing for All, 2022).

The **infrastructure** needs of India has largely been discussed and is significant. It was a major recipient given it will be a growth driver over the next decade. Total infrastructure allocation by the Government is US\$785bn, with another \$94bn allocated specifically targeting transport (\$21bn), railways (\$24bn), 'Smart Cities' project (\$32bn) and some additional spending on affordable housing and the Digital India initiative.

From a **macro-economic** perspective, the Government sees achievement of 8% growth for FY19. The fiscal deficit is expected to be reigned in towards 3.3% by the FY19-20 budget. The Government also seeks, as per recommendation of an advisory committee, to reduce its debt towards 40% of GDP.

Regulators thus far have only allowed bonds rated at AA or above as **investable bonds**. The

Government and regulators will take steps to move this a notch lower to A-rated being permissible for investment. The RBI has issued guidelines to promote greater corporate use of bond markets for funding. The Regulator (SEBI) will consider mandating large corporates to fund 25% of their needs via the bond market. This will increase breath and liquidity of these markets and reduce borrowing costs in an environment where there could be upward pressure on rates from inflation.

The Finance Minister lauded the Government of India's efforts on the **tax base** of the country. He highlighted 18.6% direct tax growth as at 15.01.2018 and the low, but rising number of tax payers in India (83m people). In fact, 41% more tax returns were filed in FY17. Tax collection is a key driver for India's growth. In fact, Tax-to-GDP ratio is expected to be over 12% in FY19 for the first time ever!

**Tax changes** were significant. An introduction of Long-term capital gains. A change to the corporate tax rate for SME's. Additionally, a standard deduction of US\$626 is offered to salaried citizens, which will marginally increase disposable income.

The following conditions were the significant changes to tax to note:

	Prior to 31 January, 2018	Post 31/01/2018
Short-Term Capital Gains (holdings of less than 1 year)	15%	15%
Long-Term Capital Gains	0%	10% (applied on total gains above Rs.100,000)*
Corporate Tax Rate	30%	25% (only for medium sized companies with T/O < US\$40m)

\*all investments made before 31-Jan-2018 to be grandfathered for changes in LTCG

Given that LTCG is grandfathered, the Government is now largely aligned with equity market investors. Their tax collections are largely going to be driven by increases in investor wealth. Additionally, from an **Australian investors perspective**, this change does not have an impact as Capital Gains Tax

paid in India is returned to investors in the form of a tax credit – given the tax treaty in place between Australian and India.

**Companies in our portfolio** that should see the benefit of this budget include large and small companies like Larsen & Toubro

(infrastructure), Mahindra & Mahindra, Maruti Suzuki, Tata Motors, Eicher Motors (automobiles, 2-wheelers, rural), Motherson Sumi, Mayur Uniquoters (auto components),

Britannia, Page Industries, Dabur, Hindustan Unilever, Godrej Consumer Products (rural consumption), Ambuja Cements and India Cements (roads and broad infrastructure).

**The Negative watch** for over the next 12 months include:

**Inflation** – with rising oil prices and price setting of crops, as well as rising global growth, it is a very real possibility that inflation will rise in India. The RBI has some scope to retain rates where they are but not much. Rising rates could hamper private capex spending and place a bottleneck on infrastructure

**Fiscal Indiscretion** – With a fiscal deficit of 3.3% forecast for FY19, there are concerns about it being held in check given significant

unaccounted spending and bullish expectations on tax collections. Moody's remarked in their recent upgrade that they expected discretion here and a focus on at least maintaining Government debt at current levels.

**Private Spending and Government Spending** – thus far the Government has been driving most of the spending on infrastructure. This will need private contribution going forward, especially as Government spending becomes more discerning. Rising rates may also impact this.

*Despite these factors, the long-term positives remain very much in play. Corporates continue to benefit from the thematics of consumption and infrastructure. The rural economy should provide a significant positive impact given favourable weather patterns over the last few years and positive action from this budget. These factors we think will continue to keep India's economy ticking along between 7-8% growth. This ecosystem will provide many opportunities for corporates to grow earnings at a far superior pace (in aggregate) compared to their global peers.*



Indian farmers learning to access crop data on their mobiles