2016 India Budget

"Politically pragmatic, fiscally prudent, directionally sound"

The budget finessed an unsettled global macro back drop whilst adding a dose of political pragmatism on the home front. The decision to retain the fiscal deficit targets of 3.5% for FY17 and 3% for FY18 recognises the importance of maintaining macroeconomic stability. Conservative tax revenue growth assumptions showed acknowledgement of the fragile state of corporate sector earnings, thereby affording credibility to the numbers. Furthermore, the decision not to meddle with capital gains tax rates registered the markets' concern on this front. We anticipate the Reserve Bank will give the Budget its seal of approval with a 25 basis point cut in interest rates at the April policy meet, if not before. The decision to focus future expenditure on the rural economy represents acknowledgement of the stress this sector has been under following successive poor monsoons, a reduction in subsidy spend, and BJP failure in recent State Elections, adding a marginally populist bias. This focus on India's lower echelons was politically reinforced by garnering incremental revenue from taxing higher income brackets. Overall the budget has been well received; it avoided potential pitfalls, though lacked "headline" reform.

Revenue – Tax high earners

- Service tax increase of 0.5% to 15%, converging towards forecasted revenue neutral GST rate
- Incremental duties on autos, jewellery and high end clothing
- 10% tax on dividends received by individuals above a US$15,000 threshold
- Renewed emphasis on divestment with a target of US$9bn vs US$4bn achieved in FY16
- Additional capital raise from telecom spectrum auction targets US$15bn. Seems ambitious

Expenditure - Spending on the low income bracket

- US$24bn on rural road connectivity, irrigation and welfare schemes
- US$4bn allocated for PSU bank recapitalisation. More available if and when needed
- 4% growth in planned and unplanned capital spending (21% in FY16)
- Retained focus on road and rail with a total outlay of US$34bn (1.5% of GDP)

Prudent measures

- Conservative 11% overall tax revenue growth projection, with emphasis on increase in personal income tax receipts whilst acknowledging a weak corporate sector
- Contrary to market fears, no introduction of a long term capital gains tax
- Uncertainty around GAAR removed. To be implemented from 1st April 2017

Market disappointments

- US$4bn for PSU banks deemed inadequate.
- Increase in FDI limit to 100% in asset reconstruction companies partially addresses this
- No reduction in corporation tax though, exempt industries will converge at 25% as will start-ups, implying this rate will apply to all in time

Recent market weakness has brought India's forward P/E valuations back in line with longer term averages (BSE30 trades at 14.9x FY17 earnings, 16% growth*), with a number of Ocean Dial's favoured stocks dropping back in the "buy zone". In spite of the well documented disappointments during 2015, BJP policy remains reform orientated in the main and the macroeconomic environment supportive. Both Centre and State governments are investing in infrastructure and the expectation of ongoing low inflation supports further (limited) monetary easing. In due course this state of affairs will lead to renewed private sector investment and a cyclical upswing in corporate earnings, which the market will anticipate. Once global volatility subsides, India offers an attractive entry point on a medium term view, particularly since the market's long INR position has largely unwound and foreign equity exposure has been meaningfully reduced.

** Kotak Institutional Equities estimates as at February 2016*

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