Union Budget Analysis FY 16 -17

Fiscal Prudence : Now spotlight on growth

29 Feb 2016

BARODA PIONEER MUTUAL FUND

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Bank of Baroda

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Agenda

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Economic Backdrop

GDP

- Expected to grow in the range of 7%-7.5% in FY17. This growth rate is more balanced and realistic assessment of the Macro economy.
  - Predicting revival in Industrial sector due to policy reforms, Easy monetary policy on benign inflation outlook, benefits on account of lower crude price, stable external sector and Normal monsoon.

Inflation

- **CPI**
  - Fell from 9-10% in the last couple of years to 5.6% in December 2015, on back of moderation in prices of petroleum products and food inflation.
  - Core inflation also softened on the back of lower housing and services inflation.
- **WPI**
  - Headline WPI moderated to 5 year low of -2.98% in 2015-16(April-December) from 6% in FY14.

Fiscal Deficit

- Government is likely to meet fiscal deficit target of 3.9% of GDP in FY16 in line with budget target
  - This is despite shortfall in direct tax revenues and divestment target.
  - Increase in Indirect tax revenue led to containing fiscal deficit.
- Government is committed to the fiscal consolidation roadmap . The deficit target is at 3.5% in FY 17E, and 3% in FY 18E.

(Source – indiabudget.nic.in)

Economic Backdrop Contd.

Current Account Deficit

- At 1.4% of GDP (US$14.4bn) in H1 of FY16 was better than 1.74% of GDP (US$17.9bn) in H1 of FY15
  - Achieved through lower import of Crude.
- Expected to be at 1.1% of GDP in FY17 due to lower Crude price

Monetary Policy

- Reduced repo rate by 50 bps to 6.75% on 29th September 2015

Conclusion

- GDP growth range of 7-7.75% is more realistic and can be achievable with Government's strong commitment to reforms measures, Lower interest rate, Normal monsoon and lower crude price
  - Regaining growth momentum requires restoration of domestic macroeconomic balances and enhancing efficiency, fiscal consolidation and removal of structural constraints.
- Raising the Tax- GDP ratio above prevailing level is critical for sustaining reduction in fiscal deficit.
- With twin deficit-fiscal and Current account contained at lower level, it is likely to lead to higher growth
- Rates are likely to fall as the CPI is on RBI glide path and Government 's commitment to fiscal consolidation.

(Source – indiabudget.nic.in)

Key Highlights

- Fiscal Deficit has been targeted at 3.5% for FY17.
- Budget estimates based on nominal GDP growth of 11%
- Receipts expected to grow at 8.7% to Rs 19.6 tn.
- Total expenditure expected to increase to Rs 19.8 tn
  - Non planned expenditure projected to grow to Rs 14.3 tn, a growth of 9%.
  - Planned allocation increased by 15.3% to Rs 5.5 tn.
- Government to borrow Rs 4.25 tn, which is lower than market expectation.

(Source – indiabudget.nic.in)

Big Picture - Snapshot of Union Budget

Sr No.	Particulars (Rs bn)	FY12	FY13	FY14	FY15	FY16RE	FY17BE	YoY (%) (FY17BE/FY16RE)	CAGR % (FY11/FY01)
	Total Receipts	13,044	14,104	15,594	15,859	18,075	19,649	8.7	13.9
1	Revenue receipts	7,514	8,776	10,147	11,015	12,061	13,770	14.2	15.1
2	Net tax revenue	6,298	7,403	8,159	9,036	9,475	10,541	11.2	15.3
3	Non-tax Revenue	1,217	1,374	1,989	1,979	2,586	3,229	24.9	14.6
4	Capital receipts (net)	5,689	5,834	5,639	4,844	6,014	5,878	(2.3)	11.6
4.a	a. Disinvestments	181	259	293	377	253	565	123.2	26.8
4.b	-Other Capital receipts	5,508	5,575	5,346	4,467	5,761	5,313	(7.8)	11.1
5	Net market borrowings	4,362	4,674	4,535	4,451	4,019	4,252	5.8	16.1
6	Gross market borrowings	5,098	5,580	5,641	5,903	5,850	6,000	2.6	15.9
	Total Expenditure	13,044	14,104	15,594	16,812	17,854	19,781	10.8	13.9
7	Non-plan expenditure	8,920	9,967	11,061	12,010	13,082	14,281	9.2	12.9
8.a	Subsidies outgo	2,179	2,571	2,546	2,583	2,578	2,504	(2.9)	20.5
9	Plan expenditure	4,124	4,136	4,533	4,626	4,772	5,500	15.3	16.4
10	Revenue deficit	3,943	3,659	3,570	3,655	3,416	3,540	3.6	11.5
	Gross fiscal deficit	5,160	4,906	5,029	5,107	5,351	5,339	(0.2)	12.1
	Nominal GDP	90,525	101,133	114,286	124,567	135,672	150,650	11.0	13.5
	Fiscal deficit as % of GDP	**5.7**	**4.9**	**4.4**	**4.1**	**3.9**	**3.5**		

- Increase in excise duty on fuel and widening of service tax net had led to higher tax receipts last year despite low growth which may not be repeated in FY17. However wider net due to div. distribution tax for HNIs, infra cess etc may compensate for the deficit.
- Lower growth in non-planned expenditure and lower subsidy outgo provided an impetus to planned expenditure.
- Govt. maintained its guidance of sticking to its fiscal deficit target and hence market borrowing was lower than expectations.

(Source – indiabudget.nic.in, BPAMC Research; CAGR – Compounded annual growth rate)

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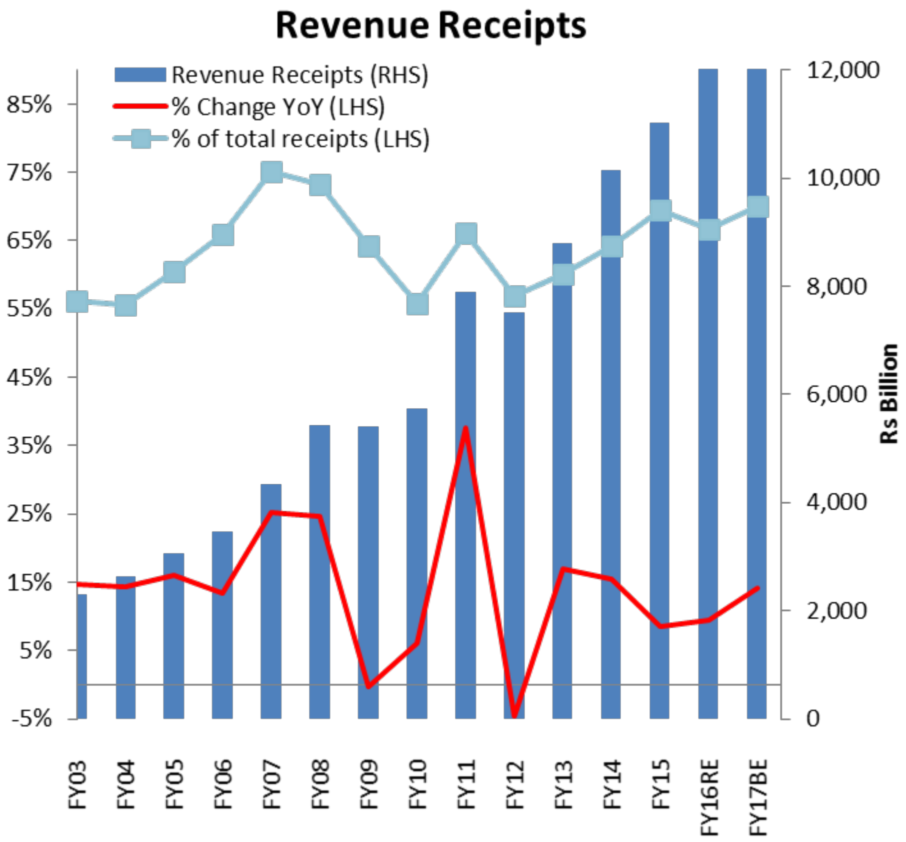
Revenue Receipts

- Net Revenue receipts are budgeted to grow at 14.2% YoY in FY17BE vs 9.5% estimated growth in FY16RE
- Gross tax receipts are budgeted to grow at 11.7% YoY in FY17BE vs 17.2% estimated growth in FY16RE
- Non - tax receipts are budgeted to grow at 24.9% YoY in FY17BE vs 30.7% estimated growth in FY16RE
- Capital receipts are expected to come down by 2.3% in FY17BE vs 24.1% growth in FY16RE (due to lower estimated borrowings)
- Target for tax revenues looks reasonable in the backdrop of nominal GDP growth assumption of 11.0%



(Source – indiabudget.nic.in)

Tax Receipts

(Rs billion)	FY12	FY13	FY14	FY15	FY16RE	FY17BE
Income tax receipt	1,703	2,015	2,429	2,657	2,991	3,532
% Change YoY	16.2%	18.3%	20.5%	9.4%	12.5%	18.1%
% of Nominal GDP	1.9%	2.0%	2.1%	2.1%	2.2%	2.3%
Corporate tax receipt	3,228	3,563	3,947	4,289	4,530	4,939
% Change YoY	8.1%	10.4%	10.8%	8.7%	5.6%	9.0%
% of Nominal GDP	3.6%	3.5%	3.5%	3.4%	3.3%	3.3%
Custom duties collection	1,493	1,653	1,721	1,880	2,095	2,300
% Change YoY	10.0%	10.7%	4.1%	9.3%	11.4%	9.8%
% of Nominal GDP	1.6%	1.6%	1.5%	1.5%	1.5%	1.5%
Excise duties collection	1,456	1,765	1,702	1,900	2,841	3,187
% Change YoY	5.3%	21.2%	-3.6%	11.6%	49.6%	12.2%
% of Nominal GDP	1.6%	1.7%	1.5%	1.5%	2.1%	2.1%
Service tax receipt	975	1,326	1,548	1,680	2,100	2,310
% Change YoY	37.3%	36.0%	16.7%	8.5%	25.0%	10.0%
% of Nominal GDP	1.1%	1.3%	1.4%	1.3%	1.5%	1.5%
Others	36	39	41	43	39	41
% Change YoY	33.9%	10.3%	5.0%	3.7%	-8.0%	4.4%
% of Nominal GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Tax Receipts	8,892	10,362	11,387	12,449	14,596	16,309
% Change YoY	12.1%	16.5%	9.9%	9.3%	17.2%	11.7%
% of Nominal GDP	9.8%	10.2%	10.0%	10.0%	10.8%	10.8%

CAGR of 16.5% during FY01-11 and budgeted to grow at 18.1% over FY16RE. Looks slightly ambitious but can be achieved given the measures like 10% tax on dividends received

Grown at a CAGR of 23.7% during FY01-11 and budgeted to grow at 9.0% over FY16RE. At 3.3% of nominal GDP we believe that the target is reasonable given the historical trends

CAGR of 11.1% during FY01-11, budgeted to grow at 9.8% over FY16RE. At 1.5% of nominal GDP the target is in line with the historical trends

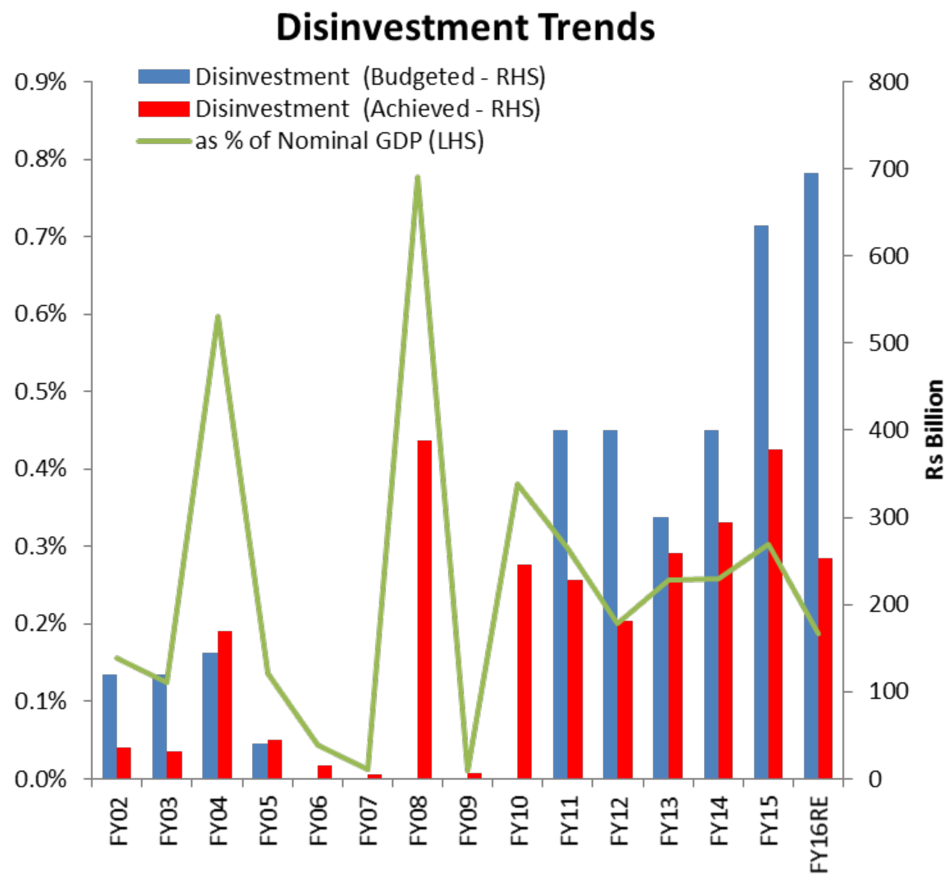
CAGR of 7.3% during FY01-11, budgeted to grow at 12.2% over FY16RE. The target looks achievable given the increase in excise duty on jewellery, branded readymade etc

CAGR of 39.1% during FY01-11, budgeted to grow at 10% over FY16RE. The target looks reasonable in the backdrop of 11% growth in nominal GDP

(Source – indiabudget.nic.in; CAGR – Compounded annual growth rate)

Disinvestment

- The budgeted number in FY17BE is Rs 565 bn vs Rs. 695 bn in FY16BE
- Rs360bn from disinvestment in PSUs and Rs205bn from other strategic disinvestments
- Disinvestment target was set at Rs695bn in FY16. Actual disinvestment achieved in FY16RE was Rs253bn
- Given the historical trend, we believe that the target is ambitious, especially given the fact that historically government has not been able to achieve the strategic sale target and the minority stake sale in Hindustan Zinc and BALCO has been facing various hurdles



(Source – indiabudget.nic.in)

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Budget Expenditure

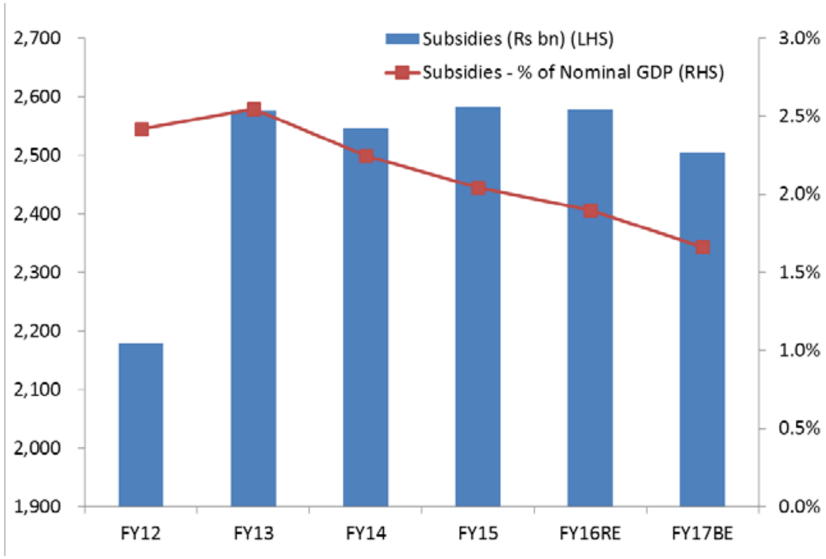
(Rs bn)	FY12	FY13	FY14	FY15	FY16RE	FY17BE	YoY (%) (FY17BE/FY16RE)	CAGR % (FY11/FY01)
Expenditure	13,044	14,104	15,594	16,812	17,854	19,781	10.8	13.9
Non-plan expenditure	8,120	9,967	11,061	12,010	13,082	14,281	9.2	12.9
Non-plan revenue expenditure	8,120	9,143	10,190	11,094	12,127	13,274	9.5	12.3
Interest payments	2,732	3,132	3,743	4,024	4,426	4,927	11.3	8.9
Subsidies outgo	2,179	2,571	2,546	2,583	2,578	2,504	(2.9)	20.5
Non-plan capital expenditure	799	824	871	916	955	1,006	5.4	19.0
Plan expenditure	4,124	4,136	4,533	4,626	4,772	5,500	15.3	16.4
Plan revenue expenditure	3,337	3,292	3,527	3,576	3,350	4,036	20.5	19.9
Plan capital expenditure	786	844	1,006	1,050	1,422	1,464	2.9	7.4

- The budget has tried hard to walk on a tight rope given the global and domestic economic concerns. Overall expenditure increase of 10.8% is highest in last 5 years due to increase in both planned and non-planned expenditure.
- Lower subsidy outgo and in-line interest payments, non-planned revenue and capital expenses led to 9.2% increase in non-plan expenditure which we think is positive and will give leeway to the govt. to control fiscal deficit and spend more on planned expenditure which is more productive and less inflationary.
- Planned expenses increased by 15.3%. The growth in revenue expenses was higher than capital expenses. With more funds being allocated to states, the capital expense of state budget is likely to compensate for lower central spending.

(Source – indiabudget.nic.in, BPAMC Research, CAGR – Compounded annual growth rate)

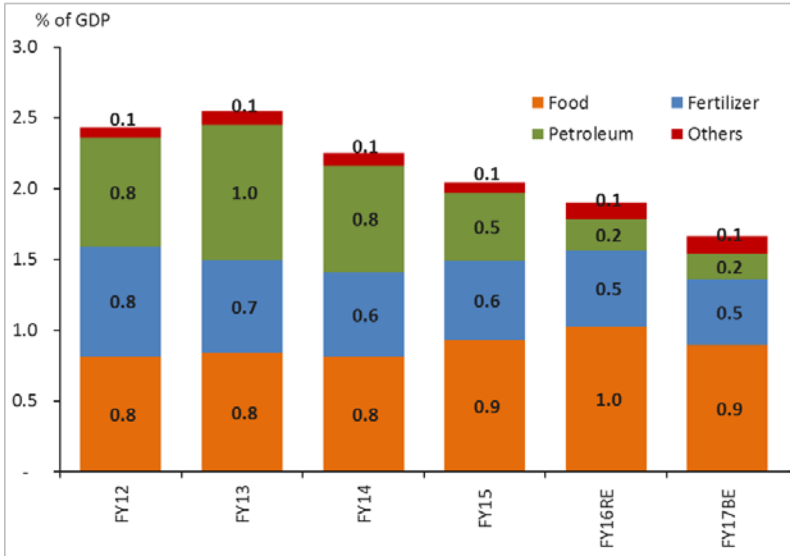
Subsidies

Lower crude leading to cut in subsidy



- For FY17BE, subsidy has been budgeted at Rs 2.5tn which is reduction of 3% yoy. Fuel subsidy is estimated to decline by 10% YoY to Rs 269bn (Rs 300 bn estd for FY16RE)
- Subsidies as a percentage of Nominal GDP is estimated to decline from 2% in FY15 to 1.7% FY17E. Decline in subsidy is a welcome signal as it puts lesser strain on fiscal deficit.

Food now form 54% of total subsidies



- The food subsidy has increased due to passage of food security bill. Food subsidy now forms 54% of total subsidy.
- Oil subsidy is budgeted to reduce further during FY17E due to lower crude prices globally.
- Fertiliser subsidy has declined in percentage terms. The budgeted amount for FY17 is Rs 724 bn, decline of 3%yoy.

(Source – indiabudget.nic.in)

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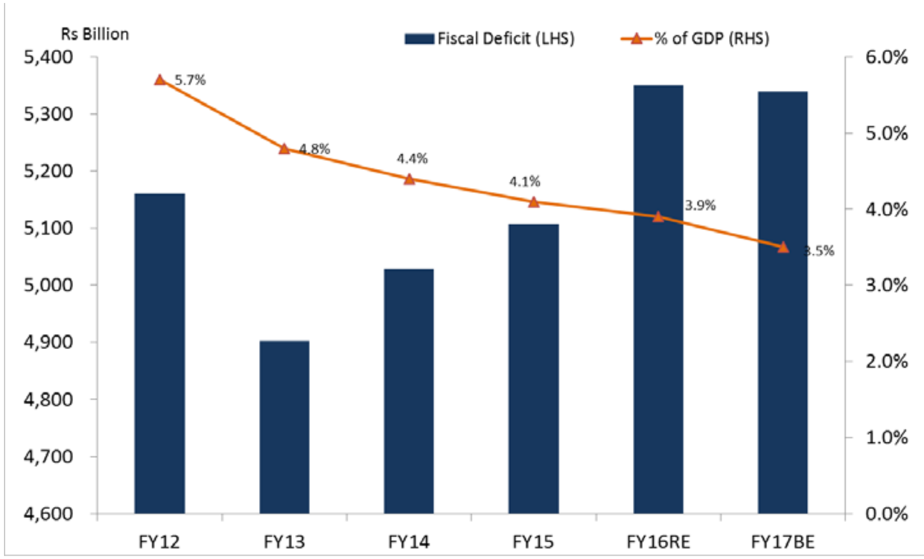
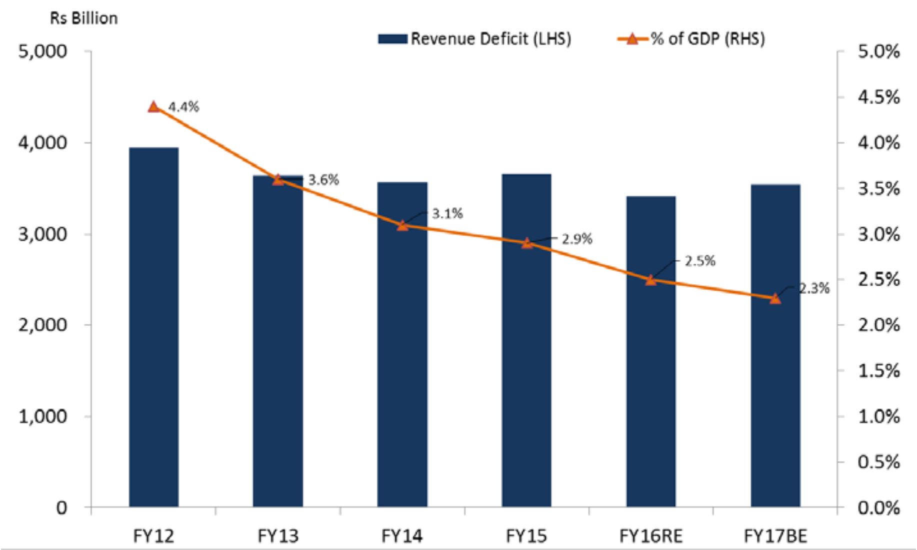
Fiscal & Revenue Deficit

Fiscal Deficit (as % of GDP)



Revenue Deficit (as % of GDP)



- Fiscal Deficit target has been maintained at 3.5% of GDP for FY17BE. For the medium term, the government has maintained the fiscal deficit target of 3% for FY18.
- Revenue deficit is pegged at 2.3% of GDP

(Source – indiabudget.nic.in, BPAMC Research)

Borrowing Program

Particulars (Rs bn)	FY12	FY13	FY14	FY15	FY16RE	FY17BE
Fiscal Deficit	**(5,160)**	**(4,902)**	**(5,028)**	**(5,107)**	**(5,351)**	**(5,339)**
Net Market borrowings	4,362	4,674	4,535	4,451	4,019	4,252
PPF & special deposits	108	109	98	119	110	120
Small savings	(103)	86	123	322	534	221
Net external assistance	124	72	73	129	115	191
Others	828	471	391	(692)	793	423
Cash Surplus	(160)	(510)	(192)	778	(221)	132
Total financing	5,160	4,902	5,028	5,107	5,351	5,339
Gross borrowing w/o switch	**5,098**	**5,580**	**5,641**	**5,903**	**5,850**	**6,000**

- Government projected Gross Market & Net borrowing of Rs 6,000 bn & Rs 4,252 bn respectively for FY17BE.
- Borrowing plan is manageable considering the current market environment.
- We expect the 10-year GOI yield to trend lower over the next 12 months as government plans to maintain fiscal deficit target of 3.5% in FY17BE with lower net market borrowings

(Source – indiabudget.nic.in)

Fixed Income Markets

Bond Market Outlook

- The Fiscal deficit target is at 3.5% in FY 17. It is targeted to be reduced to 3% in FY18. It is positive for the bond market as the government is committed to fiscal consolidation.
- The gross and net market borrowing at Rs 6,000 bn and Rs 4,250 bn is manageable considering the current market environment. It should be positive as the market was expecting increase in the borrowing program.
- We believe government is likely to achieve the fiscal deficit target with better revenue prospects due to reasonable growth assumption and prudent in expenditure.
- In the last monetary policy RBI acknowledged that currently CPI is in the projected path of disinflation. RBI has acknowledged upside risk to its target of 5% by January 2017 due to implementation of 7^{th} pay commission. However, upside risk to inflation can emerge from high fiscal slippages, uncertain monsoon and reversal of crude price.
- Policies of the central government are likely to contain food inflation. Core CPI has moderated already with lower housing inflation.
- Fiscal consolidation measures are expected to be on track with rationalization of subsidies and pruning down wasteful expenditure
- RBI may ease the policy rate with easing CPI and lower fiscal and current account deficit
- The 10-year GOI yield can potentially come down. Fiscal consolidation measures, lower CPI print and dovish stance by RBI are likely to be the key triggers for the rally

(Source – indiabudget.nic.in)

Equity Markets

Sectoral Impact – Contd.

Sectors	Budget Proposal	Impact
Auto	Imposition of infra cess on all cars & TDS on cars above Rs 10 lakhs.	Negative for the sector as cost of ownership rises for buyer of high value cars.
Banking & Financial Services	Re-capitalisation of only Rs 250 bn budgeted for PSU banks. (same as announced in 'Indradhanush' last year)	Provision amount is quite low relative to large capitalization needs. Sufficient for current anemic growth at cost of balance sheet quality.
	Bank Board Bureau to be operationalised in 2016-17. PSU banks to be consolidated.	Positive for the sector. Consolidation of PSU banks has to factor labour unions and social nature of organisation.
	Increase in FDI in ARC to 100% (currently-49%)	Positive for the banking sector as capital was a big constraint for ARCs. Diversification in funding of ARC will also help in growth.
	To introduce a comprehensive bankruptcy Code in parliament.	Positive for all banks.
	49% FDI in insurance and pension sector via automatic route General insurance companies owned by the Government to be listed in stock exchanges.	Positive for most insurance companies as they will be able to raise capital from foreign partners and market.

(Source – indiabudget.nic.in)

Sectoral Impact – Contd.

Sector	Budget Proposal	Impact
Cement	Clean energy cess on coal increased from Rs 200/t to Rs 400/t	Marginally negative for cement producers as it increases the cost of production
	Increased allocation to Roads, irrigation projects and rural sector	Positive for overall cement demand growth which has been subdued in past 2-3 years
Consumer Goods	Increased allocation to MNREGA	Positive for rural demand and consumer sector as a whole
	Excise duty increase on cigarettes by 10-11%	Is largely on the expected lines and not as harsh as in the previous 3 years, Cigarette companies would have take the price increase of 8-10% to pass it on
	Excise duty on branded readymade garments and made up articles of textiles of retail sale price of Rs1,000 or more increased.	This will impact readymade garment players negatively
	Excise duty of 1% (without CENVAT credit) or 12.5% (with CENVAT credit) is being levied on articles of jewellery	This is likely to impact all jewelry players equally and lead to additional 1% cost in the system; we expect same to be passed on to consumers, increasing jewelry prices.
Oil & Gas	Cess payable to Government changed from Rs. 4500/ton (i.e. $9/ bbl) to 20% ad valorem for upstream companies	The announced rate is higher than expectation. Upstream will start paying more than current regime when crude goes past $45/bbl. Negative for upstream.
	Incentivize exploration in difficult fields. To encourage exploration and production of natural gas from deep-sea, ultra-deep water.	Limited benefits in near future.

(Source – indiabudget.nic.in)

Sectoral Impact – Contd.

Sector	Budget Proposal	Impact
Metal	Increase in import duty on Aluminum and Zinc from 5% to 7.5%	Domestic aluminum and Zinc prices would increase. Aluminum imports account for 55% of consumption and could get reduced. Positive for Aluminum and Zinc producers
	Export duty on bauxite reduced from 20% to 15%	Domestic availability of bauxite would get reduced further. Negative for aluminum producers without captive bauxite mines
	Export duty on bauxite reduced from 20% to 15%	Domestic availability of bauxite would get reduced further. Negative for aluminum producers without captive bauxite mines
Pharmaceuticals	A new healthcare schemes for BPL Families.	Positive for healthcare service providers
	Weighted deduction on R&D will be reduced to 150% from 1st April, 2017 and 100% from 1st April, 2020.	Tax incidence for companies to increase.
	3000 medical stores under Pradhan Mantri Jan to make generic medicines available.	Slightly negative for branded players

(Source – indiabudget.nic.in)

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Sectoral Impact – Contd.

Sector	Budget Proposal	Impact
IT and Telecom	IT- Sec 10AA . The benefit of section 10AA to new SEZ units will be available to those units which commence activity before 31.3.2020. Telecom : Budget assumes INR990bn (+70%) as revenues including spectrum revenues.	Positive. Gives a clear four year window for companies to set up SEZ campus. Negative if Operators show aggression in acquiring 700 Mhz.
Infrastructure Sector	Budget increase allocation for Roads, Approval of 10,000 km of national highways, advance completion of projects	Positive for EPC and construction companies
	Irrigation – 28.5L hectares to be brought under the scheme, 89 irrigation projects to be fast tracked. Long Term Irrigation Funds to be created at NABARD	Positive for Industrial products companies
	100% village electrification by 2018	Positive for T&D players

(Source – indiabudget.nic.in)

Equity Market Outlook

Given the global economic uncertainty and huge negative expectations, the actual budget had no negatives and hence it was positive! The budget has rightly focused on agriculture. However, there are no stimulus to revive growth and hence corporate profitability is likely to struggle. Simplification and rationalization of the procedure and taxes along with encouraging new start-ups lays foundation for strong economic growth despite transitory pains.

- With many small structural reforms especially on financial sector, it lays foundation for strong growth in coming years. Capital of Rs 250 bn. to be infused in PSU banks which is lower than expectations but in line with earlier announcements. It is just enough to maintain the current credit growth at the cost of balance sheet quality.
- On the macro side, the fiscal deficit target has been retained at 3.9% and 3.5% for FY16 and FY17. This coupled with CPI within RBI comfort zone can led to interest rate cuts in future.
- We expect the interest rate cost to fall for corporate India in coming year due to lower net market borrowing.
- Sticking to 3.5% Fiscal deficit as per FRBM act ensures that global investors continue to be overweight on India despite the selloff in other emerging markets.
- At current level, equity markets are trading at 15x FY17 estimated earnings.
- With budget not resulting in any major negative, equity market is likely to start focusing on global cues and earnings. With many small structural reforms especially on financial sector, it lays foundation for strong growth in coming years. With valuations being in line with long-term averages and hopefully earnings downgrade cycle slowing, it would be good time to build an equity portfolio.

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