The Budget
"Digging in for 2019"

India's Finance Minister Arun Jaitley's last budget before the 2019 Federal Election provided little by way of surprise or excitement for investors.

The key thrust was rural in nature with education and healthcare also at the forefront. The primary purpose is to bring relief to an agricultural community justifiably in need of Government support, as well as poorer communities as a whole. The bet is on that these measures will pay requisite dividends at the rural polling booths this year (State elections) and next (Federal elections). Election results in the state of Gujarat, and more recently in Rajasthan (where Congress has just won two assembly seats and is on course to win back a parliamentary seat), suggest the Government's popularity is suffering somewhat and immediate action is being taken.

Headlining the tapes was the announcement of a new health insurance scheme for 100m families, alongside a pledge to underwrite Government procurement prices for key crops, as a way of protecting farmers' incomes. Other protectionist measures included custom duty hikes on a range of imported items (mainly from China), Trump style, to drive domestic production and support jobs.

Widely expected was slippage in the fiscal deficit targets for this year (FY18) from 3.2% to 3.5% and for next year from 3.0% to 3.3%. In previous years the Government had reined in spending at the back end of the fiscal year in order to meet targets; but given current political priorities this enforced discipline has been axed, creating a knock-on effect for FY19's fiscal deficit.

In truth there is little by way of new initiatives. It's not Modi's style to wait until the Budget to announce grandiose schemes. Hence the fiscal slippage this year has occurred as a result of over spending on schemes introduced since he came into office such as farm loan waivers, interest rate subsidies, crop insurance plans and more recently, the public-sector bank recapitalisation plan. The implementation of the Goods and Services Tax has created a revenue shortfall which will have also played its part. Government capital expenditure has been raised by 10% year on year to US$4.6bn for next year which will most likely be focused on more of the same, particularly roads and railways.

On the revenue side the Government's assumptions on tax look conservative. Corporate tax receipts are forecast to grow at 10%, indirect tax at 17% and personal tax at 18%. It's a little surprising that these numbers are not more optimistic, given the expenditure slippage but a cautionary step perhaps. The divestiture target of US$12.3bn approx. is in line with 2018's number which feels conservative but also politically driven. In a move that will disappoint equity investors across the board, long term capital gains tax (greater than 12 months) was raised from 0% to 10%, and is now aligned with short term capital gains tax at 15%. The saving grace here is that this becomes effective from 31 January 2018 meaning only incremental gains from here on will be taxed at 10% and with all losses offsetable.

The increase in the Government's expenditure plans are designed to stimulate growth but it is disappointing not to see more focused initiatives to bolster employment. The message the Government wishes to portray is that it cares for the poor whilst ensuring capital markets are not unduly flustered by the detail. It's interesting to note that rumours suggesting that the date of the General Election may be brought forward to run in tandem with State Elections, as a cost saving measure and so as not to distract the Government unduly from its core business, are picking up. Market expectations were seemingly low since the reaction to date has been benign. India is rapidly moving into Election mode.

Source: Ocean Dial Asset Management; Credit Suisse

David Cornell
+44 20 7068 9874
david.cornell@oceandial.com

Tim Adams
+44 20 7068 9877
tim.adams@oceandial.com