NovaDhruva

Union Budget 2019-20

A Balancing Act with Strong Resource Mobilization

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Background

Being elected back to power with an overwhelming mandate, the immediate task at hand for the new Government is to spur an economy which witnessed a moderate growth rate of 5.8% in Q4 FY19, as compared to 6.6% in Q3 FY19 and 8.1% in Q4 FY18. The economy was at US$ 1.9 tn in 2014 when this government first came to power. Within 5 years the economy has grown at a CAGR of 7.9% to reach US$ 2.7 tn in 2019. The government has an ambitious target to be a US$ 5 tn economy by 2024-25 as highlighted in the Economic Survey which would mean a real GDP growth rate of 8%.

The Union Budget this morning indicates a higher focus on resource mobilization and fiscal management but lacks specific emphasis on boosting consumption or investment to drive growth. However, with an average real GDP growth rate of 7.9% in the last five years, the indicated FY20 growth rate of 7.0% in the Economic Survey seems achievable under current circumstances.

Maintaining Fiscal Discipline is the Highlight

The gross fiscal deficit to GDP ratio has reduced from 4.5% in FY14 to 3.4% in FY19. In the interim budget, the government had indicated a fiscal deficit ratio of 3.4% for FY20 which has now been reduced to 3.3%, thereby signaling focus on fiscal management through increase in revenue and checking the fiscal stimulus. Therefore, we believe that the government would need to walk a tightrope of getting the economy back on its feet while adhering to a strict fiscal discipline.

As regards the tax revenue, the government has played a balancing act. The move to increase the applicability of 25% tax rate bracket for corporates from an annual turnover of INR 250 crores (c. US$ 35 mn) to INR 400 crores (c. US$ 60 mn) will add pressure on revenue. This will be mitigated with the higher surcharge on individuals having taxable income of INR 2 crores (c. US$ 300 mn) and above. In this context, the buoyancy of GST collections will also become extremely crucial to meet the stated targets.

Further, the Budget provides for an aggressive disinvestment and strategic privatization target to mobilize non-tax revenues.

Significant Emphasis on Non-tax Resource Mobilization

Disinvestment of Central Public Sector Enterprises (CPSEs)

Disinvestment target has been set at US$ 15 bn for FY19-20. The target looks achievable given the current market conditions. The following proposals to ease the disinvestment norms could be transformational, if implemented well

a) On a case to case basis, the government may consider bringing its holding below 51% in CPSEs to an appropriate level

b) The controlling stake of 51% stake would be calculated including stakes owned by Government controlled institutions

We believe this can bring significant efficiency, resources and management talent to the CPSEs.

Strategic Privatization

The Budget proposes that the Government would offer more CPSEs for strategic privatisation. This could mean more companies like Air India being offered for sale.

Public shareholding in CPSEs

Government has indicated that it will take all necessary steps to meet the minimum public shareholding norms of 25% (can be increased to 35%) for all listed CPSEs. There are a number of CPSEs which will get covered by this. This could be another significant revenue mobilization exercise for the Government.

Innovative Ways of Raising Government Borrowings

Based on the fiscal deficit numbers, the net borrowing by the Government is expected to be approximately US$ 64 bn.

For the first time, the Government is diversifying its borrowing market and currency by proposing to borrow from foreign markets. This is expected to be 10-15% of its net borrowings during the year. It is indeed a positive move with multifold benefits:

a) Will help create an India benchmark in international markets. Domestic corporates will be able to price off this India benchmark, while tapping international markets for capital

b) Government will benefit from low global interest rates

c) There will be a natural hedge in the form of forex reserves of US$ 400 bn+

d) Lower requirement from the domestic market will soften the bond yields

Additionally, in consultation with SEBI and RBI, the Government proposes to implement measures for retail investors to invest in treasury bills and securities issued by the Government. This proposed participation of retail investors in Government securities will go a long way in deepening this market.

With prudent fiscal management in place and indications of borrowing in external currencies, the sovereign bond markets reacted positively with the benchmark 10Y yield trading down by 13 basis points.

Capital Markets Take Centre-stage

SEBI to consider raising the minimum public shareholding from 25% to 35%

Upfront, this measure seems to be aimed at achieving improved depth in the capital market and to provide higher liquidity. However, if we scratch a little below the surface, it is a regressive step. It is estimated that around 150+ companies in the BSE 500 index might have to dilute or sell shares to comply with this regulation. This includes CPSEs, Multinational Corporations (MNCs) and Indian Corporates. We believe that the MNCs would prefer to delist themselves instead of diluting their stake any further. As regards the Indian corporates, only a few large corporates would fall within this ambit. Ideally, minimum public shareholding should be left to the market forces rather than implementing it through a regulation.

Attracting Foreign Investment Continues to be in Focus

Budget also addressed certain long-awaited aspects relating to foreign investment norms, including a proposed common limit for FPI and FDI investments and merger of NRI-Portfolio Investment scheme route with the FPI route. In addition, there is a proposal to increase the FDI limit for certain sectors.

Sectors in Focus

Sector	Key Announcements
 Consumer and Retail	▪ Local sourcing norms to be eased for FDI in single brand retail, currently, they need to source 30% locally ***Potential Implications*** - Push for more single brand retailers to enter with lower sourcing norms
 Financial Services	▪ **Banks**: US$ 10 bn towards recapitalization of Public Sector Banks (PSBs) ***Potential Implications*** - Strengthening of balance sheet and boosting onward lending to give a strong impetus to the economy ▪ **NBFCs**: For purchase of high-rated pooled assets of financially sound NBFCs, amounting to a total of c. US$ 14 bn during the current financial year, the Government will provide a one-time 6 months' credit guarantee to PSBs towards a first loss of upto 10% ***Potential Implications*** - To provide liquidity to financially sound NBFCs

- **HFCs**: Return of authority to regulate HFCs from NHB to RBI

  Potential Implications

  - Currently NHB acts both as a refinancer and regulator; this move will ease the current mandate of NHB which is conflicting in nature

- **Insurance companies**: Relaxation in FDI norms, currently it is capped at 49%; further 100% FDI to be permitted for insurance intermediaries

  Potential Implications

  - Encourage participation and investment from foreign insurance players and to further deepen the Indian insurance market

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Aviation

- Government will take necessary steps to develop India as a hub for aircraft leasing and financing activities
- Government to adopt suitable policy interventions to create a congenial atmosphere for the development of Maintenance, Repair and Overhaul (MRO) industry in the country
- FDI limit in the sector to be reviewed, currently FDI is capped at 49%

  Potential Implications

  - Some of the domestic players are under-capitalized and would significantly benefit from foreign investment

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Electric Vehicles

- Strong focus on Electric Vehicles (EV), with planned outlay of US$ 1.4 bn for a period of 3 years
- Income tax exemptions to global companies for setting manufacturing of Solar storage batteries and charging infrastructure in India along with customs duty exempted on certain parts of electric vehicles

  Potential Implications

  - While the government has introduced sops to incentivize the consumer to switch to electric vehicles (EV) like proposal of GST reduction to 5% and tax deduction on interest paid on loan to buy EV, lack of supply side infra both in terms of manufacturing bases and charging stations would be a key drag on increasing EV adoption

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Start-ups

- Exemption from Angel Tax for start-ups and their investors who make appropriate disclosures (regarding investments)
- Central Board of Direct Taxes (CBDT) to come out with framework for redressal of grievances pertaining to pending assessments
- Exemption from Angel tax extended to investments made by category II AIF (Private Equity funds)
- Relaxation of conditions around carry forward and set off of losses in case of start-ups

Potential Implications

- The clarification would be extremely helpful in addressing the tax issues currently faced by start-ups
- Similar tax treatment amongst private equity & venture capital funds for investment in start-ups would be helpful for the industry given PE funds are now actively investing in early stage start-ups

Media & Gaming

Media

- FDI limit in the sector to be reviewed
- FDI in print media capped at 26%, news & current affairs broadcasters capped at 49% & non-news at 100%

Gaming

- FDI limit in the sector to be reviewed

Railways

- Proposal to use PPP for faster development and completion of tracks, rolling stock manufacturing and delivery of passenger freight services

Potential Implications

- Opportunity for the global companies to foray into the space

Affordable Housing

- Additional deduction of INR 150,000 (c. US$ 2,000), over and above the current interest deduction of INR 200,000 (c. US$ 3,000), for interest paid on loans borrowed up to 31st March, 2020 for purchase of an affordable house valued up to INR 45 lakhs (c. US$ 65,000)

Potential Implications

- Incentivizing purchase of affordable houses thereby providing further Impetus to the aim of achieving “Housing For All”

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