Capital League outlook

February, 2020

Indian Economy

- Real GDP growth for FY 20 is estimated at 4.6% and Nominal GDP growth at 7.3%, the lowest in 4 decades.
- PMI (Manufacturing) - rose from 52.7 in Dec to 55.3 in January, the highest in eight years.
- PMI (Services) rose from 53.3 in December to 55.5 in January, highest in 7 yrs.
- Fiscal deficit pegged at 3.8% for FY20 and 3.5% for FY21.
- CAD (Current Account Deficit) is comfortable at 0.9% of GDP vs 2.1% in FY19.
- Forex reserves at USD 467 Bn, are healthy and equal to a year's imports.
- Currency has remained nearly flat at ~71.5 in the last 12 months.
- Liquidity surplus is in excess of INR 3 Tn at present. This is high and adequate.
- Capital Markets – Inflows of ~ USD 8 Bn from DIIs and USD 9 Bn from FIIs in CY19.

Budget 2020 – Individual Tax Payer

- New tax slabs offer reduction in applicable tax rate from 20% to 10% and from 30% to 20% while forgoing all exemptions and deductions such as HRA, 80C Investments in PPF, ELSS and Insurance premium, School fees, Mediclaim, etc.
- Dividend Distribution Tax (DDT) has been withdrawn, and Dividend income shall now be taxable in the hands of the recipient for both shares and mutual funds.
- The Insurance coverage of Fixed Deposit in a bank has been increased from INR 1 Lac to INR 5 Lac.
- The Home Loan interest exemption limit of INR 1.5 Lacs for home loans sanctioned on and before 31^{st} March 2020 has been extended by 1 year to 31^{st} March 2021.

There are 5.87 cr tax payers in India. Budget changes have no impact on about 64% of them with annual income of 5 lacs. The balance 36% are better off with the old system if availing exemptions else they can opt for the new slabs with ease in return filing. For investors in higher tax brackets, growth option in debt and equity mutual funds will be preferable.

Budget Game Changers:

Foreign Investment – Opening the doors wider

- Tax holiday for infrastructure investments by Sovereign Wealth funds (SWFs) till end of 2024.
- Foreign Portfolio Investor (FPI) limits in corporate bonds increased from 9% to 15%. This should keep a cap on interest rates despite higher Fiscal Deficit and inflation.

- Opening up of specific government bond limits freely for Non-Resident Investors –a step in the right direction seemingly aimed at creating a roadmap for India's inclusion in the EM bond index.
- Removal of DDT – Biggest beneficiary of this will be MNCs as effective tax on dividend income received for their Promoter companies will come down from 20.6% to 10%, the applicable rate in Europe and US.

Privatization and Disinvestment

- Disinvestment target has been doubled to INR 2.1 Tn. This includes privatization of BPCL, Concor, Air India, full divestment of IDBI bank and listing of LIC.
- Decision to list LIC is a big one. LIC is India's largest company with a potential market capitalisation of INR 8-10 Lac Crs. This will help raise India's weight in global benchmarks. This has long term implications in terms of attracting funds into India.

Vivad Se Vishwas

- Amnesty scheme to allow Income Tax payers to settle dues/claims with waiver of penalty or interest on pending dues for cases which are under litigation.
- De-criminalization of Civil Offenses (CSR violations, non-filing of returns, etc.) by amending Companies Act.
- Taxpayers Charter to empower citizens and curb tax harassment.

Startups

- Tax holiday for Startups with turnover of up to INR 100 Crs (earlier INR 25 Crs) for three consecutive years within first 10 years (earlier 7 years).
- Startup employees/promoters will not pay tax on ESOPs until the earlier of five years from exercise, exit or disposal of shares.

Beneficial Tax Rate

- The Power Sector is now included under the beneficial Income Tax Rate of 15% introduced earlier for new Manufacturing companies.
- Co-operative Societies now included under 22% Corporate tax rate.
- Affordable Housing: Tax holiday for developers will be extended to projects approved upto 2021.

Infrastructure

- Development of highways to be accelerated including development of 2,500 Km access control highways, 9,000 Km of economic corridors, 2,000 Km of coastal and land port roads and 2,000 Km of strategic highways.
- Push for privatization & electrification in Railways. Over next few years 150 trains through public-private partnership (PPP) model and electrification of 11,000 tracks.
- Kisan Rail with refrigerated coaches to help farmers transport perishables.
- Solar power capacity to be set up alongside rail tracks, on land owned by Railways.
- 100 more airports to be developed by 2024 under UDAAN Scheme.

RBI Policy

- RBI held rates but took bold steps to push credit. It introduced long-term repo facility to lower cost of funds for banks and facilitate better transmission and eased CRR for debt to improve lending to home and car buyers and MSMEs.

Outlook

- Disinvestment and privatization of PSUs has long term advantages of improving efficiencies and productivity of capital and plugging the losses of the government.
- Fiscal discipline displayed by government (FY 20 at 3.8%, 50 bps above FRBM limit) is positive for bond markets and viewed well by international rating agencies.
- A sharp fall in crude oil prices (~10% in Jan'20) coupled with improved attractiveness of India as an investment destination augurs well for the Rupee.
- Measures to attract FDI and FIIs coupled with ease of doing business and a stable Rupee should create the necessary impetus for the investment cycle.
- This should not only lead to job creation but provide essential funding in a capital starved economy like India. If implemented efficiently, it shall make the target of USD 5 Tn economy more real.
- Improvement in GST collection, increase in PMI of both Manufacturing and Services along with pick up in Auto sales are some indicators of economic recovery. However, given low capacity utilisation the recovery is expected to be more U shaped rather than sharp V Shaped.
- Rural demand is expected to pick up with good monsoon leading to higher Rabi crop output, higher Agri prices globally and measures announced by the government for doubling Farm Incomes by FY22.
- Interest rates are expected to soften with better transmission of previous rate cuts.
- Corporate Earnings in 1st three quarters of FY20 grew by 5%, 8%, 8%. Profits are expected to normalize with improved credit availability, low inventories and low commodity prices. It is estimated that Corporate Earnings will grow by 21% in 4QFY20 leading to 9% growth in FY20 and estimated 28% in FY21.
- Inability to control spread of Coronavirus quickly can be a spoiler for global trade and growth and lead to a Risk-off trade in Financial markets.
- Equity markets gave polarized returns in 2019.

Indices	**CY19 Returns**
NIFTY 50	14.2%
NIFTY Midcap 100	-3.6%
NIFTY SmallCap 100	-9.8%

After 2 years of low stock market returns, 2020 and 2021 can surprise markets on the upside as mean reversion kicks in and confidence in broader markets manifests itself.