Capital League outlook

Jul, 2019

Budget Key Takeaways

- The government has adhered to fiscal prudence and hence macro stability with FY20 fiscal deficit projected at 3.3% of GDP. The final decision on RBI capital reserves is awaited and the momentum in actual disinvestment is also critical.
- The govt is expecting improved GST compliance. It is important that tax-to-GDP ratio increase substantially to enable higher spending on social and physical infrastructure.
- In FY13, petroleum subsidy outlay was INR 1 Tn. It has been rationalized to nearly one third and at the same time, the excise collection on fuel stands at INR 1.9 Tn, a part of which is directed towards Infrastructure Development.
- Tapping into the foreign savings was the key message and is likely to be the policy thrust. Given the large funding needs across sectors and limited domestic savings pool, we need to attract huge foreign capital and meaningful initiatives have been announced in this budget. These include simplification of KYC documentation, allowing FIIs in listed debt securities raised by REITs and InvITs, proposal for Dollar bonds by Sovereign, easing norms for FDI in sectors like Single Brand Retail, aviation and media, tax incentives for large manufacturing.
- The budget has laid out a vision to simplify the labor laws and re-look at the power sector issues.
- The budget announced an additional recapitalization of INR 770 Bn for the PSU banks via bonds which should spur credit growth. Moving regulation and supervision of HFCs from NHB to RBI is positive and should lead to greater confidence among investors. Given the size of HFCs and systemic importance, an asset quality review (AQR) is pertinent. The government providing a partial credit enhancement for PSU banks against their purchase of asset pools from NBFC/HFC could potentially provide a way to unlock their liquidity issues.
- The budget also announced additional interest subsidy on affordable housing loans for this fiscal year to enable the clearing of inventories in the real estate sector.
- Goods exports have stagnated for last seven years. Given the dependence on imported energy sources, India remains vulnerable to global energy prices. Electronics now account for nearly 20% of non-oil non-gold imports. The budget did resort to some import substitution measures (by raising import duties) and incentivized newage manufacturing like electric vehicles. Intentions were announced to develop tourism and attracting foreign students as a means to improve foreign receipts. Given the on-going US-China trade issues, India can use this opportunity to improve its participation in the global value chain.

- Measures such as TDS on higher cash withdrawal from banks will incentivize digital transactions.

Equity Markets

- The budget proposed increasing minimum public shareholding in listed companies from the current threshold of 25% to 35%. The budget also proposed relaxing the minimum threshold requirement of 51% Government ownership for a PSU by including stake of Government controlled entities. Both these measures, when implemented, have the potential to increase the supply of equities in the market. Equity market has reacted negatively to these proposals. On the positive side, increase in free float shall increase India's weight in global indices leading to higher FII flows.
- Imposing a tax of 20% on buyback of shares like Dividend Distribution Tax (DDT) also impacted the sentiments negatively.

Debt Markets

- The budget proposes to finance a part of the Govt borrowings through Dollar bonds which is a good move at a time when USD 1 Tn of Bonds globally are at negative yields. This measure is expected to take some pressure off the domestic liquidity and bring about more discipline on the dynamics of fiscal deficit.
- The Indian bond market had rallied significantly since Jun'19 with global developments tilting towards monetary easing. The 10-yr G sec yields have dropped from 7.03% to 6.39% as of yesterday.
- There could be some further upside from the interest rate cuts during the current financial year in an enabling environment.

Outlook

- Sensex has rallied by 8% YTD, in response to favorable election outcome and positive sentiments around emerging market equities in general. The revival in economic growth is likely to be gradual, given limited policy levers.
- Corporate earnings are recovering, led by financials, and should aid market performance. Earning for NIFTY is expected to grow by 20% in FY20. The pace and quantum of downgrades have moderated. Earnings growth would be critical especially for broader markets to move higher from these levels.
- Current valuations command premium and there appears limited scope for rerating. In P/E terms, NIFTY is trading near 19.2x FY20(E) and 16.3x FY21(E).
- It is recommended to maintain asset allocation and continue to add in a staggered manner.
- On the fixed income side, though long term funds have delivered superior returns in the near term, conservative investors should stick to investment in short/medium term funds and good quality corporate fixed deposits.