BUDGET 2018

Review and Impact of The Union Budget on Equity Market & Debt Market

The Union Budget 2018 was presented by the Finance Minister Arun Jaitley in the backdrop of a strong stock market rally in 2017, elevated equity valuations, rising crude oil and rising bond yields and an expanding current account deficit. The Union Budget this year has a populist stance, given the upcoming state and General elections in the next 9-12 months. The budget has doled out a series of measures for alleviating farmer distress and boosting the rural economy and ongoing support for broader Infrastructure development.

The Finance Minister has walked a tight rope in managing the Fiscal deficit with a modest deviation of the fiscal deficit target to 3.5% from projected 3.2% of GDP for FY 18 & further expected consolidation in FY 19 to 3.3% of GDP, while not compromising on Agri-Rural development and Affordable Housing. He has focused on five key themes to Transform and Energize the Farmer, Rural India and MSMEs while addressing Education, Healthcare and Social sector reforms. The introduction of the LTCG Tax on Equity and Equity Mutual Funds dampens investor sentiment in the short term, however, a renewed commitment to fiscal prudence and increasing the effectiveness of tax administration bodes well for India's economic growth over the long term.

Key Highlights

Agriculture and Farmers Welfare

- Committed to double the farm income by 2022
- MSP for kharif crops raised to 1.5 times of the cost of production.
- Total Agriculture related budgetary outlay pegged at Rs. 63,836 Crs.
- Extend kisan credit card to fisheries & animal husbandry farmers and allocate Rs 10,000 cr for fisheries & aquaculture, animal husbandry farmers and dairy processing.
- Institutional credit to agriculture raised to Rs. 11 Lakh Crs and new mechanism for lessee cultivators to access credit.

Rural Development

- Allocation of Rs. 14.34 Lakh Crs for rural infrastructure and livelihoods.
- Rs. 2,600 Crs allocation under Krishi Sichai Yojana to boost farm irrigation.
- National Housing Bank to set up affordable housing fund.
- Allocation of Rs. 5,750 Crs for National Rural Livelihood Mission.

Health, Education and Social Protection

- Outlay for health, education and social protection at Rs. 1.38 Lakh Crs
- National Health Protection Scheme to cover 10 Crs low income families by providing coverage upto Rs. 5 Lakhs per family per year for secondary and tertiary healthcare.
- Allocation of Rs. 52,719 Crs for advancement of Schedule Caste and Rs. 39,135 Crs for Schedule Tribe

MSME

- Allocation of Rs. 3794 Crs for MSME sector for credit support, subsidies and innovation.
- Corporate Tax rate of 25% applicable for SMEs with turnover less than Rs. 250 Crs.

Infrastructure

- Overall infrastructure outlay increased to Rs. 5.97 Lakh Crs.
- Allocation of Rs. 2.04 Lakh Crs for Smart Cities and Amrut Urbanization Program
- Rs. 5.35 Lakh Crs. allocation for Bharatmala Pariyojana for road infrastructure.
- Rs. 11000 Crs for Mumbai city and Rs. 17000 Crs for Bangaluru city suburban transport system.
- Rs. 10000 Crs allocation for upgrading telecom infrastructure and Rs. 3073 Crs for Digital India Program

Financial Sector and Tax policies

- Government and Regulators to initiate select CPSE assets disinvestments through INVITS route and aims to collect Rs. 80,000 Crores.
- RBI and SEBI to nudge corporates to leverage the bond markets for about 1/4th their financing needs.
- For senior citizens
  - Interest income with banks and post office deposits upto Rs. 50000 exempted from TDS u/s 194A
  - Medical Premium paid upto Rs. 50000 will be exempted u/s 80D
  - Medical expenditure for critical illness will be Rs. 1 Lakh for all senior citizen.
  - Investments under Pradhan Mantri Vay Vandana Yojana for senior citizen upto Rs. 15 Lakhs.
- Standard deduction increased to Rs. 40000 in lieu of transport allowance and medical reimbursement.
- 100% deduction to farmer producer companies with annual turnover upto Rs. 100 Crs in respect of profits derived from agri activities. Applicable for 5 years from 2018-19.

- LTCG exceeding Rs. 1 Lakh to be taxed at 10% (without indexation). All gains before Jan 31, 2018 will be grandfathered.
- Health and Education Cess to be increased to 4% on personal income tax and corporate tax.
- Personal Income Tax slabs are kept unchanged.

Prudent Fiscal Management

- Fiscal deficit for year 2018-19 projected at 3.3% of GDP
- Government to adopt the FRBM Committee's debt rule and bring down central Government's Debt to GDP ratio to 40%
- Government to use fiscal deficit target as key operational parameter and necessary amendments included in the finance bill.

Equity Market Views and Impact of The Union Budget 2018

The Union budget 2018 has a distinct focus on providing a fillip to agriculture, affordable housing, infrastructure and rural development and various social sector programs. The overall stance in this budget is populist (with the upcoming General elections in 2019), however the budget makes a serious attempt to address the farmer distress across the country and continue with last year's thrust on infrastructure and social sector programs. This is expected to spur rural employment and rural incomes over the next few quarters and these programs may bode well for companies with a rural orientation and capital markets in general.

As such these budget announcements are positive for industrial companies linked to infrastructure, power, cement, building materials, roads, railway projects and construction activities. Companies linked to agriculture, farm irrigation and sanitation are expected to garner fresh projects on the back on the budgetary allocations. Agriculture based companies in sectors such as seeds, fertilizers, insecticides / pesticides, irrigation, food and dairy processing and aquaculture would be favorably impacted with the budgetary announcements.

Further, Housing finance, Affordable Housing and Cement companies are expected to benefit further from the robust demand scenario and continued expansion of affordable housing and rural development projects. These trends could also provide a spill-over effect onto auto and auto-ancillary firms that can benefit from expected growth in rural / farmer incomes over the next few quarters.

Companies linked to Road Infrastructure projects, rural electrification and solar projects are expected to be direct beneficiaries of the budgetary outlays. The Budgetary allocations to Digital India initiatives and investments in high speed broadband access for rural India provides a demand boost for fiber-optic cable companies. The Reduced tax rate of 25% for MSME companies with turnover less than INR 250 Crores is expected to give a fillip to resurrect growth in this sector and boost agriculture and food processing exports. Textiles sector has also been an important beneficiary and may help to strengthen the textile exports sector

Overall, the Finance Minister has taken a slightly populist approach (given the upcoming General elections in 2019) to appease the farmers and senior citizens while making meaningful allocations for Health, Education and Social sector programs.

At this point, equity markets are fairly valued and provides a good investment opportunity for patient long term equity investors to capture future potential upside. Any near-term market volatility due to global or local events would only provide potential investment opportunities.

However, the LTCG tax announced for equity and equity mutual fund investors dampens the current sentiment.

Debt Market Views and Impact of The Union Budget 2018

The RE of Fiscal Deficit for FY 18 at 3.5% was higher than our and market expectations. However the budgeted Fiscal deficit for FY19 at 3.3% is as per market expectations. The Revenue Deficit at 2.6% (RE for FY 18) is higher than BE of 1.9% which shows a decline in the quality of overall deficit. The Gross borrowing through dated gsecs for FY 19 at Rs 6.06 lakh cr is similar to the revised gross borrowing no of Rs 6.00 lakh cr for FY 18. The net borrowing including buyback is at Rs 4.62 lakh crore as compared to Rs 4.6 lakh crore in FY 18 (RE). The borrowing through short term T bills is budgeted at a far lower number of Rs 17000 cr compared to Rs 77,469 cr for FY 18 (RE). The government seems confident of meeting its target of Rs 1 lakh crore under small savings schemes for FY 18. For FY 19 the target is pegged lower at 75000 cr presumably as small savings rates are being rationalized and collections are expected to dip.

Overall while the budget numbers seem more or less in line with market expectations, yields have still moved up sharply post Budget in the debt market due to worsening quality of slippage. The ten yr benchmark gilt is trading 15 bps higher. Markets may also be fearing rate hike and RBI to sound more caution due to the fiscal slippage. We feel the negatives of the Budget seem factored into the yields at these levels as we expect RBI to remain on pause in near term. Further rise in US Treasury yields can be a negative for bond markets. Banking system Liquidity is more or less expected to remain at neutral till March. Over past few months Portfolio Gross YTMs of most debt funds have gone up as markets have been repricing to new reality. Investors can look to make a balanced allocation to Low Duration, Short Term and Dynamic Bond Funds.

Our View on Specific Sectors

Sector	Impact
Autos	Positive; Rural –driven demand could see improvement – tractors, 2-wheelers mainly and rural component of car sales
Agri and Food Processing	Positive; select companies in Dairy Farming and agri food processing to benefit from the increased allocation.
Building Materials, Cement and Construction	Positive; demand fillip from the focus on infrastructure, irrigation and affordable housing
Capital Goods	Neutral; Select companies to benefit in transportation/logistics space due to increased outlay
Infrastructure – Roads and Railways	• Good demand boost given the huge Government focus and outlays for road infrastructure and toll road companies. • Rural electrification and fiber optic companies to benefit.
Banks and Financials	Neutral; Banks should gain from growing interest income as corporates shift their borrowings to banks from money markets; however, they would continue to have stress on GSec books.
FMCG and Consumer Discretionary	Positive benefit expected from potential demand boost with growing rural income, continuing urban consumption.
Pharmaceuticals	Neutral in near term but positive in long term

Principal® Mutual Funds