Union Budget FY18-19

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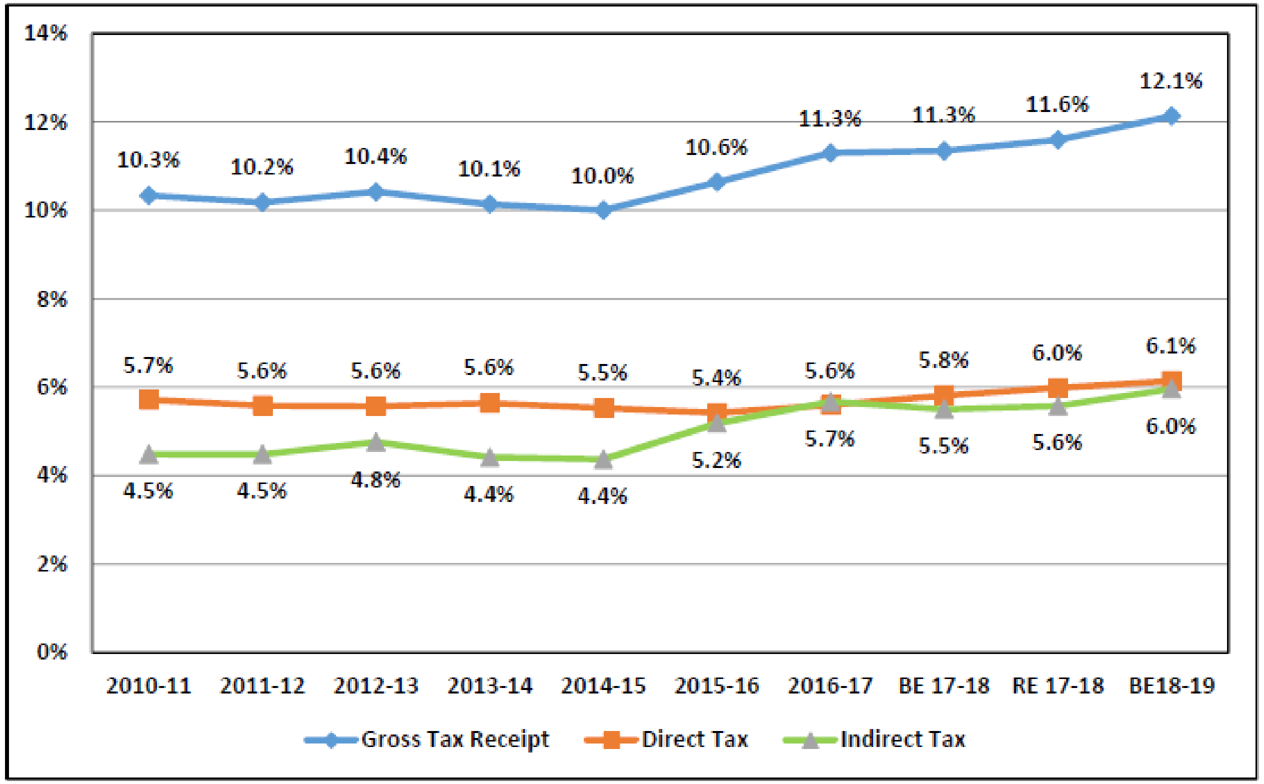
Budget Highlights – Tax to GDP to rise to 12.1%

- **Balanced budget with Rural & Infra push:**

Focus on sectors like agriculture, rural development, infrastructure, healthcare and education.

  - The govt. proposes to hike Minimum Support Price (MSP) to 1.5X of the cost of produce, to help aid its vision of doubling farmer's income by 2022.
  - Strengthening of e-National Agri Markets and Agri Market Infrastructure Fund of Rs. 2,000 crs
  - Corpus for food processing sector allocation doubled to 1,400cr; Funds with corpus of Rs10,000cr for fisheries and animal husbandry sector
  - Railway Capex to increase by 22% to Rs. 1.48 lac crs to strengthen rail network.
  - Road Capex to increase by 10% to 1.21 lac crs to boost road infrastructure.

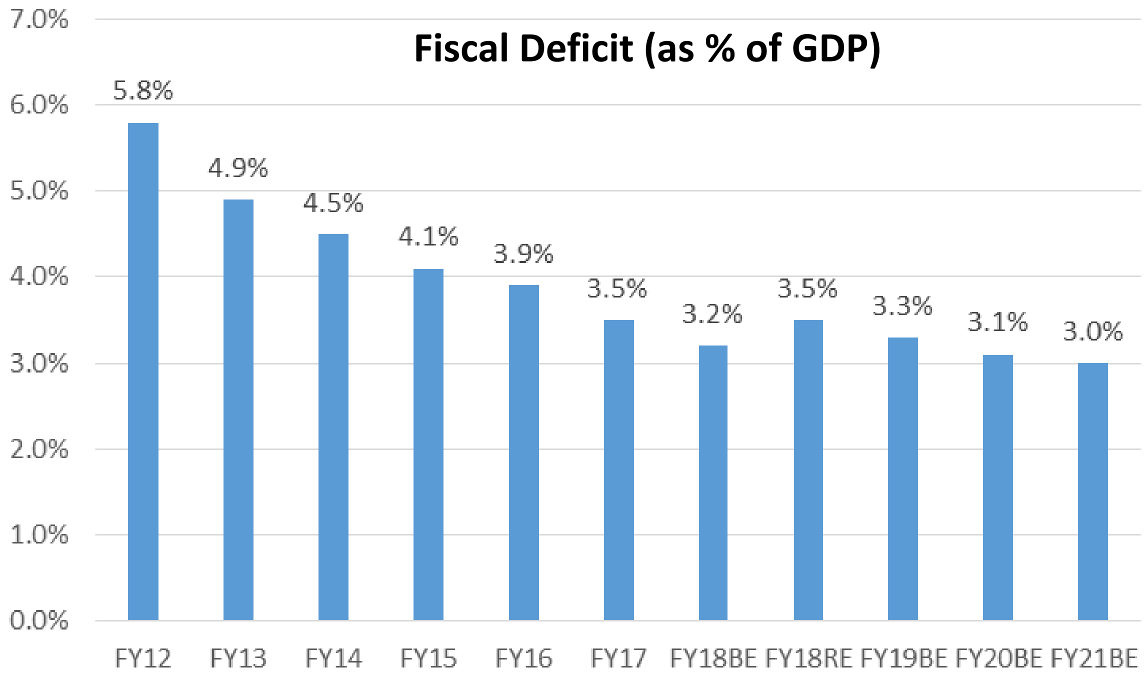


Source: Budget Documents

- **Tax Buoyancy continues:** Gross tax revenue likely to be up by 16.7% in FY19BE compared to 13.4% in FY18BE. Tax to GDP ratio to rise to 12.1% in FY19 versus 11.6% in FY18.

Budget Highlights - Fiscal deficit and LTCG has been a disappointment

- **Fiscal deficit target for FY19 came in slightly higher than expectations at 3.3% (market expectation of 3.2%)**
  - Fiscal deficit for FY18 has been revised to 3.5% of GDP from 3.2% budgeted earlier, which is in line with expectations due to lower dividend from RBI and GST collection.
  - As per the fiscal consolidation roadmap, the 3% target has been postponed by a couple of years and is now estimated to be achieved in FY21.



Source: Budget Documents

- **LTCG tax on equities makes a comeback**
  - 10% tax on Long-term Capital Gains (LTCG) greater than Rs 1 lakh for equities
  - and equity-oriented funds. However, grand-fathering clause is helpful
  - Dividend distribution tax of 10% introduced for equity oriented funds.
  - Insurance product is covered under Section 10 (10D) (maturity proceeds and partial withdrawals are tax exempt, if insurance cover is more than 10x of premium)*,

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* For taxation related matter you may refer to your tax adviser

Budget Highlights (contd.)

- **Ambitious National Health Protection Scheme:** To cover 10 crore poor families, and will provide health coverage of Rs. 5 lakhs per family per year, in case of hospitalization. Heralded by the Finance Minister as the world's largest govt. funded healthcare program.

- Changing regulatory landscape in India to permit **'A' grade** ratings as eligible for investments from the current 'AA' grade ratings

- **Corporate tax rate is cut to 25%** for Small & Medium term enterprises (SMEs) upto 250cr turnover**:** This is a positive, as it is an important segment of economy. The lower corporate income tax rate for 99% of the companies (filing their returns) will leave them with higher investible surplus which in turn will create more jobs.

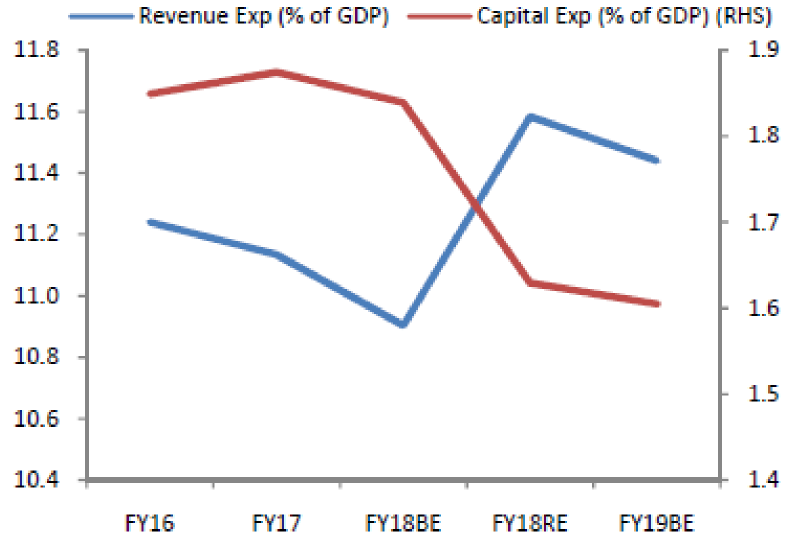
- **4% Education & Health Cess to replace 3% Education Cess:** Will have marginal impact on corporate and personal taxes, which is expected to increase govt. revenue by Rs. 11,000 crs.

Budget at a Glance– Nominal GDP to grow at 11.5%

Budget at a glance	(INR in Bln)				YoY Growth (in %)		
	FY17	FY18BE	FY18RE	FY19BE	FY18BE	FY18RE	FY19BE
Revenue receipts	**13,742**	**15,158**	**15,054**	**17,257**	**10.3**	**9.5**	**14.6**
Net Tax Revenue	11,014	12,270	12,695	14,806	11.4	15.3	16.6
Non Tax Revenue	2,728	2,888	2,360	2,451	5.9	(13.5)	3.9
Capital Receipts	**6,010**	**6,310**	**7,123**	**7,165**	**5.0**	**18.5**	**0.6**
Recovery of loans	176	119	175	122	(32.4)	(0.6)	(30.3)
Other Receipts	477	725	1,000	800	52.0	109.6	(20.0)
Borrowings & other liabilities	5,356	5,465	5,948	6,243	2.0	11.1	5.0
Total Receipts	**19,752**	**21,467**	**22,178**	**24,422**	**8.7**	**12.3**	**10.1**
Total Revenue Expenditure	16,906	18,369	19,443	21,418	8.7	15.0	10.2
Total Capital Expenditure	2,846	3,098	2,734	3,004	8.9	(3.9)	9.9
Total Expenditure	**19,752**	**21,467**	**22,178**	**24,422**	**8.7**	**12.3**	**10.1**
Fiscal Deficit	**5,356**	**5,465**	**5,948**	**6,243**	**2.0**	**11.1**	**5.0**
Nominal GDP	151,837	168,475	167,847	187,223	11.0	10.5	11.5
Fiscal Deficit (% of GDP)	**3.5**	**3.2**	**3.5**	**3.3**			
Gross Market Borrowing	**5,830**	**5,800**	**5,990**	**6,055**	**(0.5)**	**2.7**	**1.1**
Net Market Borrowing	**4,082**	**4,232**	**4,594**	**4,621**	**3.7**	**12.5**	**0.6**

Source: Budget Documents

Revenue & Capital Exp. Trend (as % of GDP)



Source: Philip Capital

Nominal GDP growth at 11.5% in FY19BE seems realistic, when compared to 10.5% growth in FY18RE

- Revenue receipts expected to grow faster in FY19, due to pick in tax revenue, as GST woes are behind
- **Capital expenditure is likely to pick up**: capital exp to pick up to 9.9% in FY19 vs decline of 3.9% in FY18.
- **Divestment target** overachieved in FY18 (RE of Rs. 1 lakh crore) and budgeted at Rs. 80,000 crore in FY19, which is prudent
- Gross & Net market borrowing rising marginally in FY19BE YoY. As a % of GDP, net borrowing falling from 2.7% in FY18RE to 2.5% in FY19BE.

Major Expenditure - Interest expenditure is 24% of total spending

Major Expenditure	INR Bn				YOY Growth in %		
	FY17	FY18BE	FY18RE	FY19BE	FY18BE	FY18RE	FY19BE
Interest	4,807	5,231	5,308	5,758	8.8%	10.4%	8.5%
Subsidy	2,348	2,729	2,641	2,928	16.2%	12.5%	10.9%
Defence	2,518	2,624	2,671	2,827	4.2%	6.1%	5.8%
Pension	1,314	1,312	1,474	1,685	-0.2%	12.2%	14.3%
Rural Development	1,139	1,286	1,356	1,381	12.9%	19.1%	1.8%
Transport	1,022	1,244	1,071	1,346	21.7%	4.8%	25.7%
Major Expenditure	**13,148**	**14,426**	**14,521**	**15,925**	9.7%	10.4%	9.7%
Total Expenditures	**19,752**	**21,470**	**22,180**	**24,420**	**8.7%**	**12.3%**	**10.1%**
Major Expenditure % of total	**66.6%**	**67.2%**	**65.5%**	**65.2%**			
Interest % of total exp.	**24.3%**	**24.4%**	**23.9%**	**23.6%**			

Source: Budget Documents

- Interest expense continue to account of major expenditure for government at 23.6% of total expenditure.
- Transport expenditure to increase sharply by 25.7% in FY19, led by Railway and Road.

Overall Tax Revenue Assumptions Seem Realistic, even though GST growth estimates are high

Gross Tax Components	(INR in Bln)				YoY Growth (in %)		
	FY17	FY18BE	FY18RE	FY19BE	FY18BE	FY18RE	FY19BE
Gross Tax Revenue	**17,158**	**19,116**	**19,461**	**22,712**	**11.4**	**13.4**	**16.7**
Direct Tax	**8,495**	**9,800**	**10,050**	**11,500**	**15.4**	**18.3**	**14.4**
Personal Income Tax	3,646	4,413	4,413	5,290	21.0	21.0	19.9
Corporate Tax	4,849	5,387	5,637	6,210	11.1	16.3	10.2
Indirect tax	**8,620**	**9,269**	**9,364**	**11,160**	**7.5**	**8.6**	**19.2**
GST			4,446	7,439			67.3
Excise Duty	3,821	4,069	2,770	2,596	6.5	(27.5)	(6.3)
Customs Duty	2,254	2,450	1,352	1,125	8.7	(40.0)	(16.8)
Service Tax	2,545	2,750	795		8.1	(68.8)	

Source: Budget Documents

- Personal income tax expected to grow 20% as there was no relief this time
- Corporate tax rate grow at 10% is realistic as Earnings are recovering
- Indirect tax growth seems optimistic at 19.2% in FY19BE versus 8.6% in FY18RE— primarily to large pick-up expected in GST collections.
  - ✓ GST projected to grow at an optimistic 67.3% in FY19RE, due to widening of tax base, and better tracking of GST collections

MSP Hikes to be inflationary, subsidy as % of GDP remain stable

Break-up of Subsidies	(INR in Bln)				YoY Growth (in %)		
	FY17	FY18BE	FY18RE	FY19BE	FY18BE	FY18RE	FY19BE
Subsidy	**2,348**	**2,729**	**2,641**	**2,928**	**16.2**	**12.5**	**10.9**
Food	1,102	1,453	1,403	1,693	31.9	27.3	20.7
Fertilizer	663	700	650	701	5.6	(2.0)	7.8
Petroleum	275	250	245	249	(9.1)	(10.9)	1.6
Nominal GDP	151,837	168,475	167,847	187,223	11.0	10.5	11.5
Subsidy bill (as % of GDP)	**1.5**	**1.6**	**1.6**	**1.6**			

Source: Budget Documents

- The govt. proposes to hike Minimum Support Price (MSP) to 1.5X of the cost of produce, to help aid its vision of doubling farmer's income by 2022.
- This could be inflationary in nature and could have ~25 to ~35bps impact on CPI.
- Food subsidy allocation increased by 21% for FY19 (on account for MSP hikes).
- Overall subsidy bill to remain at 1.6% of GDP in FY18RE and FY19BE.

Infrastructure and Rural Thrust in this budget

Infrastructure Outlay of Key Ministries / Departments			
Ministry wise	INR in bln		YoY (in %)
	FY18	FY19BE	FY19BE
Railways	1,200	1,465	22%
Road Transport and Highways	1,101	1,214	10%
Defense	915	996	9%
Power	662	557	-16%
Housing & Urban infra	390	614	57%
Communication & Information Technology	236	319	35%

Source: Budget Documents

Allocation to Key Rural Schemes

Rsbn	FY17	FY18RE	FY19BE	% YoY, FY18RE	% YoY, FY19BE
Food subsidy	1,102	1,403	1,693	27.3	20.7
Rural employment guarantee	482	550	550	14.1	0.0
Rural road construction scheme	179	169	190	(5.7)	12.4
National rural livelihood mission	32	44	58	37.8	32.2
PMAY Rural	161	230	210	43.1	(8.7)
Other rural development missions	97	98	117	0.9	19.0
National rural drinking water mission*	165	240	224	45.7	(6.9)
Power for All-rural	-	16	28	NA	77.4
Health insurance scheme	5	5	20	1.1	325.1
Total rural expenditure	2,222	2,754	3,088	23.9	12.2

Source: CLSA, Budget Documents. * Includes Swachh Bharat Rural Allocation

Out lay on infra by some of the sectors is growing at good pace

- ✓ Railways infra capex to grow 22.1% in FY19RE towards strengthening railway network
- ✓ Road infra capex to grow 10.3% in FY19BE. A total of 35,000 kms to be completed under Bharatmala scheme in Phase 1.
- ✓ Other key major capex changes from :
  - ✓ Defense capex to grow 9%
  - ✓ Communication & Information Technology capex to grow at 35%
  - ✓ Power capex to reduce by 16%, mainly on account of reduction in off balance sheet capex (ie. PSU led capex)

Rural expenditure under key schemes to increase by 12.2% in FY19BE

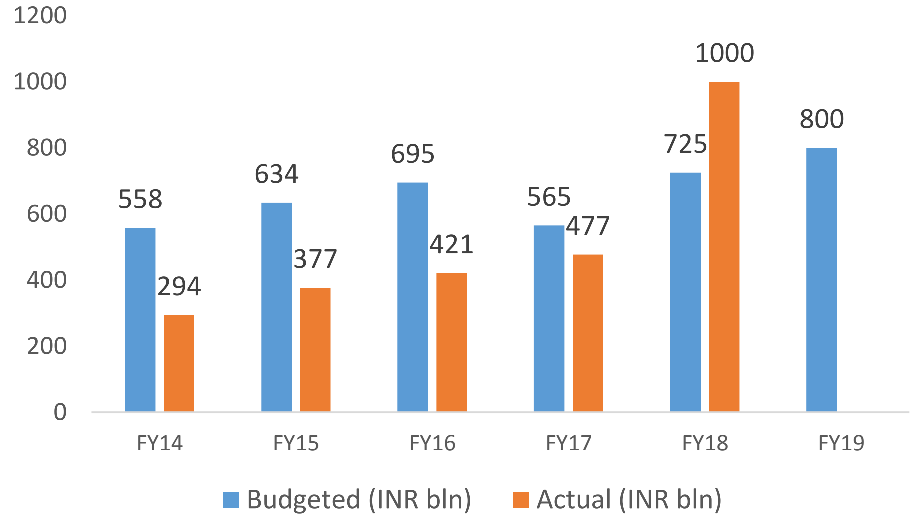
- ✓ MNREGA (Rural employment guarantee scheme) sees same budget allocation of Rs. 550 bln in FY19, as last year
- ✓ For the landmark National Health Protection Scheme a budgetary allocation of only Rs. 20 bln made in FY19BE, as implementation will take some time. Centre and state's share will be ~*60:40* for the scheme

Divestment revenues will depend on market conditions; telecom revenue optimistic

Non Tax Revenue & Capital Receipts Break-up							
	(INR in Bln)				YoY Growth (in %)		
	FY17	FY18BE	FY18RE	FY19BE	FY18BE	FY18RE	FY19BE
Disinvestment	**400**	**465**	**1,000**	**800**	**16.3**	**150.0**	**(20.0)**
Strategic	55	260	-	-	372.7	(100.0)	
Telecom	**787**	**443**	**307**	**487**	**(43.7)**	**(61.0)**	**58.6**
Dividends	**1,230**	**1,424**	**1,064**	**1,073**	**15.8**	**(13.5)**	**0.8**
Public Sector Enterprises	519	675	548	525	30.1	5.6	(4.2)
RBI	712	749	516	548	5.2	(27.5)	6.2

Source: Budget Documents

Divestment Trend (Budgeted Vs Actual)



Source: Budget Documents

- Historically, the govt. has mostly underachieved its divestment target. For FY18 the govt. has overachieved its divestment target and expected to raise a record Rs. 1000 bln in FY18RE. Innovative measures like the ONCG-HPCL deal and Bharat 22 ETF was used in FY18.
  - ✓ For FY19 divestment has been targeted at Rs.800 bln, which will largely depend on market conditions. It doesn't include the Air India divestment yet, and govt. also plans to merge 3 general insurance companies, and list them subsequently.
- Dividend income expected to rise marginally in FY19BE after contracting in FY18RE; increased dividend from RBI to be the major contributor.
- Telecom revenue had fallen by 61% in FY18RE, due to lower spectrum auction collections. But for FY19 it is expected to grow a robust 59%, which seems optimistic.

Budget Outlook & Recap

- The budget is expected to increase **food inflation** (due to MSP hikes), and this may make the **RBI cautious**.
  - Bond yields are pricing most of negatives, with a low possibility of a rate hike in 1HFY19.
  - Global bond yields have also hardened substantially over the past month.
- On the positive side, the **net market borrowing** figure has only risen marginally—broadly in-line with estimates.
- Fiscal deficit slippage **may weigh on other rating major's (like S&P and Fitch) decision to upgrade India's sovereign rating**.
- LTCG may weigh on equity market sentiments for some time. Going forward, the equity markets will soon digest the budget, and move on to the **key factor, i.e. Corporate Earning growth**.
- We feel that the worst of the corporate earnings growth is behind us, and expect earnings to pick up in H2FY18 and FY19, with earlier dragging sectors like pharma, IT and PSU banks contributing to the bounce-back.
  - Results so far for Q3 FY18 have been broadly in line with expectations, reaffirming that the earnings trajectory is on a recovery path.
- The policyholders of **life insurance companies will continue to enjoy the same tax regime** as earlier, given that Insurance investors are holding for a minimum of five years and life insurance policies are covered under section 10 (10D) .

THANK YOU

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