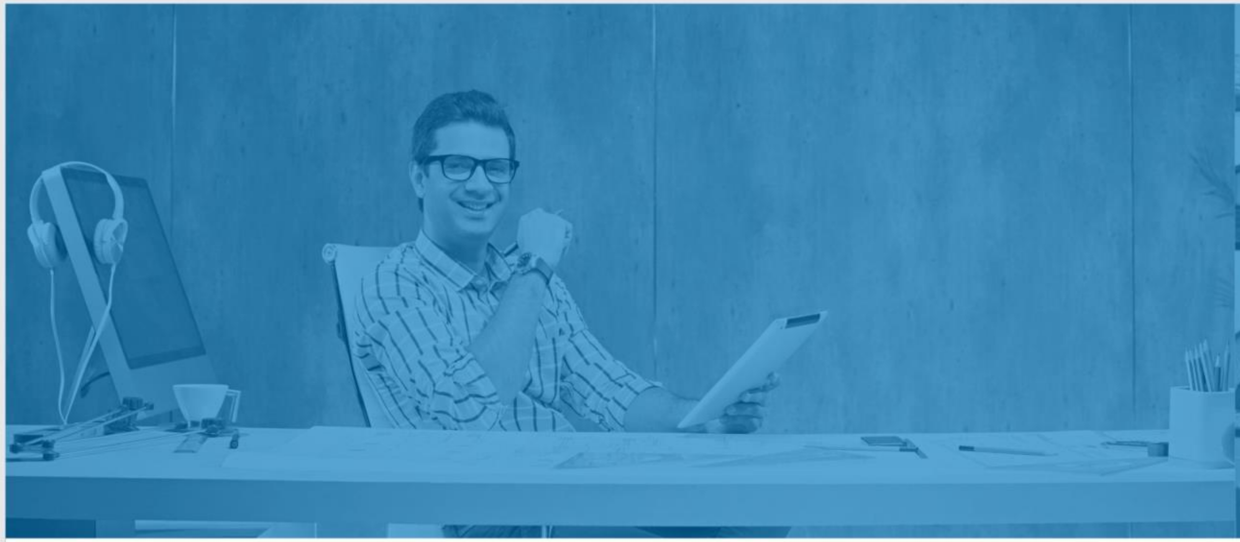
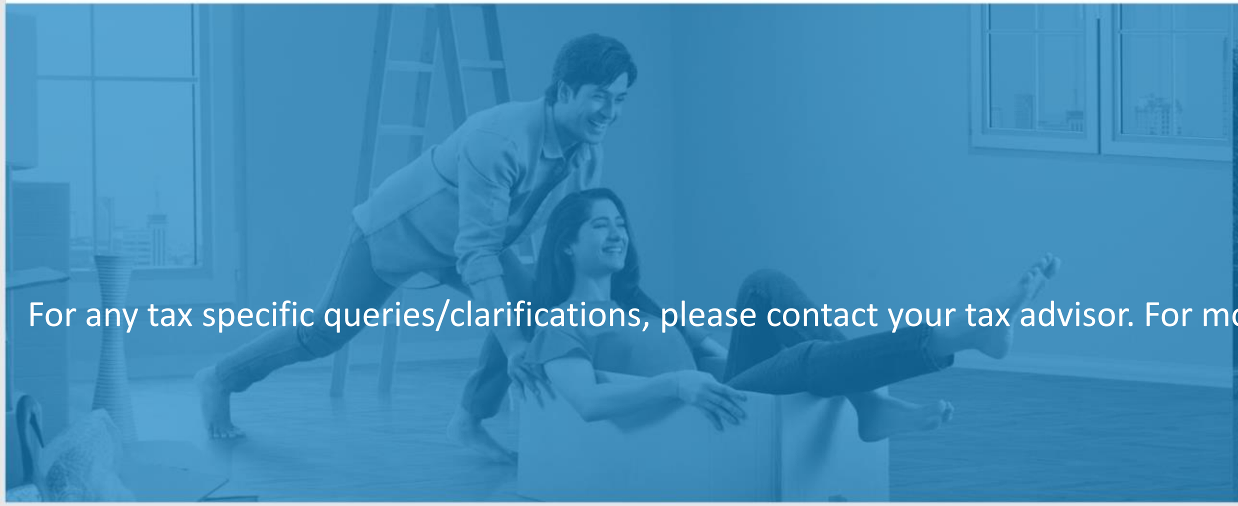
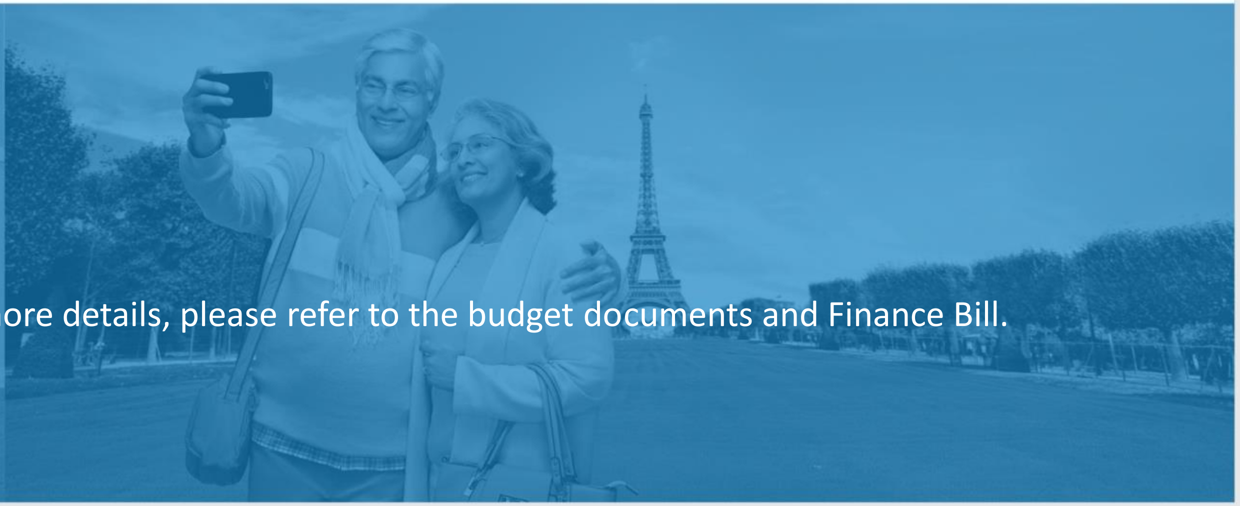


# De-coding Union Budget FY19-20

LIFE GOALS. **DONE.**

BAJAJ | Allianz





For any tax specific queries/clarifications, please contact your tax advisor. For more details, please refer to the budget documents and Finance Bill.

# Budget Highlights – A balanced and forward-looking budget; focus to now turn on execution

- **The budget focused on segments like digital economy, infrastructure and electronic vehicles (EVs)**
- **For digital economy,** the govt. wants to promote digital economy & cash-less transactions.
  - Imposed 2% TDS on cash withdrawals above Rs 1 crore per year from a bank account
  - No transaction costs or merchant discount rate on various digital modes of payment will be imposed
  - Proposed pre-filled tax returns from various income sources, which will boost the tax compliance and ease the paper work on tax payers
- Numerous measures announced to promote **electronic vehicles (EVs)**
  - GST rate on EVs to be lowered to 5% from 12%, which is significant given that two wheelers and small cars are taxed at GST of 28%.
  - Tax deduction of Rs 1.5 lakhs per year on interest paid on loans taken to purchase EVs
  - Budgetary support for FAME (Faster adoption & manufacturing of electric vehicles) scheme has been announced at Rs 10,000 crore
- Push to **infrastructure sector** continues
  - Govt. intends to provide Rs. 100 lakh crore over the next 5 years, which may help to revive the investment cycle
  - Imposed additional cess of Rs. 1/litre on petrol and diesel, to fund infra and road sector. Also excise duty on petrol/diesel hiked by Rs. 1/litre.
  - A new integrated water ministry to be formed, for supply of water to all rural households by 2024, under the 'Har Ghar Jal' scheme.
- **On taxation front:**
  - Govt. has extended lower corporate tax rate of 25% for companies having annual turnover upto Rs. 400 crore (compared to Rs. 250 crore before)
  - Sharp increase in surcharge on high net worth individuals earnings more than Rs. 2 crores- thereby increasing the effective tax rate
  - Additional deduction of Rs. 1.5 lakhs for interest on housing loans has been allowed (total deduction of Rs. 3.5 lakhs) for loans availed by 31st March 2020, for housing units costing not more than Rs. 45 lakhs.
  - Customs & excise duty increased on various commodities. Customs duty on gold increased to 12.5% (from 10.5%), on split A/Cs to 20% (from 10%).

# Budget Highlights – Contd..

- **<u>From a market perspective:</u>**
  - ➢ Govt's proposal to increase the minimum free float (public shareholding) limit from 25% to 35%, can lead to an increase in supply of equity paper in the markets. It remains to be seen what time frame SEBI allows to implement this.
  - ➢ On the positive side, the govt. has maintained fiscal discipline, and retained the market borrowing targets for FY20, budgeted in the interim budget.
  - ➢ The govt. plans to raise foreign money via foreign currency-denominated sovereign bonds, thus putting less pressure on local market borrowings.
  - ➢ Disinvestment target increased to Rs. 1.05 lakh crore (from Rs. 90,000 crore in interim budget), and the govt. also intends to do strategic sale.
  - ➢ Examine opening up of FDI in aviation, media (animation) and insurance sectors, and hike FDI limit to 100% for insurance intermediaries. This may help to provide more capital and help in better insurance penetration.
  - ➢ Tax of 20% imposed on buy-back shares of listed companies, thus plugging the tax arbitrage.

- **<u>Banking & financial sector reforms:</u>**
  - ➢ PSU bank recapitalization of Rs. 70,000 crore has been provided (which is above expectations).
  - ➢ To address the stress in NBFC sector, provide one-time six-month partial credit guarantee to PSU banks for first loss up to 10%, for the purchase of pooled assets of NBFCs amounting to a total of Rs 1 lakh crore.
  - ➢ Subsequent to the above, the RBI provided additional liquidity support of Rs.1.34 lakh crore to banks for purchase of assets from NBFC /HFCs.
  - ➢ Proposed the regulator for housing finance companies (HFCs) to be changed to RBI from National Housing Bank (NHB) so that one regulator can oversee entire lending services.

# Surcharge increased considerably on HNIs & Super-Rich, and comes as a surprise

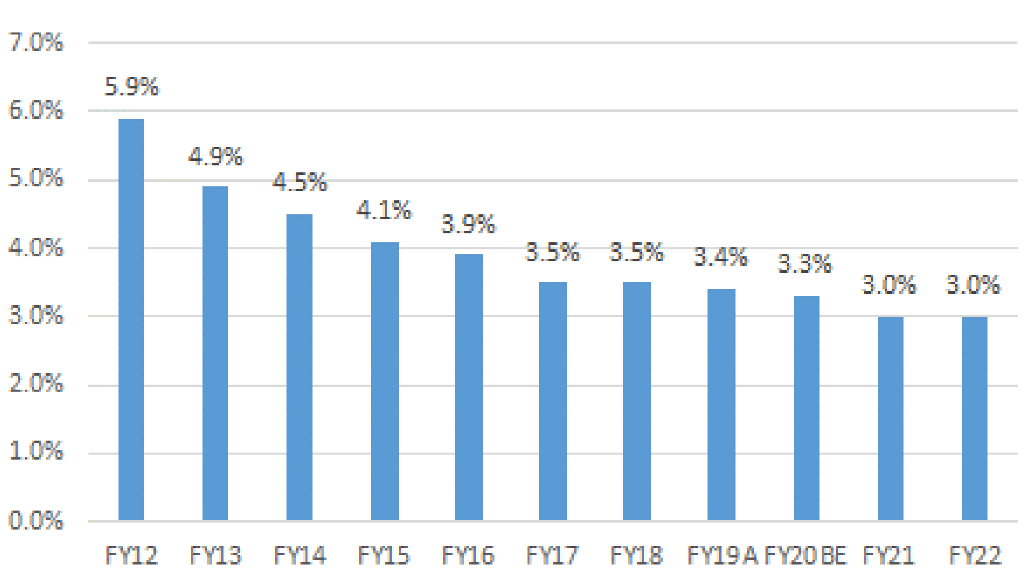
| | FY2019 | FY2020 |
|---|---|---|
| Individual tax rates | Up to Rs250,000 - Nil | Up to Rs250,000 - Nil |
| | Above Rs250,000 - Rs500,000 - 5% | Above Rs250,000 - Rs500,000 - 5% |
| | Above Rs500,000 - Rs1,000,000 - 20% | Above Rs500,000 - Rs1,000,000 - 20% |
| | Above Rs1,000,000 - 30% | Above Rs1,000,000 - 30% |
| Senior citizen (60 years) | Exemption limit - Rs300,000 | Exemption limit - Rs300,000 |
| Very senior citizen (80 years+) | Exemption limit - Rs500,000 | Exemption limit - Rs500,000 |
| Surcharge | 10% on income between Rs5 mn and Rs10 mn | 10% on income between Rs5 mn and Rs10 mn |
| | 15% on income exceeding Rs10 mn | 15% on income between Rs10 mn and Rs20 mn |
| | | 25% on income between Rs20 mn and Rs50 mn |
| | | 37% on income above Rs50 mn |
| Cess | 4% (health and education cess) | 4% (health and education cess) |

Source: Kotak Institutional Equities, Budget documents. **Individuals earning upto Rs 5 lakhs are subject to full tax rebate, and exempt from income tax, as announced in Interim Budget**

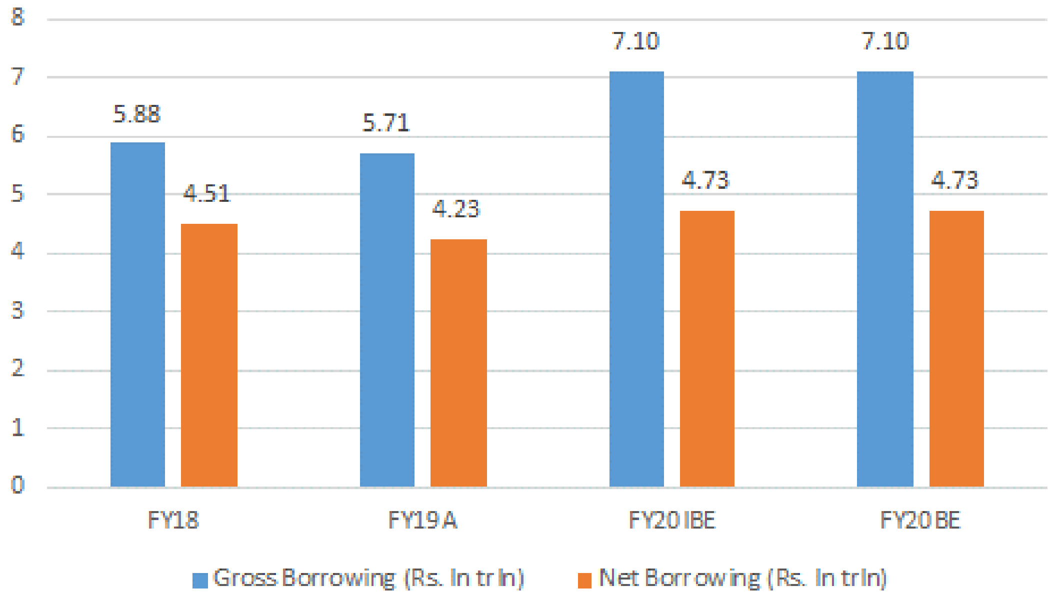
- The govt. increased surcharge on individuals earning between Rs 2 Crs – Rs. 5 Crs from 15% to 25% for FY20 ( thereby increasing the effective tax rate by 3%).
- For individuals earning above Rs. 5 Crs, the surcharge has been increased from 15% to 37% for FY20 ( thereby increasing the effective tax rate by a steep 7%).
- This makes the highest effective marginal tax rate for individuals in India at 42.7% (from 35.9% earlier). It should also be noted that surcharge is on total tax (income tax, capital gains tax, dividend distribution tax etc.), thus increasing the overall tax liability for the respective individuals.
- However, the tax base for HNI's is relatively small with govt. data estimates showing that ~31,000 IT returns were filed with taxable income above Rs 2 Crs in FY17.

# Fiscal discipline and plans to raise foreign money via sovereign bonds has been positive for bond market sentiments

**Centre Fiscal Deficit Trend (as % of GDP)**




**Gross & Net Market Borrowing Trend (Rs. In trillion)**



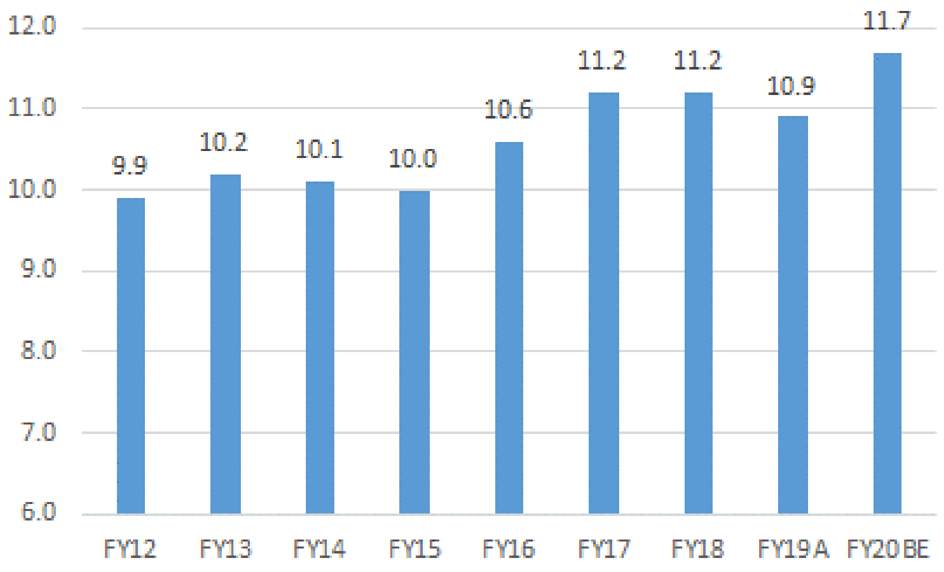

Source: Budget Documents. A= Actual, BE = Budgeted Estimate

- The govt. has stuck to fiscal discipline by announcing fiscal deficit target of 3.3% of GDP for FY20 (vs 3.4% earlier), and with a glide path to reduce fiscal deficit to 3.0% by FY22. As a result, the gross & net market borrowing for FY20 has been maintained at Rs. 7.10 trln and at Rs. 4.73 trln (in line with interim budget estimate).
- The govt. also plans to raise foreign money via foreign currency-denominated sovereign bonds, thus putting less pressure on local market borrowings. This move has been considered in the context of India’s low external debt (less than 5% of GDP), and fall in global bond yields.
- This has resulted in improved sentiments in the domestic bond markets, and led to a further fall in bond yields post the budget announcement.

# Budget at a Glance – Tax to GDP ratio to rise in FY20, after dipping in FY19

| Budget at a glance | (INR in Bln) | | | | YoY Growth (in %) | |
|---|---|---|---|---|---|---|
| | FY18 | FY19A Actual | FY20IBE Interim BE | FY20BE Final BE | FY19A | FY20BE |
| **Revenue receipts** | **14,352** | **15,632** | **19,777** | **19,628** | **8.9** | **25.6** |
| Net Tax Revenue | 12,425 | 13,170 | 17,050 | 16,496 | 6.0 | 25.3 |
| Non Tax Revenue | 1,927 | 2,462 | 2,726 | 3,132 | 27.8 | 27.2 |
| **Capital Receipts** | **7,105** | **7,483** | **8,065** | **8,236** | **5.3** | **10.1** |
| Recovery of loans | 156 | 178 | 125 | 148 | 14.1 | (16.9) |
| Other Receipts (disinvestment) | 1,000 | 850 | 900 | 1,050 | (15.0) | 23.5 |
| Borrowings & other liabilities | 5,948 | 6,455 | 7,040 | 7,038 | 8.5 | 9.0 |
| **Total Receipts** | **21,458** | **23,114** | **27,842** | **27,863** | **7.7** | **20.5** |
| Total Revenue Expenditure | 18,788 | 20,085 | 24,479 | 24,478 | 6.9 | 21.9 |
| Total Capital Expenditure | 2,631 | 3,030 | 3,363 | 3,386 | 15.2 | 11.7 |
| **Total Expenditure** | **21,420** | **23,114** | **27,842** | **27,863** | **7.9** | **20.5** |
| | | | | | | |
| **Fiscal Deficit** | **5,911** | **6,454** | **7,040** | **7,038** | **9.2** | **9.0** |
| Nominal GDP | 170,950 | 190,102 | 210,074 | 211,006 | 11.2 | 11.0 |
| **Fiscal Deficit (% of GDP)** | **3.5** | **3.4** | **3.4** | **3.3** | | |

**Tax to GDP ratio Trend**




Source: Budget Documents. A= Actual, BE = Budgeted Estimate

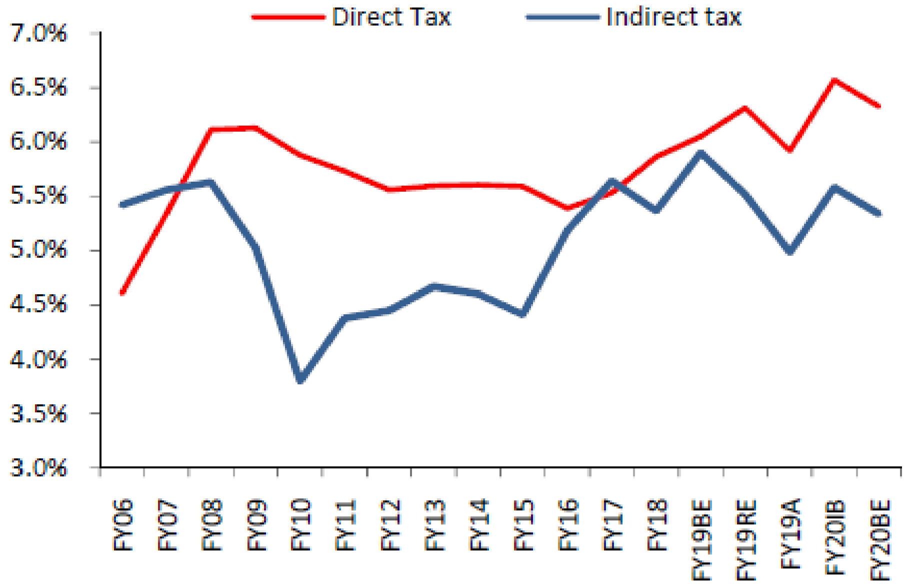
- Tax to GDP ratio fell to 10.9% in FY19 (due to lower than projected income tax and indirect tax collections). However, it is budgeted to rise to 11.7% in FY20.
- On the revenue side, tax revenue growth is quite optimistic (but manageable) for FY20. Capital receipts & non-tax revenue growth is also expected to pick-up.
- On the expenses side, revenue expenditure growth is budgeted to see a strong pick-up in growth in FY20, while capital expenditure growth is healthy, but budgeted to slow down a bit.

# Overall, tax revenue assumptions seem manageable; direct taxes contribution increasing

| Gross Tax Components | (INR in Bln) | | | | YoY Growth (in %) | |
|---|---|---|---|---|---|---|
| | FY18 | FY19A Actual | FY20IBE Interim BE | FY20BE Final BE | FY19A | FY20BE |
| **Gross Tax Revenue** | **19,190** | **20,727** | **25,521** | **24,612** | **8.0** | **18.7** |
| **Direct Tax** | **10,020** | **11,252** | **13,800** | **13,350** | **12.3** | **18.6** |
| Personal Income Tax | 4,308 | 4,617 | 6,200 | 5,690 | 7.2 | 23.2 |
| Corporate Tax | 5,712 | 6,636 | 7,600 | 7,660 | 16.2 | 15.4 |
| **Indirect tax** | **9,170** | **9,475** | **11,721** | **11,262** | **3.3** | **18.9** |
| GST | 4,426 | 5,840 | 7,612 | 6,633 | 31.9 | 13.6 |
| Customs/Excise/Service Tax | 4,744 | 3,558 | 4,109 | 4,629 | (25.0) | 30.1 |

Source: Budget Documents. A= Actual, IBE = Interim Budget Estimate, BE = Budgeted Estimate

**Direct & Indirect Tax Trend (% of GDP)**




Source: Budget Documents, Phillip Capital. IB = Interim Budget Estimate

- Direct taxes (includes Personal income tax & Corporate tax) to see healthy growth in FY20. Personal income tax collections budgeted to increase at a strong 23.2%YoY in FY20 vs 7.2%YoY increase in FY19, helped by the sharp increase in surcharge.
- The contribution of direct taxes has been increasing over the past few years, as indicated by direct tax as % of GDP—which has been higher than that of indirect taxes.
- On the indirect taxes front, GST collections final estimate for FY20 reduced to Rs. 6.63 trln from Rs. 7.61 trln estimate in the interim budget , which seems more realistic (considering the lower than expected GST collections). With the hike in excise duty & customs duty on several commodities, the budgeted final estimates for the same has been increased for FY20.

# The govt. is depending on healthy dividend from RBI & PSUs, and pick-up in disinvestment and telecom revenue

| Non Tax Revenue & Capital Receipts Break-up | | | | | |
|---|---|---|---|---|---|
| | (INR in Bln) | | | | |
| | FY17 | FY18 | FY19RE | FY20IBE Interim BE | FY20BE Final BE |
| **Disinvestment** | 400 | 1,000 | 800 | 900 | 1,050 |
| **Telecom** | 787 | 307 | 392 | 415 | 505 |
| **Dividends** | 1230 | 914 | 1,193 | 1,361 | 1,635 |
| Public Sector Enterprises | 519 | 465 | 451 | 532 | 575 |
| RBI | 712 | 449 | 741 | 829 | 1,060 |

Source: Budget Documents, Phillip Capital. RE = Revised Estimate, IBE = Interim Budget Estimate, BE = Budgeted Estimate,

- The govt. overachieved the disinvestment target for FY19 at Rs. 850 bln (vs RE of Rs. 800bln). Disinvestment target for FY20 has been increased from Rs. 900 bln in interim budget to Rs. 1,050 bln (final budgeted estimate), and achievement will depend on market conditions.
  - The disinvestment in FY20 also includes strategic disinvestment.
- Telecom revenue (from spectrum sale) budgeted to see healthy growth in FY20, and seems quite optimistic, considering the stress/consolidation in the sector.
- The govt. is depending on healthy dividends from the RBI (especially) & PSUs. The Bimal Jalan committee report on RBI capital reserves has been delayed, and yet to be released.

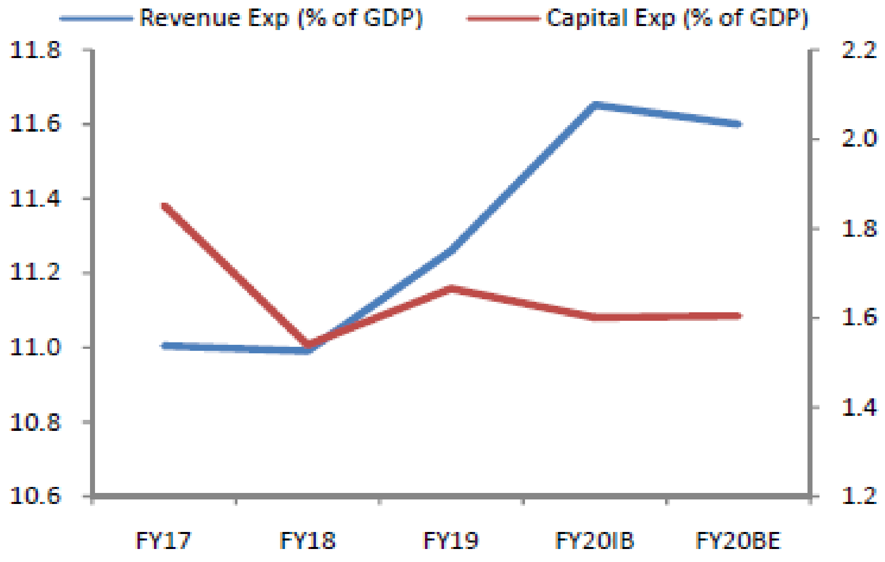
# Capex growth still healthy in FY20; some key ministries see healthy allocation/growth

Planned Outlay Expenditure for some key Ministries, March fiscal year-ends (Rs in billion)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019RE | 2020BE |
|---|---|---|---|---|---|---|---|
| Department of Atomic Energy | 51 | 66 | 73 | 69 | 85 | 126 | 114 |
| Ministry of Coal | 86 | 100 | 106 | 143 | 159 | 175 | 201 |
| Ministry of Petroleum & Natural Gas | 1,099 | 892 | 972 | 1,044 | 1,320 | 944 | 936 |
| Ministry of Power | 542 | 525 | 562 | 645 | 599 | 738 | 437 |
| **Ministry of Railways** | **520** | **565** | **935** | **1,099** | **1,020** | **1,389** | **1,599** |
| **Ministry of Road & Highways** | **196** | **184** | **510** | **480** | **744** | **993** | **1,117** |
| Ministry of Housing & Urban Affairs | 83 | 85 | 121 | 178 | 153 | 170 | 195 |

Source: Budget documents, Kotak Instiutional Equities. RE-Revised Estimate, BE=Budgeted Estimate

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




Source: Budget Documents, Phillip Capital. IB = Interim Budget Estimate. Chart Axis LHS = Revenue Exp , RHS = Capital Exp.

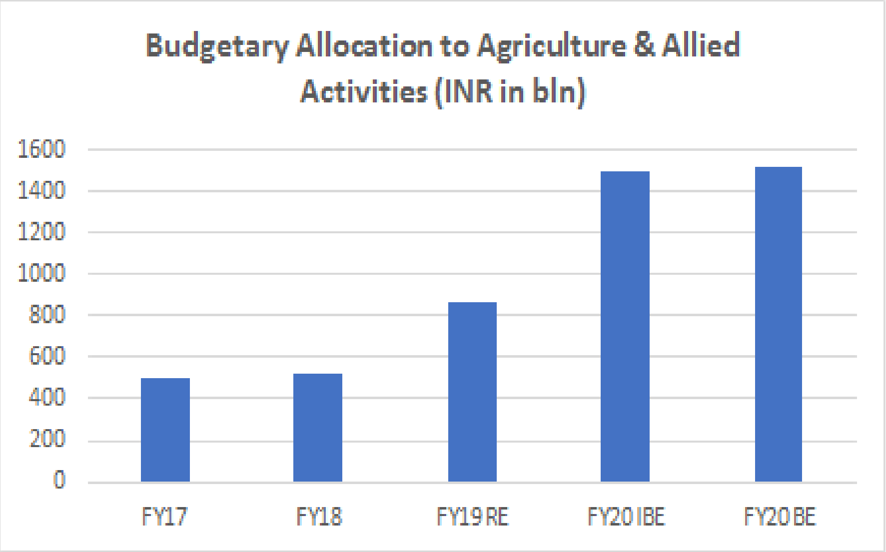
- Due to fiscal constraints, capital expenditure growth for FY20 is healthy, but budgeted to slightly slow down to 11.7%YoY, from 15.2%YoY growth in FY19.
- Also, capital expenditure as a % of GDP has moderated over the past few years, while revenue expenditure as % of GDP has been going up.
- Most ministries have seen some growth moderation in plan outlay in FY20 (esp. power), when compared to FY19. However, certain major ministries, like Railways, Road & Highways, Coal, Housing & Urban Affairs etc. have still received healthy allocation in FY20.
- The budget also announced an ambitious allocation of Rs. 100 lakh crore over the next 5 years for the infrastructure sector, which should help to revive the capex cycle.

# Although not much mention on Agri / Rural sectors has been made in the budget, the allocation to these sectors/schemes in FY20 have seen healthy growth

**Budgetary allocation to various rural/welfare schemes (Rs. in bln) – Fiscal year-wise**

| | 2017 | 2018 | 2019P | 2020BE | 2020BE/ 2019RE (%) |
|---|---|---|---|---|---|
| Food subsidy to FCI under National Food Security Act. | 783 | 1,020 | 1,401 | 1,510 | 8 |
| Income support scheme for farmers (PM-KISAN) | | | 200 | 750 | 275 |
| Mahatma Gandhi National Rural Employment Guarantee Program (NREGS) | 482 | 550 | 611 | 600 | (2) |
| Food subsidy for decentralized procurement of foodgrains under NFSA | 273 | 380 | 310 | 330 | 6 |
| Pradhan Mantri Awas Yojna (PMAY) | 210 | 290 | 264 | 259 | (2) |
| Pradhan Mantri Gram Sadak Yojna (PMGSY) | 179 | 169 | 155 | 190 | 23 |
| Interest subsidy for short term credit to farmers | 134 | 148 | 150 | 180 | 20 |
| Crop insurance scheme | 111 | 107 | 130 | 140 | 8 |
| Green revolution | 101 | 112 | 118 | 126 | 6 |
| Pradhan Mantri Krishi Sinchai Yojna (PMKSY) | 51 | 74 | 83 | 97 | 17 |
| National Rural Drinking Water Mission | 60 | 71 | 55 | 82 | 49 |
| Market intervention scheme and price support scheme | 1 | 10 | 20 | 30 | 50 |
| LPG connection to poor households | 25 | 23 | 32 | 27 | (15) |
| White Revolution | 13 | 16 | 24 | 22 | (8) |
| Total | 2,424 | 2,968 | 3,552 | 4,343 | 22 |

Source: Budget Documents, Kotak Institutional Equities. BE = Budgeted Estimate, P = Provisional / Actual




Source: Budget Documents, Phillip Capital. IB = Interim Budget Estimate

- Even though there is not much mention of agri / rural sectors in the budget, there has been healthy growth in allocation to these sectors.
- The budget allocation to various rural / social welfare schemes has gone up by a healthy 22% in FY20.
- Budgetary allocation to agriculture and allied sectors also shows a healthy increase in FY20.

# Market Outlook & Strategy

## Budget reactions

- The steep increase in surcharge for HNI's/super-rich, coupled with proposed hike in free-float limit has played on market sentiments in the short term.
- However, the increase in free-float limit will be a positive move in the long term as it will increase weight of India / Indian stocks in global indices.
- Fiscal discipline and sovereign bonds for foreign investors are positive for debt markets

## Corporate Earnings & way-forward

- The markets will soon digest the budget, and move on to fundamental factors.
- We are hopeful of a corporate earnings recovery esp. in H2 FY20. If that doesn't happen, then the markets will be disappointed.

## Sector & Market Cap Outlook

- From a sector perspective, we are 'positive' on capital goods, private financials, pharma and cement; 'neutral' on FMCG and IT, and 'underweight' on auto, metals and telecom
- We still prefer large-caps, but are also seeing selective bottom-up opportunities in mid-caps, where valuations have come down. Investors should continue to invest systematically in equities.

## Debt Markets & Interest rates

- We feel that large part of the G-Sec rally is behind us, and prefer the shorter part of the yield curve.
- On the policy front, with the fiscal discipline in budget and growth concerns, there is scope for the RBI to further cut rates (provided inflation remains within the trajectory)

## Factors to watch out for

- Eye needs to be kept on crude oil prices, US-China trade tariff developments, extent of global growth slowdown—and its impact on global risk appetite.

# THANK YOU



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