UNION BUDGET
2020-21

Market Outlook

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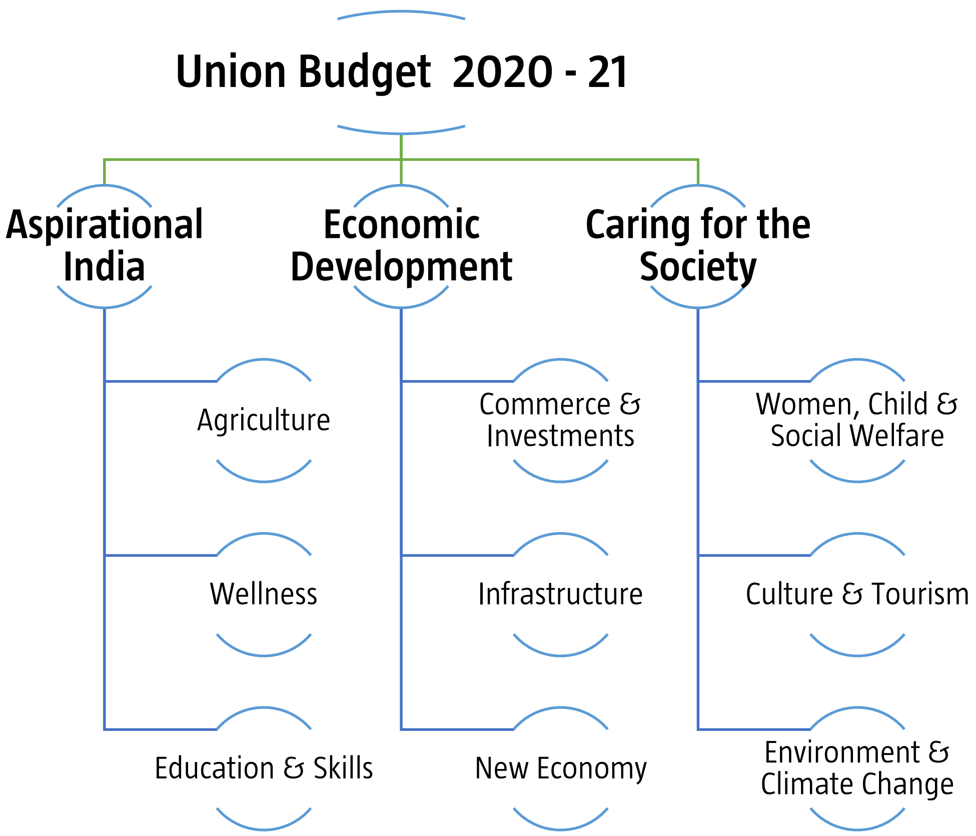
Union Budget FY2020 – Key Highlights

The Union Budget of India for 2020–2021 was presented by the Finance Minister, Nirmala Sitharaman on 1 February 2020 as her second budget. This was the second budget of Narendra Modi led NDA government's second term which revolved around the central ideas - Aspirational India, Economic development, A Caring Society. The government has in recent months announced various measures to give an impetus to the slowdown in the economy and announced tax structure change under the corporate tax segment, putting the government finances under pressure. Union Budget 2020 - 21, shifted from the fiscal roadmap with a specific attention on the privatization and divestments to adhere to the fiscal glide path.

The budget reflected the Government's commitment to enhance investment in Agriculture, Social Sector, Education and Health which has been substantiated by increase in expenditure of Rs.3,43,678 crores over RE (2019-20) while keeping the fiscal deficit at 3.8% of GDP. With an objective of enhancing capital formation government has considered fiscal expansion and announced significant outlays in key sectors such as agriculture, industry, infrastructure, education, and skill development. In addition, many measures including tax incentives have been announced to deepen the corporate bond market as well.



Snapshot of some of the key announcements under the respective sectors are as follows:

Agriculture:

- Agriculture credit target for the year 2020-21 has been set at Rs.15 lac crore. All eligible beneficiaries of PM-KISAN to be covered under the KCC scheme

- Government has allocated Rs.1.6 lac crore for Agriculture, Irrigation & allied activities and Rs.1.6 lac crore for Rural development & Panchayati Raj. “Krishi Udaan” & “Krishi Rail” to be launched which would immensely help improve value realisation
- The target of doubling farmers income by 2022, higher allocation to the Ministry of Agriculture (32% higher than the revised 2019-20 expenditure) is expected to marginally increase disposable income in the hands of rural population thereby, providing some push to the automobile segment e.g. tractors as well as two and three-wheeler segment demand

Commerce and Investments:

- DICGC (Deposit Insurance and Credit Guarantee Corporation) has been permitted to increase Deposit Insurance coverage for a depositor from Rs.1 lac to Rs. 5 lac per depositor
- Amendments to the Banking Regulation Act to strengthen the cooperative banks, for increasing professionalism, enabling access to capital and improving governance and oversight
- Government proposed to sell the balance holding of IDBI Bank to private investors to meet the need for greater private capital
- Tax exemption to interest, dividend and capital gains in rest of investment made in infrastructure and other notified priority sectors (before 31st March 2024) and with a minimum lock-in period of 3 years by the Sovereign Wealth Fund of foreign government
- To incentivise the investment by the Sovereign Wealth Fund of foreign governments in the priority sectors, proposed to grant 100% tax exemption to their interest, dividend and capital gains income in respect of investment made in infrastructure and other notified sectors before 31st March 2024 and with a minimum lock-in period of 3 years
- Reduce the withholding rate from 5% to 4% on interest payment on the bonds listed on its exchange to incentivise listing of bonds at IFSC exchange
- FPI limit in corporate bonds increased to 15% from 9% of its outstanding stock. At present, FPI limit in corporate bonds is Rs.3.17 lac crore. With this move the scope of credit default swaps expected to expand
- Budget gives option of lower income tax rates, new tax slabs minus 70 exemptions. An option to choose between the existing income tax regime and a new tax regime with slashed income tax rates and new income tax slabs but no tax exemptions and deductions

Education:

- Sourcing of External commercial borrowings and FDI to deliver higher quality education
- Under its “Study in India” programme, an Ind-SAT is proposed to be held in Asian and African countries
- To set up a National Policy University and A National Forensic Science University in the domain of policing science, forensic science, cyber- forensic etc

Infrastructure:

- Set up a project preparation facility for infrastructure projects to involve young engineers, management graduates and economists from our Universities
- To direct all infrastructure agencies of the government to involve youth-power in start-ups to roll out value added services in quality public infrastructure for citizens
- To accelerate development of highways and include development of 2500 KM access control highways, 9000 KM of economic corridors, 2000 KM of coastal and land port roads and 2000 KM of strategic highways
- 148 KM long Bengaluru Suburban Transport Project based on metro model fares
- Four station redevelopment and operation of 150 trains through PPP mode
- Completion of Delhi-Mumbai Expressway and two other packages by 2023 and initiate the project of Chennai-Bengaluru Expressway

Health & Wellness:

- More than 20,000 empanelled hospitals under PM Jan Arogya Yojana (PMJAY). To meet the need of poorer people in Tier 2 and Tier 3 cities
- Viability Gap funding windows for setting up hospitals in the PPP mode
- Aspirational Districts where presently there are no Ayushman empanelled hospitals to be covered in the first phase
- Proceeds from taxed on medical devises to be used to support this Vital health infrastructure

New Economy:

- A policy to enable private sector to build Data center parks throughout the country to be brought out soon
- INR 6000 crores to be provided to Bharatnet program in 2020- 21
- Bharatnet to link 1,00,000-gram panchayats by 2020 – 21
- Digital platform to facilitate seamless application and capture of IPRs
- Knowledge Translation Clusters to be set up across different technology sectors
- Test beds and small-scale manufacturing facilities to be established
- Early life funding to be provided, including a seed fund to support ideation and development of early stage start-ups

Women, Child and Social Welfare:

- New optional tax regime proposed for Personal Income tax for boosting economy
- Period for availing additional deduction for interest paid on loans taken for purchase of an affordable house extended by a year
- More than 20,000 hospitals to be empaneled under Pradhan Mantri Jan Arogya Yojana; servicing in Tier II and Tier III cities
- Viability Gap Funding window for setting up hospitals in PPP Mode
- Proceeds on taxes on medical devices to be used for vital health development
- INR 3.6 Lac crores approved for Jal Jeevan Mission
- INR 11,500 Crores to be provided in the year 2020 – 21 for the purpose of promoting water harvesting, de-salination and augmenting local water sources
- INR 85000 Crores proposed towards the welfare of Scheduled classes and other backward class
- Allocation of 35,600 Crores for nutrition related programs proposed for the Financial Year 2020-21
- INR 28,600 Crores allocated for the programs related to women
- Enhanced allocation of 9500 Crores to be provided to senior citizens and Divyaang.

Culture and Tourism:

- Establishment of an Indian Institute of Heritage and conservation with the status of a deemed university
- Five archaeological sites to be developed with on-site museums
- Re-curation of the Indian Museum in Kolkata
- Support for Tribal Museums in Jharkhand
- Maritime museums to be set up at Lothal – Harrapan age maritime site near Ahmedabad

Environment and Climate Change:

- Utilities running on old thermal plants emitting above pre- set norms would be asked to be closed
- States formulating plans for ensuring cleaner air in cities above one million to be encouraged further
- Coalition for disaster resilient infrastructure will help address a number of sustainable development goals and enhance climate change adaption

CANARA ROBECO Mutual Fund

Equity Market - Outlook

Shridatta Bhandwaldar
Head - Equities

The Finance Minister presented a budget which contained a mix of modestly higher spending, lower personal income taxes (with an alternative personal taxation regime to drive consumption) and abolishment of dividend distribution tax (DDT- helps corporate cash flows and lower tax rate individuals) to revive the economy. It is very evident that Government is focused on creating medium term incentives for driving private and foreign investments in real economy. DDT and tax concessions to Sovereign Wealth Funds (SWFs) was second attempt at it, post corporate tax cut in Sep-19; together these two should make a good investment case for businesses, both domestic and foreigners.

Equity market entered the event with very high expectations of LTCG removal, short term real estate and infra push, personal tax cuts etc. Thus, equity market will be little disappointed with the outcome and would move back to fundamentals now. Incremental global growth risk from Corona Virus will also keep the market subdued for the time being as Indian market didn't react to this event fully because of Budget expectations. While the Govt has projected nominal GDP growth rate of 10% for FY21 from 7.5% for FY20RE; growth recovery is likely to be gradual in the absence of any meaningful short-term demand dose from budget.

There is no change in earnings of nifty because of this event and the EPS growth is at 10% in FY20 and 15-17% for FY21 remains (as things stand today). Focus will shift back to earnings as long as these earnings are in place, we remain constructive on market from 12-18 months perspective at and below 11500(16-17xFY21) levels. The central government's GFD/GDP of 3.5% for FY2021 may not be too high for the bond or equity markets, although there is a upside risk given high collection assumption of divestment and telecom revenues.

Removal of dividend distribution tax is in line with objective of encouraging private sector investment. The government has removed the dividend distribution tax (DDT) applicable to dividends paid by companies. However, it will tax dividends in the hands of shareholders at income tax rates as applicable for domestic shareholders and as per taxation treaties for overseas shareholders. The government projects revenue foregone of Rs.250bn on account of the removal of DDT. This would be beneficial for holding companies and foreign companies.

Budget has re-iterated and focused on the infrastructure sector by providing Rs.220bn to infra finance companies, who in turn would leverage to create financing pipeline of more than Rs.1 trillion. To attract foreign investment in infrastructure and other notified sectors, sovereign wealth funds will get 100% exemption on interest, dividends and capital gains for certain period. The increase in turnover threshold for tax audit from Rs.1.0cr to Rs.5 cr should provide relief to the MSMSE segment and help in improving the sentiment of smaller businesses.

Government clearly indicated its intention to monetize aggressively. For FY21, its building Rs.2.1trn from divestment of BPCL, Concor, IDBI, Air India and IPO of LIC. Although the target looks little stretched; there are back-up options such as SUTTI stake sell, in case of short fall. More importantly there is hardly any budget allocation of equity capital to PSU banks and have been advised to access capital markets for the same. This clearly indicates its intention of going below 51% in PSU banks over period; as they need growth capital (IDBI seems like a test case).

Government has tried to give short term consumption push through higher rural spending and alternate tax mechanism which gives option of consumption or investment to taxpayers. The additional interest deduction of Rs.1.5lac for individuals buying affordable housing has been continued for next Financial Year.

Debt Market – Outlook

Avnish Jain
Head – Fixed Income

In line with expectations, the government invoked the escape clause to revise the fiscal deficit for FY2020 to 3.8% from 3.3%. However, there was no change in the overall government borrowings as the government took advantage of higher than expected collections in small savings schemes at Rs.2.4 lac crores (vs BE of Rs.1.3 lac crore). The budget expects to get similar collections as well in FY2021. For FY2021, the government chose to continue to with fiscal consolidation and pencilling in a fiscal deficit of 3.5% of GDP. The attainment of this target hinges on a record high disinvestment target Rs.2.1 lac crore (sale of LIC stake and IDBI) and telecom revenues of Rs.1.33 lac crore (AGR dues and 5G auction). Off balance sheet borrowings (GOI serviced bonds, NSSF loans etc.) for FY2020 were 1.49% of GDP and is expected to reduce to 1.25% of GDP in FY2021.

The markets were pleasantly surprised when the Budget did not show any extra borrowings for FY2020. Further the borrowing for FY2021 were within market expectations. Bond markets opened with a gap, with 10Y G-Sec dropping by about 10 bps. The longer bonds rallied more as in the near term the supply pressure is not there. Corporate bonds, across the curve, also rallied with yields dropping from 5-10 bps point.

While absence of any additional borrowings in FY2020 is likely to support market sentiment, participants will look forward to the monetary policy committee (MPC) meeting scheduled for 5-6 February. The recent spike in CPI inflation is likely to main point of discussion within MPC members as the last CPI print of 7.4% is much higher than upper range of 6% of MPC mandate. While the MPC would be happy that there was no major fiscal stimulus in the budget to impact the core inflation or inflation expectations, the higher CPI prints will likely keep the MPC in a prolonged pause mode.

Further the Budget has put a provision for Gilt switches to the extent of Rs.2.7 lac crore. This is a huge amount (~35% of gross borrowing for FY2021). While liquidity impact is zero, since government issues longer term securities and extinguishes short term debt against the issued amount, it adds to supply pressure in the longer term. This could additionally pressure long term yields, preventing any major duration outlook.

While sentiment on the bond markets have improved post Budget, the same could get dented if the MPC takes hawkish view on recent inflation prints. Near term CPI numbers will likely remain high and inflation is likely to trend near RBI's 4% mark toward latter part of FY2021. With liquidity also remaining good, need for RBI OMO's is limited. We expect that in near term 10Y G-sec would likely trade in a narrow range of 6.40-6.70%. Excess liquidity and likely pause from in monetary policy will likely support short term corporate bonds (2-5 years) and the yields may drift lower in near term. We believe that Funds investing in money market and bonds like Savings Fund, Short Duration and Corporate Bond fund can deliver superior risk adjusted returns.

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