CIO Memo

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Authors:
Mayank Khemka
Chief Investment Officer, India

Sagar Singh
Investment Officer, APAC

India budget: pro-growth capex raised but fiscal profligacy avoided

Key takeaways

- In today's budget, the government kept its focus on job creation and growth-oriented capital expenditure, while staying on the path of fiscal consolidation.
- Bond yields moved down slightly in a relief rally on lower-than-expected government borrowing, while equities sold off after an initial rally, likely on foreign investor selling.
- Fixed income may continue to offer attractive accrual yields. Equity market returns will turn more sector-specfic.

1. What happened?

In what was her last full budget before national elections in May next year, Finance Minister Nirmala Sitharaman struck a fine balance between fiscal prudence and maintaining growth via a capital spending push. The target fiscal deficit for FY24 was lowered by 0.5 percentage points to 5.9% of GDP – generally in line with expectations – while keeping the revised estimate for current FY23 at 6.4% of GDP.

Nominal GDP was conservatively estimated to grow by 10.5% YoY in FY24, forming the base for growing tax revenues to fund capital spending. Total tax receipts are expected to grow by 11% to INR23.3tn while gross government borrowing is expected to increase marginally to INR15.4tn.

The finance minister proposed a total budget spend increase of 7.5% vs. last year's revised estimate, to INR45.0tn. Looking at the components, capital spending in effect expected to rise by 37% to INR10tn (after an increase of +35% last year). The overall proposed outlay will be almost three times that in the last pre-pandemic financial year of 2019-20. The allocation to railways is the highest ever.

Income tax bands were revised upwards, providing relief to middle-class taxpayers earning up to INR1.5mn. The surcharge on the highest tax band was reduced, bringing the top tax rate down from 42% to 39%. Tax exemption on single premium insurance products (above INR0.5mn) was removed, as well as the exclusion on buying property from capital gains of above INR100mn. The loophole on the popular market-linked debenture instrument was also plugged.

'Green growth' was mentioned as one of the seven priorities in the budget, reinforcing India's commitment to climate change targets.

2. How did markets react?

The 10-year Indian government benchmark yield moved by 6 bps, settling at 7.28%, showing a minor relief rally as official borrowing expectations were well below market expectations. The INR was largely flat at 81.94 to the USD. Equities rallied smartly during the budget announcement, but later gave up all their gains to close lower. The Nifty 50 Index fell -0.26% and the Nifty Bank Index was down -0.35%, likely due to a continuation of heavy foreign investor selling in the past few days.

3. What does it mean for investors?

In a pre-election year budget, the government did well by avoiding fiscal profligacy in the form of hand-outs and subsidies. With the FY24 fiscal deficit estimated at 5.9%, and an ambitious target of reducing it to 4.5% by 2025, inflationary pressures from printing money are probably reduced.

The fall in food and fertiliser subsidy payments (as commodity prices cool off) was prudently used to increase capital expenditure, now budgeted at an all-time high of INR10tn, an increase of 37% on FY23, taking it to 3.3% of GDP. Capital spending is once again focused on infrastructure sectors, with railway and road outlays being increased by 25% and 51% respectively; together they will account for INR4.98tn. Defence spending remains the third-highest spending area at INR1.62tn, but this is only an 8% rise. The focus of the government remains on job creation, and less on welfare sectors such as education and healthcare.

With tax revenues projected to increase at 11% in FY24, almost in line with the expected nominal GDP growth rate of 10.5%, the fiscal math appears to be credible. Rationalisation of income taxes at the lower end also means more money in the hands of the middle class, providing much needed relief in an inflationary environment. Consumer staples should benefit the most from this, followed by selected discretionary sectors.

Although little was done to address the high current account deficit, the push towards digital infrastructure as well as climate change targets augurs well in the medium term for productivity, governance and environment.

Fixed income markets are likely to climb over the fiscal "wall of worry" and continue to focus on inflation and global central bank actions. A likely shift in RBI's stance as inflation trends lower should further help bond yields to stabilise. Good accrual gains over the next year seem likely and yields can probably be locked in at attractive levels, both for government and corporate bonds. Equity returns will be more sector-driven and the financial as well as industrial sectors should benefit from increased government outlays.

Glossary

The NIFTY 50 Index is a benchmark Indian equity index representing the weighted average of 50 stocks over 12 sectors.

The NIFTY Bank Index is comprised of the most liquid and large capitalised Indian Banking stocks.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The Indian rupee (INR) is the currency of India.

The Reserve Bank of India (RBI) is the central bank of India.

USD is the currency code for the U.S. Dollar.

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