UNION BUDGET

2017 - 2018

INDEX

KEY HIGHLIGHTS

Though the Union Budget is essentially a Statement of Account of public finances, it has historically become a significant opportunity to indicate the direction and the pace of India's economic policy. The 2017-18 Union Budget was presented amidst a somewhat wobbly backdrop of the world economy facing considerable uncertainty, increasing signs of a retreat from globalization of goods the world over, and high expectations from people back home relating to good governance. Amidst all these developments, India has stood out as a bright spot in the world economic landscape. India's macro-economic stability continues to be the foundation of economic success.

With this in the background, we present the key highlights of Union Budget 2017-18.

Economy

- Net tax revenues are expected to grow by 12% in FY18, maintaining a double digit growth rate for third year in a row.
- Total expenditure is slated to grow more modestly at 6.6% in FY18 from 12.5% last year.
- Revenue expenditure is expected grow at 5.9% in FY18 (12.8% last year) while capital expenditure will grow at 10.7% (basis FY17 RE) in FY18 (10.6% last year).
- Adherence to fiscal consolidation path reiterated with fiscal deficit target of 3.2% in FY18
- Use of ETF as a vehicle for further disinvestment in listed CPSEs to continue as the government plans to launch a new ETF with diversified CPSE stocks in FY18.
- Net market borrowing limited to Rs. 3.48 lakh crore, much lower than Rs. 4.25 lakh crore of the previous year.

Direct Taxes

- Personal income tax rate at lowest slab (Rs. 2.5 lacs to Rs. 5 lacs) is reduced to 5% from 10%.
- While the taxation liability of people with income up to Rs. 5 lakhs is being reduced to half, all the other categories of tax payers in the subsequent slabs will also get a uniform benefit of Rs. 12,500/- per person. The total amount of tax foregone on account of this measure is Rs. 15,500 crores.
- A surcharge of 10% has also been introduced for individuals whose annual taxable income falls between Rs. 50 lakhs and Rs. 1 crore.
- The concessional with-holding rate of 5% (charged on interest earned by foreign entities) on ECBs / Govt bonds / Masala bonds got extended up to June 2020 (from June 2017)
- Corporate tax rate for MSMEs with annual turnover up to Rs50 crore is reduced to 25% from 30%. Government expects 96% of all companies filing taxes to benefit.
- LTCG holding period for immovable property reduced to 2 years from 3 years.
- Foreign Portfolio Investor (FPI) Category I & II receives exemption from indirect transfer provision. Budget clarified that indirect transfer provision shall not apply in case of redemption of shares or interests outside India as a result of or arising out of redemption or sale of investment in India which is chargeable to tax in India.

- ***Positive***: Reduction in corporate tax for MSMEs and tax rate cut for lowest slab (of Rs. 2.5 lac to Rs. 5 lac) are positive developments for investors/individuals/savers. The benefits will accrue on account of tax saved as well as help create a corpus for the future.

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Miscellaneous

- Rs. 10,000 crore recapitalisation for PSU banks during FY18 in line with “Indradhanush” roadmap.
- Agriculture credit for FY18 targeted at Rs 10 lakh crore, with 60 days interest waiver.
- The government intends to double the NABARD fund (for long term irrigation) corpus from Rs. 20,000 crore to Rs. 40,000 crore.
- The government plans to spend Rs 3 lakh crore on rural India. With MGNREGA, it aims to double farmers' income.
- The government aims to achieve 100% rural electrification by March 2018.
- Total allocation for infrastructure development in FY18 pegged at Rs 3.96 lakh crore.
- Affordable housing receives infrastructure status.
- Railway lines of 3,500 km to be commissioned in 2017-18
- Foreign Investment Promotion Board (FIPB) will get abolished in FY18.
- Further liberalisation of FDI policy is under consideration.
- The shares of Railway PSEs like IRCTC, IRFC and IRCON will get listed on stock exchanges.
- A committee will be constituted to create legal framework to integrate spot market and derivatives market in the agricultural sector for commodities trading.
- Cash Donations which can be received by a charitable trust will now be restricted to Rs 2,000 from earlier limit of Rs 10,000.

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Equity Market

- Equity markets reacted positively on the Budget day. An immediate relief rally was witnessed as soon as the finance minister Mr. Arun Jaitley ended his speech without commenting anything on the LTCG (long term capital gains) for equity investments. In the run up to the budget, investors were worried that the government might tinker with the 1 year period by raising it to 3 years.
- The government managed to avoid populist measures as widely anticipated by the market and opted to move ahead on the steady path of fiscal prudence.
- At market closing, S&P BSE Sensex settled at 28,142 levels with a gain of 1.76%.
- Among the BSE sector indices, Realty index was up by 4.83% while Auto index gained almost 3.5%. FMCG, Bank, Metal and Capital Goods were up by 2.79%, 2.76%, 2.28% and 2.18%, respectively. IT sector index lost 1.07%, while Telecom and Health Care lost 0.5% and 0.3%, respectively.
- Among Sensex stocks, Maruti Suzuki (4.7%), M&M (4.6%), ITC (4.5%) & ICICI Bank (4.4%) were the top gainers while TCS (-2.7%), Infosys (-1.4%) and NTPC (-1.3%) were among the major losers.

Debt Market

- The Union Budget took a middle path by balancing the need for higher public infrastructure spending with the medium-term need for continued fiscal prudence.
- The fiscal deficit has been budgeted at 3.2% of the GDP in FY18 with a target of achieving 3% in FY2019. The net market borrowing has been pegged at Rs. 3.48 lakh crore in this financial year, lower than Rs. 4.25 lakh crore in the last year
- Adherence to the fiscal deficit number by the centre arms the central bank with ammunition to cut rates further.

FY18 fiscal deficit target set at 3.2% of GDP – Assumptions on higher income tax compliance critical to meeting targets; FY17 RE revenue a little on the higher side

FY18 centre fiscal deficit target at Rs. 5.47 tn; nominal GDP growth assumed at 11.75%

FY18 total receipts estimated to rise 8.1% to Rs. 16 tn

FY18 gross tax receipts seen rising 12.2% YoY, leading net tax up by 12.7%

- FY17RE revenues on the higher side, biasing up FY18 numbers by ~Rs. 0.4 tn
    - Corporate tax forecast expected to rise 9% in FY17RE as opposed to 4.8% growth seen in the Apr ‘16-Dec ‘16 period
    - Excise duty growth also appears highly elevated given current run rate
- FY18 income tax growth at 25% appears to be aggressive, especially given 23% growth rate in FY17RE. It will also require large scale efforts by tax authorities to identify and correct tax avoidance

FY18 non-tax revenues seen lower at 13.7%, with 43.7% fall in telecom revenues (no spectrum auction) and lower dividends (special dividends taken in FY17)

Non-debt capital receipts up 49.3%; pickup hinges on disinvestments in insurance and SUUTI

FY18 expenditure estimated to rise 6.6% to Rs. 21.5 tn

- Revenue expenditures seen rising slowly at 5.9%, with salaries, defence & pensions reverting after the 7th CPC led jump in FY17.
- Robust increases budgeted in water, health and rural development spending
- Capex growth budgeted at 10.7% with focus on railways, roads, urban development and energy

FY18 fiscal math: Assumptions of FY17RE corporation tax and excise duty, FY18 income tax appears optimistic

Rs. Tr.	FY16	FY17	FY18	% YoY FY16	FY17	FY18
	A	RE	BE	A	RE	BE
GDP	136.8	150.8	168.5	10.0%	10.2%	11.8%
Tax Receipts (Net)	9.44	10.89	12.27	4.4%	15.4%	12.7%
Non-Tax Revenue	2.51	3.35	2.89	27.0%	33.2%	-13.7%
Disinvestments & Others	0.63	0.57	0.84	22.3%	-10.2%	49.3%
Total Receipts	**12.58**	**14.80**	**16.00**	**9.1%**	**17.7%**	**8.1%**
Revenue Expenditure	15.38	17.35	18.37	4.8%	12.8%	5.9%
Capital Expenditure	2.53	2.80	3.10	28.6%	10.6%	10.7%
Total Expenditure	**17.91**	**20.14**	**21.47**	**7.6%**	**12.5%**	**6.6%**
				% of GDP		
Fiscal Deficit	5.33	5.34	5.47	3.9%	3.5%	3.2%
Revenue Deficit	3.43	3.11	3.21	2.5%	2.1%	1.9%
Primary Deficit	0.91	0.51	0.23	0.7%	0.3%	0.1%

FY18 NGDP growth assumed at 11.75%

Reversion in revenue expenditure after 7CPC led increase provides space for capex in FY18

Disinvestment receipts pick up on SUUTI and insurance sales – but numbers still seem slightly optimistic

Source : Axis Bank Business & Economic Research

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FY17RE tax collections assumed better than current run rate till Dec'16, pushes up absolute number next fiscal

Rs. Tr.	FY16	FY17	FY18	FY16	FY17	FY18
	A	RE	BE	A	RE	BE
Gross Tax Revenue	**14.56**	**17.03**	**19.12**	**16.9%**	**17.0%**	**12.2%**
Income	2.88	3.53	4.41	8.2%	22.8%	24.9%
Corporation	4.53	4.94	5.39	5.7%	9.0%	9.1%
Excise	2.88	3.87	4.07	51.7%	34.5%	5.0%
Customs	2.10	2.17	2.45	11.9%	3.2%	12.9%
Service	2.11	2.48	2.75	25.9%	17.1%	11.1%
Tax Revenues (Net to Centre)	**9.44**	**10.89**	**12.27**	**4.4%**	**15.4%**	**12.7%**
Non-Tax Revenues	**2.51**	**3.35**	**2.89**	**27.0%**	**33.2%**	**-13.7%**
o/w Dividend & Profit	1.12	1.53	1.42	24.8%	36.7%	-7.0%
Telecom	0.55	0.79	0.44	80.0%	42.8%	-43.7%
Revenue Receipts	**11.95**	**14.24**	**15.16**	**8.5%**	**19.1%**	**6.5%**
Capital Receipts	**0.63**	**0.57**	**0.84**	**22.3%**	**-10.2%**	**49.3%**
o/w Disinvestments	0.42	0.46	0.73	11.6%	8.0%	59.3%
Total Receipts	**12.58**	**14.80**	**16.00**	**9.1%**	**17.7%**	**8.1%**

Income tax collections in FY18 assumed higher on phase shift in compliance

Corporate tax collections in FY17 exceed current run rate till Dec'16 and keep next fiscal numbers buoyed

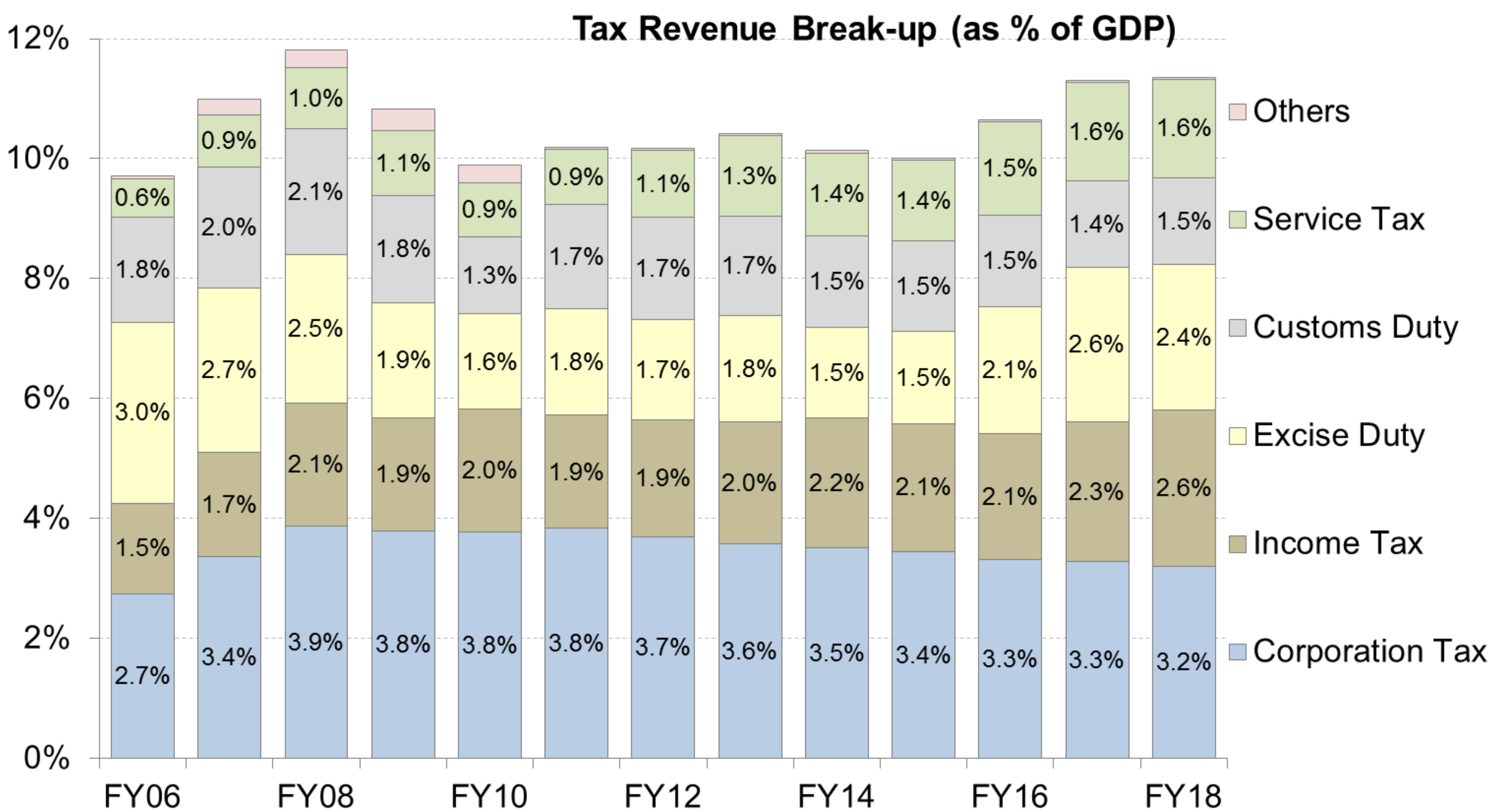
Excise collection this fiscal seem difficult to achieve and keep next fiscal number elevated as tax rates likely to remain at current level.

Non-tax revenues projections seem reasonable: no inflows from spectrum auctions and no spike in **transfers from RBI**

Disinvestment target set at Rs.72K cr.: listing of IRCTC, IRFC and IRCON and PSU insurance companies

Source : Axis Bank Business & Economic Research

Higher income tax collections (on improved compliance) likely to drive increase in FY18 tax collections



Note: FY16: Actuals, FY17: Revised Estimates and FY18: Budget Estimates

Source : Axis Bank Business & Economic Research

Establishment expenditure growth falls post implementation of 7CPC in FY17. Central sector schemes growth slows on restructuring of schemes

Rs. Tr.	FY16 A	FY17 RE	FY18 BE	FY17 RE	FY18 BE
Centre's Expenditure					
Establishment Expenditure	3.35	4.07	4.38	21.5%	7.6%
Central Sector Schemes / Projects	5.21	6.24	6.67	19.8%	6.8%
Other Central Sector Expdn.	5.93	5.86	6.19	-1.2%	5.7%
Centrally Sponsored Schemes and other Transfers					
Centrally Sponsored Schemes	2.04	2.45	2.78	20.5%	13.4%
Finance Commission Grants	0.85	0.99	1.03	17.2%	4.0%
Other Grants/ Loans/ Transfers	0.53	0.53	0.42	-0.3%	-21.4%
Total Expenditure	**17.91**	**20.14**	**21.47**	**12.5%**	**6.6%**

Source : Axis Bank Business & Economic Research

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Food subsidy increase on coverage of NFSA across all states; Reversion in salary and pension growth rates (incl defence) after 7CPC led increase provides space for capex in FY18

Rs. Tr.	FY16	FY17	FY18	FY16	FY17	FY18
	A	RE	BE		RE	BE
Expenditure	**17.91**	**20.14**	**21.47**	**7.6%**	**12.5%**	**6.6%**
Subsidies	2.64	2.60	2.72	2.3%	-1.4%	4.5%
o/w Food	1.39	1.35	1.45	18.5%	-3.0%	7.5%
Fertilizer	0.72	0.70	0.70	1.9%	-3.3%	0.0%
Petroleum	0.30	0.28	0.25	-50.2%	-8.2%	-9.2%
Interest	4.42	4.83	5.23	9.7%	9.4%	8.3%
Salary	0.90	1.06	1.12	10.6%	17.4%	5.5%
Pension	0.97	1.28	1.31	3.4%	32.4%	2.4%
Defence	2.26	2.48	2.62	3.3%	9.8%	5.8%
Revenue Expenditure	**15.38**	**17.35**	**18.37**	**4.8%**	**12.8%**	**5.9%**
Capital Expenditure	**2.53**	**2.80**	**3.10**	**28.6%**	**10.6%**	**10.7%**

Source : Axis Bank Business & Economic Research

FY18 fiscal deficit primarily financed by net borrowings (Rs. 3.5 tn) and small savings (Rs 1 tn)

	FY16	FY17	FY18
Rs. Tr.	A	RE	BE
Fiscal Deficit % GDP	3.9%	3.5%	3.2%
Fiscal deficit	**5.33**	**5.34**	**5.47**
Financing of Deficit			
Net Borrowings (incl. Short term)	4.55	3.66	3.50
Small Savings	0.52	0.90	1.00
State PF's	0.12	0.13	0.14
Others	-0.12	0.10	0.54
External Assistance	0.13	0.15	0.16
Cash Surplus	0.13	0.40	0.13
Gross G.Sec. Supply	**5.85**	**5.82**	**5.80**
Redemptions (-)	1.44	1.75	1.57
Net G.Sec. Supply	**4.41**	**4.07**	**4.23**
Buybacks (Net) (-)	0.38	0.59	0.75
Switch (Net)	0.01	0.00	-
Net Market Borrowings	**4.04**	**3.47**	**3.48**
Short term Borrowings (Net)	0.51	0.19	0.02
Net Borrowings (incl. Short term)	**4.55**	**3.66**	**3.50**

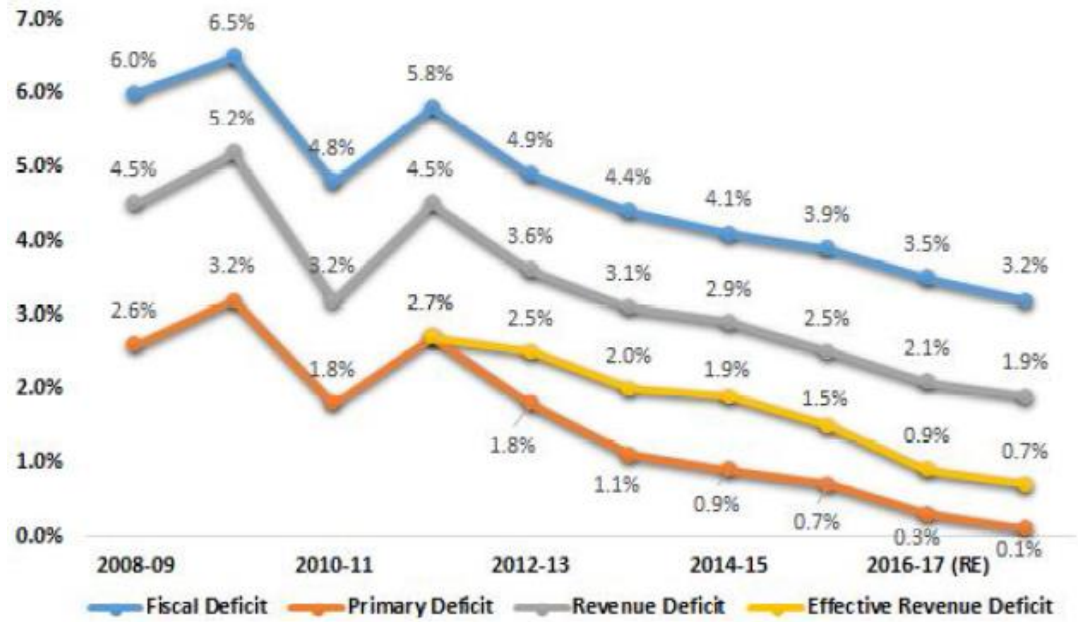
Source : Axis Bank Business & Economic Research

Gross borrowings of Centre and States rise with steep increases in state deficits and higher redemptions

				% GDP		
Market Loans (Rs. Tr.)	**FY16**	**FY17**	**FY18**	**FY16**	**FY17**	**FY18**
(incl. buyback & switch)	A	RE	BE	A	RE	BE
Central Govt.						
Gross G.Sec. Supply	5.85	5.82	5.80			
Redemptions (incl. buyback)	1.81	2.35	2.32			
Net	4.04	3.47	3.48	3.0%	2.3%	2.1%
State Govts.						
Gross	3.71	3.84	4.17			
Redemptions	0.40	0.32	0.70			
Net	3.32	3.53	3.47	2.4%	2.3%	2.1%
Centre + States						
Gross	9.56	9.66	9.97			
Net	7.36	7.00	6.95	5.4%	4.6%	4.1%

Source : Axis Bank Business & Economic Research

Deficit Trends
(as a % of GDP)



Debt Trends
(as a % of GDP)

Government by disciplining its fiscal deficit is looking to:

- Improve India's international credit rating,
- Creates headroom for RBI to reduce key policy rates
- Makes investment/ borrowings for private sector cheap

Source : Axis Bank Investment Research; http://indiabudget.nic.in

Sector	Key budget measures	Impact
Agriculture	**Maintained target** of doubling farm income by 2022 FY18 **Budgetary allocation for rural and agri segment rose 5% YoY**. Govt exceeded its FY17 budgetary targets by ~7% **Highest-ever MGNREGA allocation at Rs 480 bn** (Rs 475 bn in FY17) – higher rural income and lower crop cultivation costs Contract farming - higher realization and lower post-harvest losses for farmers with **government encouraging tie-ups between agro processing units and farmers**	Positive:for all agri related companies
Autos	Pro rural measures to **improve farm productivity and spur rural income growth** **Road (urban + rural) capex increased to Rs 1.4 tn** (vs. Rs 1.3 tn YoY)	Positive: For auto companies
Banking & Financial Services	**Affordable housing given infrastructure status** Allowed **listing and trading of security receipts issued by ARCs** Additional benefits for provisions made for bad assets **MUDRA lending target doubled** to ~Rs 2.44 trn (key beneficiary – MFIs)	Positive: for corporate lenders, MFIs, HFCs Expectations of additional capital for PSU banks not met

Source: Axis Capital

Sector	Key budget measures	Impact
Capital goods	**Budgetary allocation towards capex up by 13%:** Bulk of the increase in railways (up 8%), roads (up 17%), and T&D (up 32%) **Push on metro rail projects :** Allocation for metro up 15% in FY18BE after upward revision in FY17RE (vs. BE) by 57% **Discontinuation of GBI incentive for wind power developers is a disappointment.** GBI was ~1/6th of capital cost, and its discontinuation negatively impacts developer's IRR resulting in margin pressure on equipment supplier **Defense capex the only disappointment:** FY17 RE was ~7% below budget allocation, and FY18BE is just 8% higher	Positive: For capital goods and EPC companies Negative : For wind energy companies
Cement	Demand support from increase in road and rural housing spending	
FMCG	**Excise duty on cigarettes hiked by ~6%.** Positive for cigarette cos if GST is revenue neutral. Increased investment on the rural side in the form of various schemes and increased MNREGA investment to aid FMCG companies Impetus to rural and affordable housing	Positive : for most consumer companies in general and particularly for cigarette manufacturing companies

Source: Axis Capital

Sector	Key budget measures	Impact
Pharmaceuticals	Proposal to amend legislation to prescribe generic names MAT credit allowed to be carried forward up to 15 years vs. 10 years at present	
Power	No change in clean energy cess (Rs 400/ton) 80IA Income tax exemption not extended 25% increase in power T&D expenditure	Positive: For IPPs selling merchant power
Realty	Multiple impetus for affordable housing **Reduced holding period for LT capital gains on transfer of property** Impetus to rural housing (to complete 10 mn homes by 2019)	Positive: Affordable housing sops beneficial for developers with strong execution track record
Telecom	Budget receipts of Rs 990 bn for 2016-17 from Communications revised downwards to Rs 787 bn owing to lower-than-expected response to Oct '16 spectrum auction Budgeted receipts of Rs 443 bn for 2017-18, as spectrum auction receipts not expected in the year	

Source: Axis Capital

Sector	Key budget measures	Impact
Oil & Gas	**Custom duty on LNG cut to 2.5%** (vs. 5% currently). Priority sectors (fertilizer and power) are already exempted from custom duty Fuel subsidy budgeted at Rs 250 bn for FY18. This looks lower as at current oil prices, FY18 gross under-recoveries are likely to be at Rs 400 bn **Government mulling consolidation in oil PSU space** to create one large integrated oil company	Positive : for all gas downstream companies as it will reduce gas cost and boost volumes **No subsidy impact** on oil PSUs, as current subsidy sharing mechanism caps government subsidy burden at Rs. 455 bn

Source: Axis Capital

- The Union Budget 2017-18 delivered a pleasant surprise by sticking to the fiscal deficit target of 3.2% of GDP as this move is likely to have a positive impact on the macro economy by preserving stability.
- The Union Budget puts forward Government's focus of continuing on the path towards fiscal consolidation which also makes it easier for the central bank to continue with its accommodative stance.
- The Budget also underlines the Government's determination to provide an impetus to the economy especially through the infrastructure, rural and financial sectors.
- The Indian economy is poised to grow at a healthy rate in contrast to the global economy which is expected grow at a slower rate of 3.1% in CY 2016 to 3.4% in CY 2017 (as per the IMF estimates).
- India's macroeconomic fundamentals remain intact with improvement in growth, moderate inflation, improving CAD and robust forex reserves.
- Amidst a global slowdown in economic growth, India continues to be a leading investment destination.
- Equity market valuations are also reasonable when compared to their long term Price to Earnings (P/E) averages.
- With a sharp fall in interest rates, improving growth outlook and signs of improving corporate profitability, the outlook for equity market is positive.
- **We recommend investors to accumulate equities from a 3 to 5 years investment horizon.**

- The government has retained its fiscal deficit target for BE 2017-18 and BE 2018-19 at 3.2% and 3%, respectively.
- The Centre is likely to borrow Rs. 5.8 lakh crores in FY18 (same levels as seen in FY17). However, the net borrowings in FY18 will be Rs. 3.48 lakh crores (Rs. 4.25 lakh crores in FY16), after considering repayments of past loans and interests.
- Gross supply of Central and State government securities is likely to be around Rs. 10.50 lakh crore in FY18, compared to ~ Rs. 9.3 lakh crore in the current fiscal.
- The RBI in its December monetary policy stated that they continue to maintain an accommodative stance, while keeping an eye on inflation data. With the Government committed to walk a tightrope and stick to its fiscal deficit target of 3.2%, the onus now shifts to RBI on the monetary policy front.
- Although the net market borrowing has dropped to ~Rs 3,48,000 crores from ~Rs 4,25,000 crores last year, markets shall now focus on global yields and oil prices. Even though there is downward bias to interest rates, room for further fall is limited given the sharp fall from 8.8% to 6.5% in last 3 years and hence investors may consider incrementally investing in short/medium term funds and dynamic bond funds.
- **Investors who have an investment horizon of at least 18 to 24 months and who can digest (possible) interim volatility can look at investing in dynamic bond funds.**
- **Short term income funds can be recommended for investors with an investment horizon of minimum 12 -18 months to benefit from current accruals and ensuing capital appreciation if yields head lower during this period.**

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