Research

CRISIL
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Rural mural

Budget analysis

February 2018

Executive summary

This Union Budget came against the backdrop of a raft of reforms, economic slowdown and fiscal stress.

While the budget proposals will incrementally contribute to economic expansion, with its de facto elements of stimulus, the pace of growth will largely be due to factors outside the budget.

Growth has already bottomed out, so the key drivers in fiscal 2019 will be: 1) improved ability to benefit from strong global growth as domestic headwinds from demonetisation and implementation of the Goods and Services Tax fade, 2) enhanced ability of banks to lend following recapitalisation, and 3) normal monsoons.

To be sure, there was limited headroom for a big spending push due to fiscal constraints.

The government has for the second consecutive year already breached its fiscal deficit to gross domestic product (GDP) target of 3%. As opposed to a budgeted 3.2%, fiscal deficit in fiscal 2018 stood at 3.5% of GDP and is budgeted at 3.3% in fiscal 2019. But the more worrisome part is that the breach in fiscal deficit is despite a cut in capital expenditure (capex); that means, had the government stuck to its targeted capital expenditure for fiscal 2018, fiscal deficit would have been still higher.

Moreover, it is the productive spending in the economy that has seen a compromise, making way for revenue spending. The fiscal deficit target for fiscal 2019 overtly relies on a large indirect tax collection target. In sum, the government's fiscal consolidation path has got stretched by three years. As opposed to achieving a 3% fiscal deficit in fiscal 2018, the government now hopes to achieve the same in fiscal 2021.

Yet, the budget has focused on raising rural demand. Rural sector has been the primary focus of the budget with measures such as an assured minimum support price, export liberalisation of agri-products expected to revive farm realisations, and increased expenditure on rural infrastructure.

The focus on rural housing and roads will help build assets and create jobs. Construction is a very labour-intensive activity and, more importantly, it can absorb low skilled workers – a key characteristic of rural India.

However, announcing new measures and committing resources is not enough to improve the condition of the farming community. For success, these have to be complemented by measures outside the budget, such as support from states, and relentless implementation of the already announced schemes and measures.

Three announcements stood out – the new National Health Protection Scheme (NHPS), the facilitations to deepen the corporate bond market, and lowering of corporate tax for the micro, small and medium enterprises.

NHPS proposes to provide 10 crore poor and vulnerable families coverage of up to Rs 5 lakh per family per year for secondary and tertiary care hospitalisation. The scheme – India's version of Obamacare – is certainly ambitious, as it proposes to cover a whopping one-third of Indian households.

The corporate bond market should get a fillip from the proposed move to relax regulations to permit investments in bonds with a credit rating of 'A' and also nudge large corporates to meet about one-fourth of their financing needs from the bond market.

The budget lacked big ideas to boost consumption, which would be a disappointment for consumption-oriented sectors, although the rural thrust could provide some succour. The salaried class, particularly, would have been hoping for more.

In the bond market, yields took off as the government announced breaching of the fiscal deficit target by 30 basis points for this fiscal and 20 bps for the next. The upward bias on debt yields warrants a cautious approach for duration investing.

The imposition of long term capital gains tax on sale of equity shares and equity-oriented mutual funds was a widely expected move. This could bring in some volatility in the short term even as the proposal to ‘grandfather’ gains made up to January 31, 2018, limits the impact. Regardless, equity will continue to be a preferred investment option for long-term financial planning.

Economy

The pick-up in economic growth in fiscal 2019 will be largely due to factors outside the budget, with some incremental support from budgetary proposals. For instance, in fiscal 2018, despite a good monsoon and rural-focused budget, the economy slowed down and rural distress increased, as extra budgetary factors turned adverse. In what follows, we focus on the demand-side gross domestic product (GDP) and evaluate the implications of budget proposals for each GDP component.

That said, the fiscal stance of the budget has implications for government bond yields and monetary policy. Also, the budget can help make growth inclusive and distributive.

How will the budget affect India's economic growth?

The budget looks to support growth in fiscal 2019 primarily through raising rural demand. The rural sector has been the primary focus with measures such as an assured minimum support price (MSP), export liberalisation of agri-products expected to revive farm realisations, and increased expenditure on rural infrastructure expected to improve overall rural demand. The budget has also taken measures to boost growth of small and medium enterprises (MSMEs) by measures such as cut in corporate tax rate. In addition, incentives given to create employment in MSMEs can contribute to private consumption growth.

Impact on key demand-side components of GDP

	Current situation	Factors that will shape the outlook for fiscal 2019	How will the budget affect the outlook
Private consumption expenditure	Private consumption growth is estimated to slow to 6.3% in fiscal 2018 from 7.3% in the previous fiscal. Nevertheless, its share in GDP is the largest among demand side components of GDP.	Consumption will remain the engine of growth in fiscal 2019. Implementation of the Seventh Pay Commission hikes at the state level would help.	The budget can mainly impact private consumption through improved rural demand. The budget has focused on improving price realisation for farmers by measures such as assured MSP, liberalisation of agri-exports, and improvement in rural infrastructure. In addition, the measures to boost employment (such as extending 30% tax deduction for footwear and leather industries on hiring new employees) will improve purchasing power.
Investment	Investment growth[1] is expected to decline 0.9% in fiscal 2018 after growing 10.1% in the previous fiscal. The share of investments in GDP will decline to 29% from 31.1% in the previous fiscal.	Investments are expected to see a gradual recovery, as the balance sheet clean-up progresses. The recapitalisation of public sector banks and the implementation of the	Central government investment[2] is projected to increase 7.2% in fiscal 2019 from 2.7% growth in fiscal 2018. However, the impact on overall investment will be modest since states play a greater role in investment than the central government. States account for 64% of

[1] *As measured by gross fixed-capital formation*
[2] *As measured by productive expenditure, which is a sum of budgeted capital expenditure and grants in aid of creation of capital assets*

	Current situation	Factors that will shape the outlook for fiscal 2019	How will the budget affect the outlook
		Insolvency and Bankruptcy Code will help speed up resolution of non-performing assets. Continued growth in consumption demand will raise capacity utilisation, which will help trigger investments.	total government capital expenditure, and this share has risen in the recent years. Nevertheless, the central government's continued increase in infrastructure spending will help crowd-in private investments over medium term. The focus this time is on rural infrastructure, which has been allocated Rs 14.34 lakh crore (Rs 2.4 lakh crore from budgetary resources, the rest from non-budgetary resources). Capital expenditure for transport has increased 22% on-year to 1.1 lakh crore, driven by 32% increase in railway expenditure. Cut in corporate tax rates for MSMEs can also increase investment in these industries.
Government consumption expenditure	Government consumption's contribution to GDP growth has risen significantly in the past few years. Growth in government consumption expenditure is expected to rise further to 15.2% in fiscal 2018 from 12.2% in previous fiscal.	State expenditure could rise as they implement Pay Commission and farm loan waivers	Central government's consumption expenditure is expected to moderate in fiscal 2019, given that effective revenue expenditure of central government is expected to decline modestly to 10.5% of GDP in fiscal 2019 from 10.6% in fiscal 2018.
Exports	Despite improving global growth and trade, India's export growth of goods and services is expected to slow to 4.4% in fiscal 2018 from 5% in previous fiscal. Domestic disruptions, such as glitches in the GST implementation, hampered business activity, especially in sectors comprising small and medium enterprises.	As glitches related to the GST implementation dissipate, export growth is expected to catch up with the continued recovery in global trade expected in 2018. S&P Global expects global trade to grow 3.7% in 2018, 10 bps higher than previous year. This will help increase India's export growth.	The budget is expected to boost labour-intensive export sectors such as agriculture, textiles, leather and footwear. Agriculture exports will rise with removal of export restrictions for crops. Small and medium enterprises – mainly textiles, leather and footwear industries - will be boosted by the cut in corporate tax rate announced for companies with turnover up to Rs 250 crore in fiscal 2017. The tax cut will also help in improving India's competitiveness vis-à-vis its competitors like Vietnam and Bangladesh in these low-end manufacturing industries.
Imports	Import growth at 8.2% is expected to be higher than export growth in fiscal 2018. Import growth was boosted by a sharp rise in oil imports (due to higher oil prices), gold imports (which had risen significantly before the	Import growth can rise further in fiscal 2019, due to the continued rise in oil prices.	Increase in customs duty in certain electronics goods such as mobile phones and its parts and television parts is an import-substituting measure, which will help in curtailing imports, besides boosting domestic manufacturing in these goods. The share of electronic goods in India's total imports has risen rapidly from 7.6% in fiscal 2014 to 11.7% in fiscal 2018.

	Current situation	Factors that will shape the outlook for fiscal 2019	How will the budget affect the outlook
	GST implementation due to uncertainty regarding tax rates), and a recovery in consumption demand due to the dissipating effect of demonetisation.		Fiscal 2018 saw an average 30.5% on-year growth in electronics imports, which pushed overall import growth in addition to higher oil and gold imports`.

Overall macroeconomic outlook

The fiscal slippage on part of the central government can undermine macroeconomic stability, already facing significant risks from external developments. With this in view, we give our overall macroeconomic outlook and highlight key risks to watch out for in the near term.

	FY17	FY18F	FY19F	
GDP (% y-o-y)	7.1	6.5	7.5	GDP growth will bounce back to 7.5% in fiscal 2019, from a low base of 6.5% in fiscal 2018, driven by consumption. Investment will improve at a gradual pace, aided by bank recapitalisation and improved capacity utilisation. Export growth, held back in fiscal 2018 due to domestic disruptions, is expected to recover, taking advantage of the improving global trade and GDP growth.
CPI inflation (% y-o-y)	4.5	4.0	4.6	Inflation will pick up due to rising consumption demand, impact of house rent allowance revisions on housing inflation, and higher global crude oil prices. Food inflation is likely to stay benign given a normal monsoon.
Fiscal deficit (% of GDP)	3.5	3.5	3.3	The government deviated from its budgeted target for fiscal 2018 by 30 basis points and extended the target of achieving the 3% target by three years.
10-year G-sec yield (%)	6.8	7.5-7.55	7.5*	With the deviation from the fiscal consolidation path, rising oil prices, and inflation, yields on 10-year government securities have come under pressure. The net market borrowings for fiscal 2019 are lower than fiscal 2018, yet the FPI[3] outflows due to unfavourable global financial developments (outlined in the section 'Risks to growth') can further raise yields.

**with upside bias*

Risks to growth

- **Risks to capital inflows from global financial developments**: Foreign capital inflows, which had adequately financed the current account deficit in fiscal 2018, face risks in fiscal 2019 from the following possible global developments:
  - Corrections in asset prices, which can lead to withdrawal of capital from emerging markets, including India

[3] *Foreign Portfolio Investment*

- Tightening of monetary policy by major central banks which can gradually shrink global liquidity
- Rise in the US treasury yields, which can also lead to transfer of capital flows to the US economy and an appreciation of the US dollar

- **Rising oil prices**: The continued rise in oil prices will further inflate the import bill, widening the current-account deficit. Rising oil prices will also increase inflation and put pressure on the fiscal deficit. This can spook foreign investors, threatening capital inflows further.
- **Lingering GST-related glitches**: Delays in tax refund and other glitches in GST infrastructure had hampered business activity. This was especially for small and medium enterprises, which suffered a shortage of working capital. The downturn was evident in the export slowdown in sectors such as gems and jewellery, textiles, and leather, which are mostly composed of MSMEs and are also labour-intensive. If the glitches from GST implementation (including introduction of the e-way bill) persist, industrial activity will remain subdued in fiscal 2019.
- **Below-normal monsoon**: A below-normal monsoon will reduce agricultural growth, depressing rural demand. Although the initial forecasts from the India Meteorological Department (IMD) rule out an El Nino effect (associated with weak summer monsoons) in 2018, risks remain due to the rising unpredictability of weather.

Government breaches fiscal deficit target for the first time

Government laid to rest speculations about the ensuing fiscal slippage this year as it announced in the budget the fiscal deficit target of 3.2% of GDP for fiscal 2018 would be breached by a good 30 bps. Interestingly, the lower GDP growth this fiscal on account of the lingering impact of demonetisation and implementation of the landmark GST taxes didn't hamper the tax collection. In fact, the government collected more taxes than it budgeted – both on the direct and indirect tax front. Another positive development was the government was able to garner more disinvestment receipts than budgeted – Rs 1 lakh crore vs Rs 0.725 lakh crore. This was after several consecutive years of missed disinvestment targets. The slippage, therefore, was largely on account of the following key reasons:

- **Lower non-tax revenue**: This part majorly consists of receipts from dividends and profits (the largest chunk under non-tax revenue) and spectrum sales. As opposed to the budgeted Rs 2.89 lakh crore in non-tax revenue, the government collected Rs 2.36 lakh crore. Receipts on account of spectrum sales were significantly lower at Rs 30,736 crore as opposed to the targeted Rs 44,342 crore.
- **Overshooting of revenue expenditure**: The government ended up spending Rs 19.44 lakh crore as opposed to the budgeted Rs 18.37 lakh crore. The higher revenue expenditure was on account of higher-than-budgeted interest payments (the largest component of revenue expenditure) and pensions. Both are considered to be non-productive revenue expenditure. GST compensation paid to states too created fiscal stress.
- **Lower oil excise collections**: The government had budgeted revenue at a healthy Rs 3.45 lakh crore from excise on petrol and diesel, hoping it would increase the excise as it was assumed oil prices would stay low last year. Inability to do so in the wake of a sharp surge in oil prices[4] has meant that government's excise collections fell short by Rs 87,945 crore.

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[4] *Brent oil prices have risen by about 16% so far this fiscal, after having declined by 11.4% and 46.2% in fiscal 2017 and fiscal 2016 respectively*

But a greater cause for concern is that despite a cut in its capex, there was a breach in the fiscal deficit. This means had the government stuck to its targeted capex for fiscal 2018, the fiscal deficit would have been still higher. Government cut its capital expenditure by Rs 36,356 crore and, likewise, grants for creation of capital assets were also pruned by Rs 6,105 crore. This suggests productive spending in the economy was compromised in fiscal 2018 on account of fiscal stress.

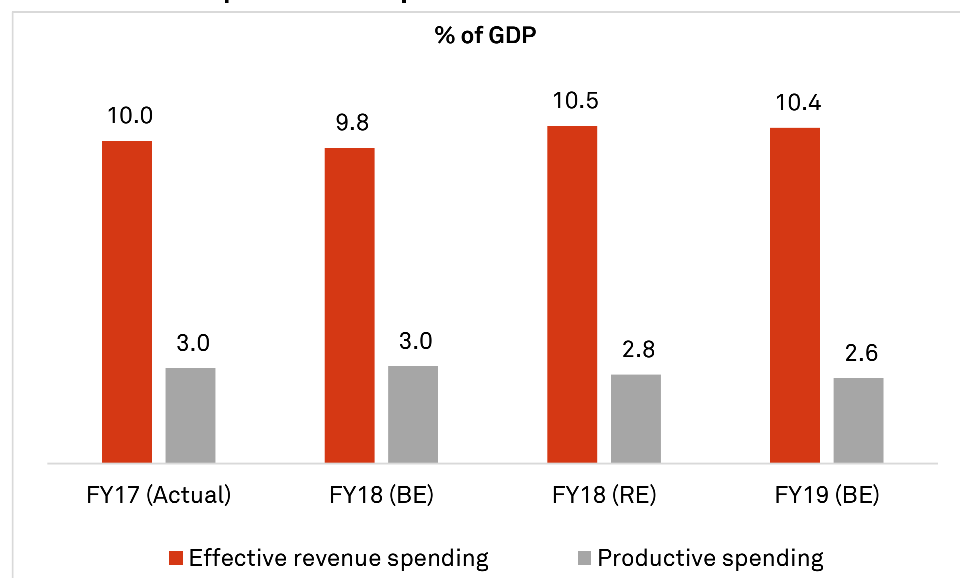
The quality of spending has suffered

While the fiscal consolidation targets have been stretched, the expenditure mix too has worsened with the share of revenue in total expenditure rising to 88% (in fiscals 2018 and 2019) from 86% in fiscal 2017 at the cost of capital expenditure.

More critically, the share of productive spending (capital expenditure *plus* grants in aid for capital creation) is steadily coming down. In fiscal 2018, productive spending rose modestly (2.7% higher on-year but 8.4% lower than budget) while effective revenue spending spiked (15.7% on-year and 7% over budgeted). The mix is unlikely to improve much for fiscal 2019 despite slower growth in effective revenue spending and a 7.2% growth in productive spending.

Most of the increase in effective revenue spending during the two fiscals is on account of compensation paid to states on the GST rollout, higher pension outgo, and higher interest payments on market loans. In contrast, sectors which faced the brunt of a capex curtailment in fiscal 2018 are irrigation and flood control, energy, and transport (especially railways).

Revenue versus productive expenditure



Source: Budget documents, CRISIL Research

Fiscal math banks on aggressive indirect tax collection targets

While the government's direct tax collection target appears achievable, the indirect tax growth assumption of 19.1% over an 8.7% growth in fiscal 2018 seems a tad ambitious. This entails indirect tax buoyancy rising sharply to 1.7 from the 1.0 achieved this fiscal. It is largely premised on the assumption of a high growth of 67.3% in GST collections next fiscal.

While the GST assumption looks high, it may be attained since the GST is expected to stabilise this year and see greater improvement in the tax base. Furthermore, the growth would also benefit from the low base effect. Another important thing to note is not only will the GST regime boost indirect-tax collections, but also direct-tax collection. The latter will be in the form of corporate taxes in the coming years as more firms come under the formal tax net.

Major tax heads

	Rs lakh crore				Growth (%)				
	FY16	FY17	FY18 RE	FY19 BE	FY16	FY17	FY18 RE	FY19 BE	Average FY16-FY18
Gross tax revenue	14.59	17.16	19.46	22.71	17.2	17.6	13.4	16.7	16.1
Direct tax	7.42	8.49	10.05	11.5	6.6	14.5	18.3	14.4	13.1
o/w corporation tax	4.53	4.85	5.64	6.21	5.7	7.0	16.3	10.2	9.6
income tax	2.88	3.65	4.41	5.29	8.2	26.8	21.0	19.9	18.7
Indirect tax	7.14	8.66	9.41	11.2	30.0	21.4	8.7	19.1	20.0
o/w GST	--	--	4.45	7.44				67.3%	67.3%

Source: Budget documents, CRISIL Research

Some possible avenues for fiscal slippage

Are there any risks in achieving the fiscal deficit target of 3.3%?

There aren't many risks, but some factors to watch out for include:

- **Spectrum receipts**: Government faltered on its spectrum revenue receipts in fiscal 2018. As opposed to the budgeted Rs 44,342 crore in spectrum receipts this fiscal, the government could rake in only Rs 30,736 crore. For fiscal 2019, it has again set an ambitious target of Rs 48,661 crore. We believe government may be able to realise only Rs 33,672 crore, implying a revenue shortfall of Rs 14,989 crore.
- **Disinvestment receipts**: Given the extraordinary buoyancy in capital markets this year and pressure on other sources of revenue, the government did manage to more than achieve its disinvestment target of Rs 72,500 crore, garnering receipts of Rs 100,000 crore. Looking at the past trend, it may not be easy to replicate the same feat next year. Hence it may be reasonable to expect some shortfall in the government's ambitious Rs 80,000 crore disinvestment target for fiscal 2019.

  Growth recovery below expectations: While the government's 11.5% nominal GDP growth assumption is in sync with CRISIL estimates, the tax collection targets can be missed should growth surprise on the downside (see the 'Risks to growth' section in Outlook).

Diminishing role of Centre's budgetary spending in spurring GDP growth

Increasing role of states

It is important to note that while the Centre is being looked at as the beacon for growth and investments in the economy, it is the states that have assumed a greater role over the years. This is at least as far as the size of their budgetary spending is concerned. All states together have a greater share in the expenditure than the Centre. The ratio is still higher if we compare the capital expenditure, a more critical component for creating productive assets and enhancing future growth. Moreover, the share of states has increased over the years. Since states are now past the UDAY burden, one can expect states to play a more critical role in the coming fiscal years.

Total expenditure

Rs bn	FY14	FY15	FY16 RE	FY17 BE
Centre	15,594.47	16,636.73	17,907.83	20,144.07
States	16,243.00	19,388.40	24,600.20	27,239.20
States' share (%)	51.0	53.8	57.9	57.5

Capital expenditure

Rs bn	FY14	FY15	FY16 RE	FY17 BE
Centre	1,876.65	1,966.81	2,530.22	2,798.47
States	2,445.40	3,015.50	4,707.90	4,873.90
States' share (%)	56.6	60.5	65.0	63.5

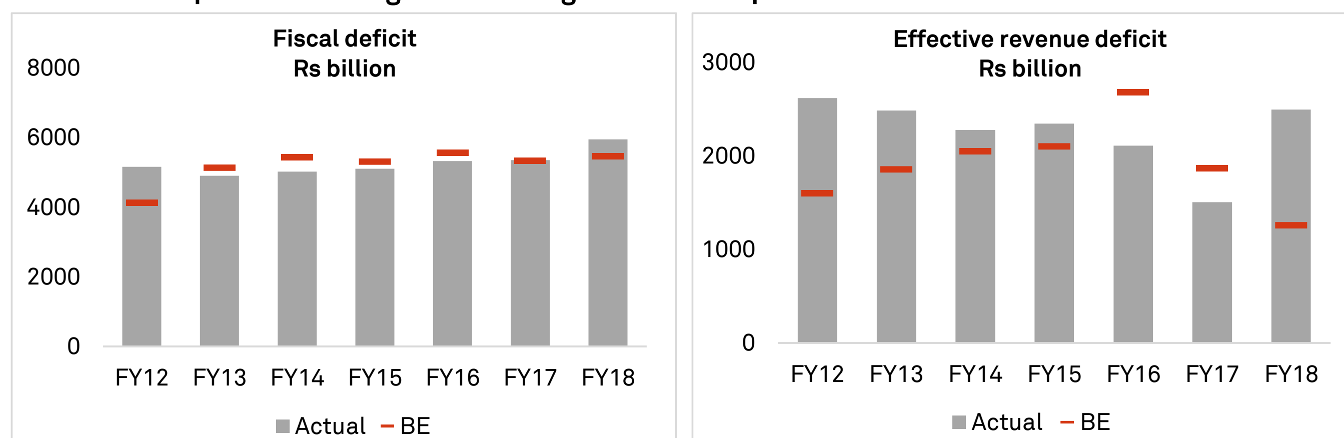
Higher dependence on IEBR

Another noteworthy observation is that over the years, the central government's reliance on Internal and Extra Budgetary Resources (IEBR) too has gone up significantly to support capital expenditure in the economy. To put it in context, the share of IEBR in total capital spending in the economy is estimated at 61.4% in fiscal 2019, up from 47.4% a decade ago. This implies the share of budgetary support has declined from 52.6% to 38.6% during this period.

Government skids on fiscal marksmanship

So far, the government had displayed reasonable fiscal marksmanship. But in fiscal 2018, deficit targets have been missed consequent to a sharp increase in revenue expenditure and some shortfall in non-tax revenue. About 60% of the increase in revenue spending relative to the budget is because of payment of compensation to states for revenue loss on account of the GST rollout, 15% due to higher pension outgo, and 7% due to higher interest payments on market loans, 91-day treasury bills and payment on interest of reserve funds. Higher disinvestment revenue only covered about half the shortfall in non-tax revenues. ***The point to reiterate here is the fiscal slip is despite a near 12% cut in capital expenditure relative to what was budgeted.***

Government slips on fiscal targets due to higher revenue spends



Note: Effective revenue deficit is revenue spending after deducting grants in aid for creation of capital assets

Source: Budget documents, CRISIL Research

Fiscal consolidation path stretched by three years

Last year, the government set itself the target of lowering the fiscal deficit to GDP ratio to 3% by fiscal 2019. This year's budget has not only upped this target to 3.3% for fiscal 2019, but also proposes to stretch the glide path to achieve the 3% target, to fiscal 2021. In the proposed amendment to the Fiscal Responsibility and Budgetary Management (FRBM) framework, the government will simultaneously target debt and fiscal deficit reduction and do away with targeting revenue deficit.

The worry, however, is that the improvement in fiscal position over the glide period critically hinges on three key assumptions:

- A sharp increase in the tax buoyancy in the economy
- An average GDP growth rate of ~12% (7.6% real growth) over the fiscal consolidation target period
- The tax to GDP ratio, accordingly, is forecast to rise 12.7% in fiscal 2021 from an already decade-high 12.1% in fiscal 2019. The government believes there could in fact be a further upside to these numbers.
- An average 7.8% growth in non-tax revenue (mainly through dividends) compared with a 13.5% decline in fiscal 2018.

What lies beneath the glide path

	FY18 RE	FY19 BE	FY20	FY21	Average growth
Fiscal deficit to GDP (%)	3.5	3.3	3.1	3.0	-
Debt or outstanding liabilities to GDP (%)	50.1	48.8	46.7	44.6	-
Nominal GDP growth (%, y-o-y)	10.5	11.5	11.8	12.3	11.9
Real GDP growth (%, y-o-y)	6.7	7.2	7.5	8	7.6
Gross tax revenue growth (%, y-o-y)	13.4	16.7	14.3	14.7	
Tax to GDP (%)	11.6	12.1	12.4	12.7	-
Non-tax revenue growth (%, y-o-y)	-13.5	3.9	8.4	11	7.8

Source: Medium term fiscal policy statement, Budget documents, CRISIL

Financing of fiscal deficit

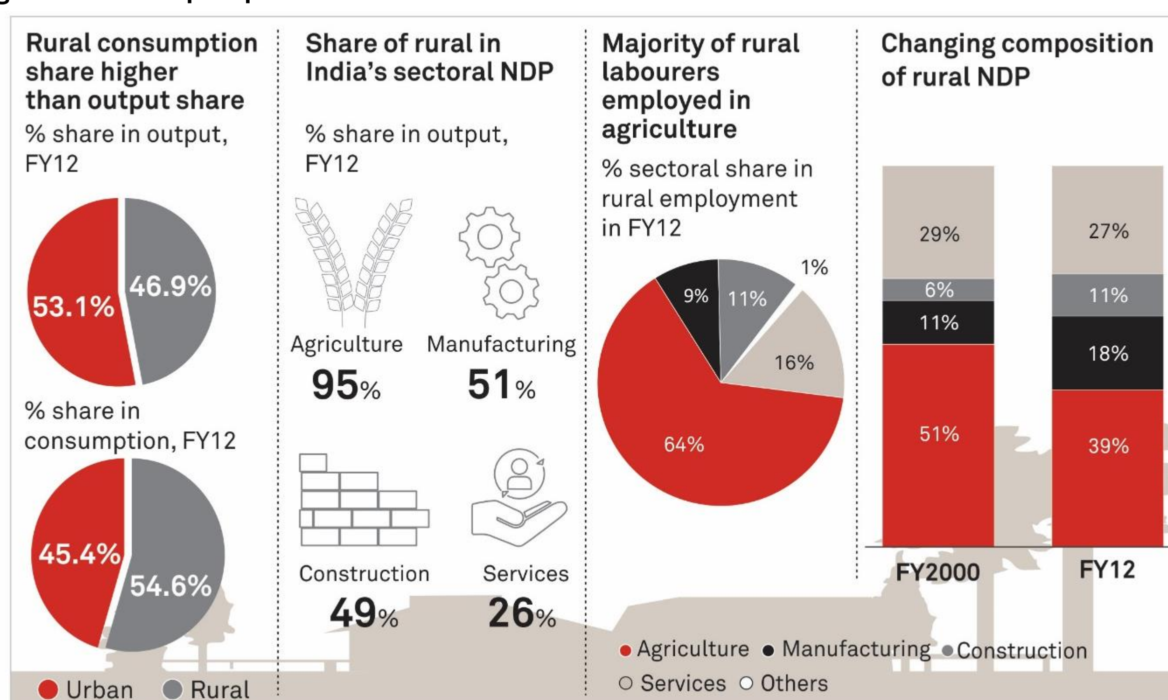
Over the past few years, the pattern of fiscal-deficit financing has undergone some change. While market borrowing still remains the dominant source of financing, borrowing from the National Small Savings Fund (NSSF) has increased in the past two years because of changes in regulations. This is largely attributable to the fact that the size of the NSSF has been rising, as its constituent small-savings instruments have offered higher interest rates to savers than those offered by comparable market instruments, along with the existing tax incentives on savings. In addition, it is no longer binding on states to finance their deficits from the available pool of small savings, and they have the option to avail market borrowing if costs are lower. That leaves the small savings pool to be absorbed by the Centre. While the share of market borrowing in the fiscal deficit (or total borrowing requirement of the government) stood at 80.7% in fiscal 2018, that of the NSSF was 17.3% up from 12.6% in fiscal 2017.

This fiscal has seen some changes in this trend. The share of the NSSF in financing the fiscal deficit is estimated to again come down to 12% in fiscal 2019. As for the market borrowings, net market borrowing through dated securities and treasury bills combined is estimated to come down to Rs 4.07 lakh crore in fiscal 2019, from Rs 4.79 lakh crore in fiscal 2018. Of this, net market borrowing through dated securities is slated at Rs 3.9 lakh crore in fiscal 2019, down from Rs 4.02 lakh crore. This should limit the upside to the yields.

Easing the pain in hinterland

The importance of the rural sector in India's growth story cannot be less emphasised, as it accounts for ~69% of India's population, 47% of net domestic product (NDP), and 55% of private consumption. Therefore, providing an impetus to rural development is critical for India's growth story.

Putting rural India in perspective:



Source: Central Statistics Office, National Sample Survey, Niti Aayog discussion paper on 'changing structure of rural economy of India implications for employment and growth', CRISIL

In fiscal 2018, the rural economy witnessed two major setbacks – depressed domestic and global food prices in a year of bumper crop production which led to a fall in cultivation incomes and profitability. In addition, the twin disruptions from the lingering impact of demonetisation and GST implementation glitches, coupled with constrained spending on social safety net schemes, dented rural demand. All these piled on to the rural woes. The magnifying rural distress also spilled over to the streets, with farmers in various parts of the country demanding loan waivers. To help the rural community overcome these setbacks, it was imperative to provide a boost to rural income. So, what does the budget for fiscal 2019 have in store for the rural economy?

The agrarian push

As per the Constitution of India, the legislative onus of agriculture and land rests with the states. Therefore, the Central government's role in addressing the woes of the agrarian economy is limited to providing an overarching policy framework for the states to emulate and offer some resources. Within its limited purview and given its ambitious target of doubling farmers' income by 2022, the government has increased its budgetary allocation for agriculture and allied activities from the revised estimate of Rs 56,598 crore in fiscal 2018 to Rs 63,836 crore in fiscal 2019. The allocation has increased 12.8% on-year in fiscal 2019 similar to that in fiscal 2018.

Budgetary allocation for agriculture and allied activities

	FY16	FY17	FY18 RE	FY19 BE
Agriculture and allied activities (Rs crore)	23,694	50,184	56,589	63,836
%, y-o-y		111.8%	12.8%	12.8%
of which				
Pradhan Mantri Fasal Bima Yojana (Rs crore)	2,983	11,052	10,698	13,000
%, y-o-y		270.5%	-3.2%	21.5%
Pradhan Mantri Krishi Sinchai Yojana (Rs crore)	7,781	5,134	7,392	9,429
%, y-o-y		-34.0%	44.0%	27.6%

Source: Union Budget 2017-18 and Union Budget 2018-19, CRISIL

Looking to provide relief to farmers, the government has focused on providing long-term relief by empowering farmers in withstanding weather and supply shocks. In Budget 2018-19, the government has announced the following price smoothing mechanism which CRISIL had highlighted in the insight ***Pulses and Rhythms*** released in September 2017.

- **Effective price discovery and efficient markets:** The government has announced two key measures that will enable better price discovery for farmers – development of Gramin Agricultural Markets (GrAMs) and encouraging Farmer Producer Organisations (FPOs). The GrAMs will be electronically linked to e-NAM and exempted from regulations of Agricultural Produce Marketing Committee (APMC) Act, enabling farmers to sell the produce directly to the consumers and bulk purchasers. In addition, the Budget has also encouraged FPOs by providing them tax incentives. These measures will enable farmers to break free from the cobweb phenomenon trap[5].

[5] *Cobweb phenomenon is where production responds to prices with a lag, causing a recurring cycle of rise and fall in output and prices*

- **Flexible export policy:** The government intends to liberalise export of agri-commodities which would pave the way for India to release its agri-exports potential of $100 billion against current exports of $30 billion. In addition, this will help in insulating the farmers against positive supply shocks.
- **Improving price realisation:** The government has extended the MSP programme for all kharif crops for which the MSP hasn't been announced. The MSP would be set at 1.5 times the cost of production. In addition, to ensure that benefits of the MSP programme accrue to the farmers, the government, in the event of the prices in agriculture produce market being less than MSP, intends to either purchase the crops at the MSP or work to provide the MSP rate for farmers through some other mechanism. The government has also launched 'Operation Greens' scheme on the lines of 'Operation Flood' to address the price volatility in perishable crops such as potato, tomato and onion, thus insulating farmers from decline in prices due to positive supply shocks.

Besides these, the government has also announced increased allocation for irrigation (Pradhan Mantri Krishi Sinchai Yojana) and crop insurance (Pradhan Mantri Fasal Bima Yojana) which will help in strengthening the farmers' position in the face of a weather shock. However, effective implementation of these schemes is critical for the agrarian community actually enjoying the benefits.

The non-agrarian rural boost

Encouraging the non-agricultural rural economy is extremely critical to absorb the surplus labour employed in the agricultural sector. Creating employment opportunities and increasing the non-agricultural rural wages will help in increasing the overall productivity of the rural economy – both agricultural and non-agricultural. In fiscal 2018, the government overshot its budgetary allocation for rural development by about Rs 7,044 crore (5.5% relative to budgeted), primarily on account of higher expenditure on MGNREGS (Mahatma Gandhi National Rural Employment Guarantee Scheme). Overall, in its budget for fiscal 2019, the increase in budgetary allocation for rural development appears muted at 1.8% on-year.

Budgetary allocation for rural development

	FY16	FY17	FY18 RE	FY19 BE
Rural development (Rs crore)	90,235	113,877	135,604	138,097
%, y-o-y		26.2%	19.1%	1.8%
of which				
MGNREGS (Rs crore)	37,341	48,215	55,000	55,000
%, y-o-y		29.1%	14.1%	0.0%
Pradhan Mantri Gram Sadak Yojna (Rs crore)	18,290	17,923	16,900	19,000
%, y-o-y		-2.0%	-5.7%	12.4%
Pradhan Mantri Awas Yojna – Rural (Rs crore)	10,116	16,071	23,000	21,000
%, y-o-y		58.9%	43.1%	-8.7%
National Rural Livelihood Mission (Rs crore)	2,514	3,158	4,350	5,750
%, y-o-y		25.6%	37.8%	32.2%

Source: Union Budget 2017-18 and Union Budget 2018-19, CRISIL

- ***Non-agri rural employment:*** Despite the expenditure on MGNREGS overshooting the budgetary allocation (by 15% to ~Rs 7,000 crore) in fiscal 2018, the government opted to allocate to keep the budgetary allocation for the scheme in fiscal 2019 unchanged from the revised estimate of fiscal 2018. However, the government has increased the scope of the construction activities covered under the scheme by including development of physical infrastructure for GrAMs under the ambit of the scheme. Thus, the scheme would also focus on providing quality infrastructure which will benefit the agricultural sector along with creating non-agri rural employment. In addition, the government has increased the budgetary allocation on National Rural Livelihood Mission by 32% on-year to help improve employment opportunities.
- ***Rural construction:*** As in other years, the government continued its support for rural road construction (under the Pradhan Mantri Gram Sadak Yojana) by increasing the budgetary allocation by 12.4%. But, the allocation on rural housing, which had received significant support in the previous years, has been reduced by 8.7% on-year. However, including extra-budgetary and non-budgetary resources of ~Rs 12 lakh crore the government intends to pump in Rs 14 lakh crore into the rural economy to fulfil its ambitious target of generating 321 crore person days, 3.17 lakh km of rural roads, and 51 lakh new rural houses. Increasing employment opportunities, especially through construction of infrastructure projects, can help absorb agricultural labourers and offset agricultural losses (if monsoon underperforms in fiscal 2019), and can boost rural consumption in case of a normal monsoon.

In a nutshell, the Budget has focused on easing the rural distress. However, as past experience shows, announcing new measures and committing resources is not enough to improve the condition of the farming community. For success, these have to be complemented by measures outside the Budget, such as support from states and relentless implementation of the already announced schemes and measures.

Sectoral impact

Agriculture: A ray of hope

Positive

Budget announcements

- Minimum support price (MSP) for kharif crops (that have not been announced) to be at least 1.5x of production cost
- NITI Ayog to put in place optimal mechanism to ensure farmers receive adequate prices for their produce
- Agri institutional credit up 10% at Rs 11 lakh crore compared with the budgeted number of last year
- Development and upgradation of 22,000 rural haats into gramin agricultural markets (GrAMs)
- Agri market infrastructure fund, with an outlay of Rs 2,000 crore, to be set up for developing and upgrading agricultural marketing infrastructure in the 22,000 GrAMs and 585 agricultural produce market committees
- To set up state-of the-art testing facilities in all 42 mega food parks
- 100% tax exemption to farmer producer organisations (FPOs) with turnover of up to Rs 100 crore
- Rs 500 crore outlay announced for 'Operation Greens' to address price volatility of perishable commodities, such as potato, tomato and onion
- Allocation to Pradhan Mantri Fasal Bima Yojana increased 44% to Rs 13,000 crore from Union Budget 2017-18 estimate of 9,000 crore
- NITI Aayog to evolve a mechanism to enable access to credit of lessee cultivators
- Allocation to Pradhan Mantri Krishi Sinchayi Yojna (PMKSY) increased 26% to Rs 9,324 crore, split between Ministry of Water Resources, Department of Agriculture, Cooperation and Farmers' Welfare, and Department of Land Resources
- Allocation for fertiliser subsidy at Rs 70,090 crore. Revised estimate for Budget 2017-18 was 7% lower than budgeted estimate

Our view

- MSP at 1.5x of production cost is expected to increase the exchequer's bill by ~Rs 7,000 crore.
- Payment of differential between *mandi* price and MSP to farmers, if implemented, could increase government's burden by over Rs 20,000 crore, based on 14 key crops of crop year 2017 (Rabi 2016 output sold in 2017 and Kharif 2017 output).
- No major impact of 10% increase in credit target for agriculture, which is in line with the previous year
- Various infrastructure initiatives to help farmers earn better prices for their produce
- Most of the 706 registered FPOs (as of December 31, 2017) are expected to benefit from 100% tax exemption
- Access to credit for lessee cultivators, comprising ~75,000 households, could improve
- Under PMKSY, ~60% of the incremental spend is towards 'Har Khet ko Pani', which will focus on 96 deprived irrigation districts where less than 30% of the land holdings get assured irrigation. Spends for fiscal 2018 in line with budgeted estimates.

- Budgeted fertiliser subsidy of Rs 70,090 crore adequate as the subsidy bill for fiscal 2019 is expected at Rs 53,000-54,000 crore (assuming energy efficiency in line with pre set norms for fiscal 2019) . The rest of the provision can go towards substantially reducing the arrears of the previous years
  - Owing to timely payment of subsidies and payment of arrears, working capital requirement of fertiliser companies will decline sharply. Consequently, overall interest cost for these players will fall

Automobiles: Agri push to boost tractor and two-wheeler demand **Positive**

Budget announcements

- Presumptive tax: Heavy vehicles (GVW>12 tonne) to have presumptive income of Rs 1,000 per tonne per month, while lighter trucks will continue to be charged Rs 7,500 per month
- Increase in basic customs duty to 15% from 10% on radial tyre imports for trucks and buses
- 5-7.5% increase in customs duty on fully built vehicles (FBVs), completely built units (CBUs), completely knocked down (CKD) units, and automotive components across vehicle and component categories
- Subsidy for over 1000 e-vehicles (EVs) and charging infrastructure for public transport in 11 cities
- Agriculture and rural-focused announcements, including hike in MSPs, corpus for developing agricultural markets, a 10% on-year increase in institutional credit for agriculture sector to Rs 11 lakh crore
- Reduction in corporate tax from 30% to 25% for companies having turnover less than Rs 250 crore

Our view

- Increase in agricultural income and institutional credit to the rural economy will increase finance penetration in the automotive sector, particularly for two-wheelers and tractors
- Since 25-30% of radial tyres for trucks and buses are imported, increase in customs duty would increase the price of imported tyres by ~Rs 500/ tyre. Domestic tyre manufacturers thus stand to gain
- Around 50% of transporters currently opt for presumptive tax scheme. With an increase in presumptive income from Rs.7500 per month to Rs.1,000 per tonne per month for heavy trucks (GVW> 12 tonne); transporters with trucks with GVW >= 25 tonne may not opt for presumptive tax
- Customs duty increase in a few automotive component segments will have a marginal impact as these components form less than 1% of total imports in value terms while they form 50% of the $43.5 billion domestic component industry's turnover and over 30% of its $11 billion exports
- Reduction in corporate tax will help 80% of the auto component MSMEs expand margins
- Customs duty increase on FBVs and CBUs to promote local manufacturing
- Subsidy for over 1,000 EVs for public transport too miniscule to aid government's vision of adoption of EVs

Cement: Demand set to get a boost **Positive**

Budget announcements

- Capital outlay on Pradhan Mantri Awas Yojana -Urban (PMAY-U) boosted five-fold to Rs 31,500 crore
- Outlays for the Ministry of Road Transport and Highways (MoRTH) and Railways increased 11% and 22%, respectively
- Numerous incentives for agri sector such as minimum support price (MSP) to be at least 1.5x of production cost and allocation to Pradhan Mantri Krishi Sinchayi Yojna (PMKSY) increased 26%
- Replacement of the education and higher-education cess (3%) on the custom duty for imported goods with a social welfare surcharge of 10%

Our view

- Further, the government's focus on improving farm income in the budget, coupled with a dedicated fund for affordable housing, should aid rural growth
- A hefty allocation of Rs 31,500 crore for the Pradhan Mantri Awas Yojana - Urban (PMAY-U), compared with Rs 6,000 crore in the previous year, to aid some recovery in the otherwise muted urban-housing demand (~30% of cement demand)
- Healthy budget outlay for cement-intensive infrastructure segments like roadways, irrigation and railways should cement growth (infrastructure share estimated at 20%). However, achievement of budgeted outlay to be key monitorable as some shortfall was observed in previous fiscal
- The replacement of 3% education cess on custom duty with a 10% social-welfare surcharge will marginally increase the cost of imported inputs:
  - Petcoke and imported non-coking coal prices should increase 0.6-0.8% and 0.1-0.2%, respectively

Financials: Affordable housing, MSMEs and rural credit to benefit **Neutral**

Budget announcements

- Higher credit targets for the agricultural sector and Pradhan Mantri Mudra Yojana at Rs 11 lakh crore and Rs 3 lakh crore, respectively
- The limit on the tax deducted at source (TDS) for interest income on deposits has been raised from Rs 10,000 to Rs 50,000 for senior citizens
- Affordable housing fund to be set up under the National Housing Bank
- The Securities and Exchange Board of India (SEBI) will mandate large corporates to meet about one-fourth of their financing requirement from the bond market
- The National Health Protection Scheme (NHPS) will provide coverage of up to Rs 5 lakh per family per year for secondary- and tertiary-care hospitalisation to more than 10 crore households
- Three public-sector general insurance companies to be merged

Our view

- No major impact from the 10% increase in credit target for the agriculture sector in fiscal 2019, considering the previous-year trend, when agriculture credit grew by 12%
- A Rs 0.56 lakh crore increase in the credit target under Pradhan Mantri Mudra Yojana to Rs 3 lakh crore is lower than Rs 1.22 lakh crore increase to Rs 2.44 lakh crore last year. Hence, micro-enterprises will only be marginally benefitted
- A five-fold increase in the TDS limit for interest income should make bank deposits more attractive for senior citizens
- Affordable-housing fund and construction of affordable houses to boost the real estate sector and increase lending opportunities
- MSMEs and retail borrowers should witness higher credit flow, as large corporates tap the bond market to meet the 25% target. Government support towards MSMEs in the form of capital allocation, interest subsidy and tax-rate cut will boost credit demand from the segment
- As of March 2017, around 44 crore Indians were covered under health insurance schemes, and the ambitious NHPS could potentially increase coverage significantly. The modalities of the scheme's implementation have not been specified, but the administration would certainly be challenging, given the scale envisaged and the paucity of health infrastructure in large swathes of the country. In the long term, the scheme will help in increasing the insurance penetration, subsequently boosting the gross-premium growth in health insurance
- The merger of three public-sector general insurance companies – National Insurance Company Ltd, United India Assurance Company Ltd and Oriental India Insurance Company Ltd – would lead to better capital usage and operating efficiency

Healthcare: Budget addresses coverage and affordability **Positive**

Budget announcements

- A new National Health Protection Scheme (NHPS) to provide cover for 10 crore families (~50 crore individuals) of up to Rs 5 lakh per family per annum, for secondary and tertiary healthcare/hospitalisation expenses
- Rashtriya Swasthya Bima Yojana (RSBY) allocation hiked to Rs 2,000 crore in fiscal 2019 from Rs 1,000 crore in fiscal 2018
- Rs 1,200 crore allocated for 1.5 lakh new comprehensive health care and wellness centres
- 24 government medical colleges and hospitals to be set up by upgrading existing district hospitals
- Rs 600 crore allocated for nutritional support to all tuberculosis patients at the rate of Rs 500 per month during treatment
- Increase in allocation under Jan Aushadhi scheme to Rs 84 crore for fiscal 2019 from Rs 75 crore in fiscal 2018

Our view

- Thrust on affordable and quality healthcare for all, especially the economically disadvantaged citizens
- To be introduced as a pilot scheme, the NHPS highlights the government's intent to reduce the out-of-pocket expenditure on healthcare by the poor. However, funds allocated for the scheme appear to be inadequate and therefore, it is likely that this scheme will be administered over a period of time rather than having any immediate impact.
- Higher allocation under the RSBY is expected to increase health insurance penetration among below poverty line families
- Allocations for 1.5 lakh health and wellness centres and 24 new government medical colleges and hospitals will ensure adequate and affordable healthcare facilities for large sections of the population
- With the government planning to set up 1,000 more Jan Aushadhi stores (in addition to the current 3,000 stores), the affordability of drugs for the consumers will increase; nevertheless, the share of generic drugs in domestic sales will remain low at 4-5%
  - Though there would not be any immediate impact on the pharmaceutical players, the government's increasing focus on selling generic drugs may have a slightly negative impact on the branded drug firms in the long run
- Overall, the budget has treated the healthcare sector well, with positive fallouts in the offing

Infrastructure: Railways the biggest beneficiary **Neutral**

- Capital outlay for the infrastructure sector is Rs 3.9 lakh crore, a meagre 3% increase compared with fiscal 2018 budget estimates (BE) and revised estimates (RE). Only Rs 1.3 lakh crore of this is through budgetary allocation; the rest is through Internal and extra budgetary resources (IEBR)
- Railways saw the highest boost, with a rise of 12% over fiscal 2018 BE and of 22% over RE. Roads saw a modest increase of 7% over fiscal 2018 BE and 10% over RE
- Capital outlay for infrastructure segments

(Rs crore)	Budget 2017-18			Revised 2017-18			Budget 2018-19			Growth in outlay	
	Budget support	IEBR	Total	Budget support	IEBR	Total	Budget support	IEBR	Total	Vs FY18 RE	Vs FY18 BE
Ministry of Road Transport and Highways	54,177	59,279	113,456	50,864	59,279	110,143	59,440	62,000	121,440	10%	7%
Ministry of Urban Development	18,332	15,763	34,095	19,422	15,558	34,980	16,415	16,252	32,668	-7%	-4%
Ministry of Civil Aviation	1,921	3,268	5,188	1,844	7,148	8,992	721	4,601	5,322	-41%	3%
Ministry of Power	3,586	61,881	65,467	1,896	64,318	66,214	2,211	53,469	55,680	-16%	-15%
Ministry of Railways	55,000	76,000	131,000	40,000	80,000	120,000	53,060	93,440	146,500	22%	12%
Ministry of Shipping	384	4,802	5,186	192	5,159	5,351	362	4,830	5,191	-3%	0%
Ministry of Rural Development	5	-	5	5	9,000	9,005	5	-	5	-100%	0%
Minstry of Water Resources	784	9,020	9,804	388	9,020	9,408	708	6,000	6,708	-29%	-32%
Ministry of New and Renewable Energy	40	8,244	8,284	1	9,466	9,467	40	10,317	10,357	9%	25%
Pradhan Mantri Gram Sadak Yojana*	19,000		19,000	16,900		16,900	19,000		19,000	12%	0%
Total	**153229**	**238256**	**391486**	**131513**	**258947**	**390460**	**151963**	**250909**	**402872**	**3%**	**3%**

**PMGSY investments have been considered as revenue expenditure in the Ministry of Rural Development allocations; however, the investments include construction of roads*
IEBR includes spending by government enterprises like NHAI and other public sector undertakings
Source: Union Budget 2018-19

Roads: No major booster announced

Budget announcements

- Total capital expenditure in fiscal 2019 higher than fiscal 2018 RE by 10.25% and BE by 7%
- Cess on petrol and diesel increased, to cover other infrastructure segments too
- Capital outlay for NHAI increased by modest 10% over fiscal 2018 BE and RE
- PMGSY allocation unmoved at fiscal 2018 BE level

Our view

- With only 10% increase in NHAI's capital outlay and a stagnant private investment scenario, awarding and execution momentum in NHAI projects will show limited improvement

- Road cess has been increased from Rs 6/L to Rs 8/L. Further, there is increase in its scope to cover the entire infrastructure industry
- Fiscal 2018 saw only one bundle of 9 projects being floated under TOT; comparatively larger number of projects can be expected to be awarded in fiscal 2019
- NHAI might raise funds from its operational assets via InvITs, depending on the bidding for the first few TOT bundles

Power: Reduced outlay by CPSUs and T&D system strengthening scheme to result in investment slowdown

Budget announcements

- Investments by the central public sector undertakings (CPSUs) such as NTPC, NHPC and NEEPCO to decline by 20%, 22% and 68%, respectively
- Total budget outlay of Rs 15,000 crore towards power sector, a marginal increase of 1% compared with last fiscal
  - Capital outlay hiked by 85% under the SAUBHAGYA scheme to Rs 3,700 crore and 12% under the Integrated Power Development Scheme (IPDS) to Rs 4,930 crore; allocations under the Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY) reduced by 6% to Rs 6,500 crore
- Budgetary outlay for the Ministry of New and Renewable Energy increased by 26% to Rs 5,140 crore
  - Basic custom duty (BCD) on solar tempered glass removed for manufacture of solar modules
  - Net metering to be encouraged for agri-solar pumps
  - Education cess of 3% replaced with 10% social welfare cess on imported goods

Our view

- Tepid growth in power demand, low PLFs for coal-based generation, coupled with reducing peak deficit is expected to result in lower investments in conventional power generation space, which justifies declining investments by public enterprises
- Higher capital outlay under SAUBHAGYA and IPDS is expected to boost power demand and improve last-mile connectivity
- No hike in PGCIL investment is expected to moderate growth in transmission infrastructure. However, rise in budgetary allocations for the Ministry of New and Renewable Energy is likely to drive higher investments in solar parks, canal top solar PV plants and rooftop solar PV plants
- Removal of BCD on solar tempered glass will pare manufacturing cost of solar modules for domestic manufacturers
- Net metering (selling surplus power to discoms post self-consumption) for agri-solar pumps will boost installations and lower under-recovery for discoms from agri-consumers (~22% of power consumption)
- Substitution of 3% education cess by social welfare surcharge of 10% on customs duty is expected to result in marginal increase in landed cost of imported components for solar PV and wind energy plants, which is likely to be passed on to consumers

Railways: Increased allocation, but too much ground to cover

Budget announcements

- Capital outlay rises to Rs 1,46,500 crore, budgetary allocation stands at Rs 53,060 crore
- Rolling-stock procurement gets a boost with 12,000 wagons, 5,160 coaches, and 700 locomotives
- Budgetary allocation for safety increased to Rs 19,215 crore
- Outlay for electrification jumps to Rs 6,297 crore
- Outlay for network expansion grows to Rs 28,484 crore

Our view

- Capital outlay up 22% vs fiscal 2018 RE, but only 12% higher vs BE, leaving a huge and seemingly unlikely target of Rs 3.8 lakh crore for fiscal 2020, considering an investment plan of Rs 8.6 lakh crore between fiscals 2016 and 2020. The bulk of outlay will be met through IEBR (up 17% to Rs 93,520 crore vs RE), while budgetary allocation saw 33% increase vs RE (down 4% vs budget estimate)
- Rolling stock rules (allocation up 8% vs RE to Rs 31,882 crore). Coach and locomotive procurement up 11% and 8%, respectively, vs fiscal 2018 RE, with impetus towards electric locomotives. Wagon procurement, which stood steady in fiscal 2019 vs fiscal 2018 BE, however, saw a 69% jump vs RE due to a dip in procurement in fiscal 2018
- Safety sees 15% rise in budgetary allocation compared with fiscal 2018 RE, with bulk of the funds towards track renewals
- Outlay for electrification rose 25% vs fiscal 2018 RE on account of increased physical targets from 4000 km currently to 6000 km in fiscal 2019
- Outlay for network expansion rose 29% vs fiscal 2018 RE despite slow progress in fiscal 2018. The physical target for fiscal 2019 stands at 1000 km, a 25% rise over fiscal 2018 BE. However, fiscal 2018 RE halved the BE to 402 km, indicating slow progress on this front

Airports & ports: No new project announced

- Outlay, including IEBR for civil aviation, increased 13% to Rs 11,204 crore compared with fiscal 2018 RE, of which budgetary allocation is Rs 6,603 crore. The increase is steeper at 88% compared with BE due to:
  - Extraordinary allocation of Rs 4,470 crore towards purchase of aircraft for special purposes
  - 55% rise in outlay by AAI to Rs 4,086 crore, towards capacity augmentation of airports
  - However, there was a 50% on-year decline in outlay for Air India
- Fiscal 2018 RE increased by 66% compared with BE due to higher IEBR by Air India, which stood at Rs 4,630 crore as against Rs 508 crore
- No new projects have been announced for the ports and shipping sector in the budget. The outlay for fiscal 2019 of Rs 6,700 crore remains flattish compared with fiscal 2018 BE as well as RE

Metals: Infra and rural push to aid demand **Positive**

Budget announcements

- Outlay for railways increased 22%, with budgetary support rising 33%
- Outlay for roads and highways stepped up 10%, with budgetary support rising 17%
- Numerous incentives for agri sector such as minimum support price (MSP) to be at least 1.5x of production cost and allocation to Pradhan Mantri Krishi Sinchayi Yojna (PMKSY) increased 26%
- Education cess (3%) on customs duty for imported goods replaced with social welfare surcharge of 10%

Our view

- Budget outlay for steel-intensive infra segments of rail, roadways and urban infrastructure (infrastructure share in steel demand estimated at 27%) is healthy, thereby aiding steel demand. However, achievement of budgeted outlay to be a key monitorable, as some shortfall was observed in previous fiscal
- Hefty allocation of Rs 31,500 crore, against Rs 6,000 crore in previous year, for Pradhan Mantri Awas Yojana - Urban to propel demand for long steel. Further, with government's focus on improving farm income and rising spend on irrigation sector, rural housing construction is expected to increase, thereby boosting steel demand
- No major upside to aluminium sector as PGCIL's outlay remains flat (56% of aluminium demand emanates from power transmission and distribution)
- Replacement of 3% education cess on customs duty with social welfare surcharge of 10% to marginally raise cost of imported goods:
  - Imported hot rolled coil steel prices to increase 0.7-0.8% and imported aluminium prices 0.5%
  - Imported coking coal prices to rise 0.1-0.2%

Oil & gas: Government under recoveries burden to increase **Neutral**

Budget announcements

- Proposal to release additional 3 crore free LPG connections (to Rs 8cr from Rs 5 cr) to poor women under Pradhan mantri ujjwala yojana (PMUY) scheme
- Introduction of social welfare surcharge of 10% on aggregate duties of customs on imported goods (except petrol & diesel) replacing 3% education cess

Our view

- There is no change in the tax structure for natural gas & other refined petroleum products. However, introduction of social welfare surcharge is expected to result into a marginal rise in input prices of imported LNG & some petroleum products like LPG, bitumen and petcoke, which will be passed on to consumers.
- LPG consumption is expected to rise by ~10% in fiscal 2019 on account of increase in roll out of additional LPG connections under PMUY scheme

- Higher LPG consumption coupled with firm crude oil prices will result into increase in under-recovery burden for Government
  - In fiscal 2019, petroleum product under-recoveries are expected to rise to Rs 320-370 billion on account of growth in LPG demand , coupled with an expected 15-20% rise in oil prices to $ 63-68/bbl in 2018-19.
  - The Government has budgeted an amount of Rs 250 Billion for petroleum related subsidies in fiscal 2019. As the under-recovery amount is expected to be higher than the budgeted amount, the additional burden of ~ Rs 100 billion might impact oil PSU's negatively, leading to some burden sharing by these companies.

Household appliances: Panel TV prices to rise **Marginally negative**

Budget announcements

- Customs duty hiked on LCD/LED TV panels from 7.5% to 15.0%
- Customs duty hiked on panel TV components from 10.0% to 15.0%
- Education cess of 3.0% replaced by social welfare surcharge of 10.0%

Our view

- TV panels account for 85-90% of the panel TV cost. Panel TVs are largely assembled in India and companies majorly use imported panels or open cell units (which are assembled into TV panels). With the hike in customs duty across all the components, prices of panel TVs are estimated to rise by 5-6% y-o-y, despite a 6-7% y-o-y fall in global panel prices.
- Panel TV prices have declined by 4.5-5% annually over the last two years. Increase in prices during fiscal 2019 will pull down the domestic demand growth by 200 bps from the earlier estimate of 6% y-o-y growth.
- Introduction of social welfare surcharge will not have any major impact on the demand of other household appliances, such as refrigerator, washing machine, ACs, as the increase in cost by Rs 100-300 per unit is most likely to be absorbed by the players.

Housing: Marginal reduction in PMAY budgetary support **Neutral**

Budget announcements

- Budgetary support reduced marginally to Rs 27,500 crore to Pradhan Mantri Awas Yojana (PMAY); however, extra budgetary resources (EBR) of Rs 37,000 crore permitted
- Dedicated affordable housing fund under National Housing Bank
- Marginal change in calculation of income from transactions in immovable property

Our view

- Of the total budgetary support of Rs 63,300 crore over fiscals 2016 to 2018 for PMAY (Urban, Gramin), the actual outlay was Rs 61,500 crore. Continuing the emphasis on Housing for All, this year's budget has

allocated Rs 27,500 crore to the mission (PMAY-Urban: Rs 6,500 crore, PMAY-Gramin: Rs 21,000 crore). Compared with last year (Rs 29,000 crore), allocation is lower by 5% due to lower allocation on PMAY-Gramin. However, the government has countered this reduction by permitting EBR of Rs 37,000 crore (PMAY-Urban: Rs 25,000 crore, PMAY-Gramin: Rs 12,000 crore). However, this remains a key monitorable

- Establishing a dedicated affordable housing fund under the National Housing Bank will support government's demand-side intervention in the form of credit-linked subsidy scheme and will increase focus on affordable housing. However, the allocation has not been quantified. Hence, its implementation also remains a key monitorable
- Capital gains arising out of sale of immovable properties are calculated based on the consideration or circle rate value, whichever is higher. As per the budget proposal, the calculation will be based on the higher value in case the difference between the circle rate and consideration values is more than 5% of the consideration value. In the current market scenario, where circle rates in a few localities exceed the actual consideration value, change in calculation methodology will benefit sellers (maximum 5% of consideration value, based on market factors). However, this announcement is unlikely to affect the overall demand scenario

MSME: Easier credit availability and lower tax rates augur well **Positive**

Budget announcements

- Corporate tax rate for entities having turnover of less than Rs 250 crore reduced from 30% to 25%
- Fiscal 2019 target set at Rs 3.0 lakh crore under the Pradhan Mantri Mudra Yojana, 25% higher than the targets of fiscal 2018
- Increase in customs duty on a few auto-components by 5-7.5% across vehicle categories

Our view

- Corporate tax cut will make MSMEs more competitive, facilitate ease of business and give impetus to schemes like 'Start-up India' and 'Make in India'
- A Rs 0.56 lakh crore increase in the credit target under Pradhan Mantri Mudra Yojana to Rs 3 lakh crore is lower than Rs 1.22 lakh crore increase to Rs 2.44 lakh crore last year. Hence, micro-enterprises will only be marginally benefitted.
- Customs duty increase to have marginal impact on auto component MSMEs, as these components form less than 1% of total imports in value terms

TMT: Enhancing connectivity and digitisation remain focus areas **Neutral**

Budget announcements

- Augmentation of telecom infrastructure, including setting up 5 lakh wi-fi hotspots
- Allocation under Digital India increased to Rs 3,073 crore in fiscal 2019 from Rs 1,426 crore in fiscal 2018
- Effective customs duty on mobile handsets increased to 22% from 19.62%
- NITI Aayog to initiate programme on artificial intelligence (AI)
- Department of Science and Technology to launch a mission on cyber physical systems

Our view

- Estimated receipt for fiscal 2018 revised lower by ~31% following drop in adjusted gross revenue and absence of spectrum auction. In fiscal 2019, revenue receipt is projected to decrease further to ~Rs 0.34 lakh crore compared with government's estimate of Rs 0.487 lakh crore as no auction is expected, considering the financial distress of incumbents
- BharatNet spend stands at only ~60% of allocation in fiscal 2018. For fiscal 2019, allocation increased by 43% on fiscal 2018 spends, which will be largely funded via market borrowings. This will enhance rural internet connectivity. Execution, though, remains a monitorable
- Customs duty hike on handsets to promote local manufacturing. Handset prices, though, to rise in the short term
- Doubling of allocation under Digital India is expected to provide more opportunities for IT/ITeS companies in the domestic market

Capital Markets

Hardening yields offset by measures to deepen the debt market

Increase in the fiscal deficit target for fiscal 2019 to 3.3% from 3.0% has had a debilitating impact on the government securities (G-sec) market. The 10-year G-sec yield moved up 17 basis points on budget day. This is in continuation of the uptrend in yields since the announcement of additional market borrowing by the government in December 2017. The upward bias on debt yields warrants a cautious approach for duration investing.

India's corporate bond market has seen healthy growth in the past few years. Budget 2018-19 highlights the government's focus on further developing the bond market. Key announcements include:

- Mandating large corporates to meet 25% of their funding needs from the bond market. The proposal to nudge large borrowers to the bond market would improve the breadth as well as depth. CRISIL's analysis, based on FY2017 data pertaining to 100 listed large non-finance borrowers indicates that 20 new issuers would have been required to tap the bond market. The incremental bond issuance by these 100 firms would have gone up by 10-15%. This may be slightly impacted by the higher interest rates in the short term, from the perspective of borrowing costs vis a vis banking sector. In the long run, this would increase the fund raising pattern through bond issuances versus bank funding currently.
- Regulatory recognition for investment in bonds to include A-rated bonds as well (in addition to existing stipulations of only up to AA rating) – this is a win-win for both investors and issuers, and will help bridge the demand-supply mismatch. Risk-adjusted returns will be key for investment decision making.
- Introduction of uniform stamp duty for issuance of bonds across the country – will help make the bond issuance process cost effective and efficient.
- The proposed debt exchange traded fund (ETF) for divestment will lay the path for fixed income ETFs in the country. However, illiquidity in the debt market remains a challenge.

We expected a few more announcements such as establishment of a bond guarantee fund to provide credit enhancements for lower-rated bonds and regulatory recognition to the recently launched expected loss (EL) scale by rating agencies.

LTCG makes its foray into the equity segment, dividends will also be taxed

After having increased the long term capital gains (LTCG) for market-linked debt investment products in the Union Budget 2014-15, this year the budget introduced LTCG for equity investments while retaining security transaction tax (STT). The new regime will tax equity investments at 10% without indexation for an investment horizon of more than one year, subject to threshold capital gains of over Rs 1 lakh per assessee per year. The latest rule will be applicable for incremental investment gains from February 1, 2018. This will have a negative impact on the equity market. Within the mutual fund space, equity-oriented schemes which recorded sharp growth owing to inflows and mark-to-market gains (crossed the Rs 10 lakh crore mark) could be adversely impacted. Taxation on equity linked savings schemes (ELSS) will change from exempt exempt exempt (EEE) to exempt exempt tax (EET), thus reducing its investment attractiveness. Further, dividends paid from equity funds will be taxed 10%, which will provide a level playing field between growth and dividend plans.

Regardless, equity will continue to be a preferred investment option for long-term financial planning.

The budget also included fund of funds (FoFs) that invest in an underlying fund which is listed on an exchange and which invests more than 90% in equity shares as an equity-oriented fund, thus putting it under the LTCG rule for equity-oriented funds. This will provide a boost to FoFs, especially in the light of evolving intermediation landscape in India.

Focus on social security for senior citizens and the lower income strata

The government has retained focus on social security for senior citizens and the lower income strata. Among key decisions, it launched National Health Protection Scheme (NHPS) – a health insurance plan that will provide medical insurance worth Rs 5 lakh to 10 crore poor families (50 crore individuals). As per the government, this will be the world's largest government-funded health care programme. Further, the government plans to expand the coverage under Prime Minister Jan Dhan Yojana by bringing 60 crore basic accounts within its fold, and undertaking measures to provide services of micro insurance and the unorganised sector pension schemes through these accounts. These measures will significantly deepen pension and insurance penetration in the country.

To supplement senior citizen income, the current investment limit under Pradhanmantri Vaya Vandana Yojana (PMVVY) has been extended to Rs 15 lakh from Rs 7.5 lakh. The scheme investment period has been extended until March 2020 against May 2018 as initially proposed. The scheme allows a fixed and assured income in the range of 8% to 8.3% depending on the mode of payment chosen for a 10-year investment horizon and is a suitable alternative to annuity plans available in the market.

Further, the budget has proposed to extend the benefit of exemption for withdrawal up to 40% to all national pension system (NPS) subscribers and not only to employees.

Other measures

- Cess on income tax has been hiked to 4% from 3%, increasing the tax payable by all categories of tax payers.
- For salaried individuals, a standard deduction of Rs 40,000 from salary income will be allowed, replacing the current transport allowance of Rs 19,200 and medical reimbursement of Rs 15,000.
- Investment in notified bonds under Section 54EC of the Income Tax Act will be restricted to capital gains from land or building or both compared with hitherto available all capital assets such as shares, jewellery, etc. Further, the investment horizon of these bonds has been increased to five years from three.

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