

February 2021

Our Take

Clear intent, right direction and no negative surprises. Clearly, markets have given it a huge thumbs up and some critical reviews too have come in. Sharing our brief thoughts on the union budget.

It was a difficult year to manage finances given the backdrop of pandemic, lockdowns and the rollout of social schemes. FM seems to have managed the balance by keeping focus on reflation of the economic engine. The budget has aptly deviated from the path of fiscal contraction to support economic growth which is currently impacted due to pandemic.

By not tinkering with the direct taxation and minimal changes in indirect taxes the message was to maintain consistency and clarity.

The intent of privatising PSU banks is more important even though execution has been lacking yet. The willingness to initiate tough reforms that have not worked in the past but are necessary for the economy is something that investors and economists will appreciate most.

It also highlights that the government will prefer asset sales to raise resources over just printing money and risking inflation.

Budget-FY22 ushered a steep increase in Capital expenditure to the tune of ~34% higher than last year's originally budgeted number. The budget provides for a Capital expenditure of Rs5.54 Lac Cr for FY22.

While the Fiscal deficit for FY21(RE) at 9.5% and 6.8% of GDP for FY22 is on the higher side of market expectations, frankly we believe the government had no other option. In the post-pandemic era where other governments have been running double-digit deficits, India certainly can live with this. Also, it has the backing of record forex reserves and if the government had focussed only on deficit then economic growth would have been at risk which would have been a bigger disaster.

Infrastructure was one of the key focus areas with the focus on roads, railways, ports, etc. Setting up of Development Financial Institution (DFI), issuance of zero-coupon bonds, Debt Financing by FPI's in InVIT's and REIT's, etc will address the financing issues for the infrastructure sector. Additionally, monetization of assets will further unlock value and bring in additional funds for the infrastructure sector. We believe the budget has addressed the key areas of funding and monetization of assets which will ensure smoother and faster implementation of projects.

Overall, planned expenditure is always welcome over unplanned one. Higher Capex to start re-leveraging of the system and aid financial systems credit growth. We have a roadmap of three to five years and that would lead to a big capital formation and a virtuous

cycle of Capex coming back. What this country was lacking from 2011-12 to 2020-21 was a Capex cycle building up and now with cement companies and steel companies and metal companies and even on the renewable power side, all of them are bracing for Capex along with this huge push from the government towards infrastructure and domestic manufacturing.

On the banking sector, which is the backbone of any economy, the government has made the right moves of setting up a Reconstruction and Asset Management company to take over the existing stressed debt and then manage and dispose of the assets to Alternate Investment Funds and other potential investors for eventual value realization is the best NPA solution. It's like realising the issue, accepting it and instead of pushing it under the carpet deciding to bite the bullet and professionally resolving it at the earliest. Looks like in the wake of ongoing farmer protests government scaled down its initial plans and have allocated lower subsidy only to NPK fertilizers and increased urea subsidy. The fertilizer subsidy budget overall increased by 11.5% which is fair considering the elevated crude prices. Capital outlay for Defence kept flat YoY in FY22. This is another clear signal that the focus is to indigenize manufacturing and reduce on the overall cost of ownership. Move towards increasing FDI in Insurance to 74% with management control is another bold reform.

On Markets

The budget continues with the pro-growth sentiment. What we saw today was a relief rally as there was no Covid tax, wealth tax, extra cess, surcharge, etc nor any unfair subsidies or unrealistic assumptions. Despite their rapid rise since the start of November, we don't think that equity markets have necessarily become overvalued. In our view, lower interest rates mean that the sustainable levels of price/earnings ratios have risen and, despite signs of froth in some market segments, we do not think that we are currently in the late stages of a broad-based bubble in risky assets. Finally, we continue to expect that government bond yields will remain at very low levels, and the US dollar will lose ground gradually against most other major currencies.

There is a possibility that we go back to the trajectory of 7-7.5% sustainable GDP growth. And if that happens, then this earnings trajectory for corporates might surprise on the upside and therefore these naysayers who says that Nifty is trading at an all-time high might change their views when they realise that on an FY23 basis suddenly Nifty starts to look at 18-18.5 times. This is India's 10-year average valuations which are neither cheap nor expensive and certainly not in bubble territory. So, for the market, we believe the focus will now shift back to earnings growth and the pace of economic recovery.

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