

# ASG Analysis: The Indian Budget

July 10, 2019

## Key Takeaways

- On July 5, India's new finance minister, Nirmala Sitharaman, presented the first post-election annual budget to the parliament, spelling out the government's ambitious target of making India a USD 5 trillion economy by 2024.
- Gross Domestic Product (GDP) grew at 6.8 percent in 2018-2019 and is expected to grow at 7 percent in 2019-2020, largely driven by increased investment and consumption.
- The biggest surprise was the government's prioritization of incremental changes over bold structural reforms, counter to analyst expectations that the budget would include stimulus measures to fuel economic growth and stabilize the economy.
- The budget also reiterated the government's commitment to fiscal discipline and development, an area of focus in the early years of Prime Minister Narendra Modi's first term.
- The budget includes an increased emphasis on boosting FDI, with several policy changes designed to attract investment.
- The manufacturing, electric vehicles (EVs), infrastructure, and digital payments sectors are expected to benefit from the new initiatives announced in the budget.

## Budget specifics

The budget, which refers to a conservative "virtuous cycle" of investment, comes at a time when the Indian economy is facing increasing headwinds. Economic growth is slowing, unemployment is at an all-time high, and non-performing assets (NPAs) in the financial sector have increased significantly in recent months.

### Incremental changes take priority over structural reforms

While the budget did not include structural reforms, several provisions are expected to improve the ease of doing business and make it easier for entrepreneurs to access credit.

The importance of these new measures highlights the considerable slowing of new credit advances over the last few years due to the poor financial health of India's commercial banks and non-banking financial companies (NBFCs). The new measures include:

- The creation of the Credit Guarantee Enhancement Corporation, which will be announced by India's central bank, to enable an estimated investment of USD 300 billion annually for infrastructure financing.

- An action plan to deepen the market for bonds with longer maturity periods to deepen the market for corporate bond repos and credit default swaps.
- An allocation of USD 10 billion for Public Sector Banks (PSBs) to ease the capital crunch and incentivize lending. In addition, the Reserve Bank of India's Monetary Policy Committee (MPC) has also reduced interest rates by 25 basis points, a third straight cut since the start of 2019.
- An allocation of USD 14 billion to provide short-term partial credit guarantees to high-rated pooled assets of NBFCs. This is expected to provide relief to the financial sector.
- A dedicated online portal to provide loans up to USD 145,675 to Micro, Small & Medium Enterprises (MSMEs).
- An allocation of USD 50 million for a 2 percent interest subsidy for credit borrowed by MSMEs (new or incremental borrowings).

#### Fiscal discipline is a priority

The budget demonstrated a strong commitment to fiscal discipline, including an ambitious target for tax revenue in 2019-2020, which will be achieved by increasing compliance among existing taxpayers and widening the tax base in the country.

Tax surcharges have been increased for Indians who earn over USD 290,000. However, corporations whose annual turnover is below USD 58 million will now pay a reduced 25 percent annual corporate tax. This rate was previously only applicable to companies with a turnover limit of USD 7.2 million, and now 99.3 percent of all Indian corporations will be eligible for a lower 25 percent annual corporate tax rate.

It is notable that India's World Bank ease of doing business ranking under the "paying taxes" category has improved from 172 in 2017 to 121 in 2019. The announcements made under this budget will further improved the ease of filing taxes by allowing for the Permanent Account Number (PAN) card to be used interchangeably with Aadhar, India's Unique Universal ID.

#### Attracting foreign investment remains high on agenda

Despite global headwinds, India's Foreign Direct Investment (FDI) inflows in 2018-2019 remained robust at USD 64.4 billion, marking a 6 percent growth over the previous financial year. This budget has placed an increased emphasis on boosting foreign investment, with several policy changes designed to attract FDI, including:

- The promotion of a harmonized and hassle-free investment experience for Foreign Portfolio Investors (FPIs) by easing Know Your Customer (KYC) norms, which made it difficult for FPIs to quickly make investments in the country.
- The relaxation of existing FDI limits in the aviation and media sectors; an allowance of 100 percent FDI for insurance intermediaries; and an easing of local sourcing norms for single-brand retail in India.
- A proposed annual Global Investors Meet in India. The National Infrastructure Investment Fund (NIIF) would serve as an anchor to attract three sets of global players: industries and corporations; pension, insurance, and sovereign wealth funds; and leading digital technology and venture funds.

- A proposed streamlining of multiple labor laws, which would include restructuring labor codes into four simplified codes to help boost FDI in the manufacturing sector.

The government has also proposed to start raising part of its gross borrowing program by tapping into the international bond market. As a percentage of GDP, India's public external debt is among the lowest in the world and currently stands at less than 5 percent, giving the government significant room to raise foreign bonds to meet its financing needs.

#### Development programs continue to be a priority for the government

In the recently concluded elections, Prime Minister Modi greatly benefitted from the development programs rolled out during his first term. The government has continued to maintain its focus on these programs, and the finance minister announced a new development program that seeks to provide access to clean water to every household in India. The government has also reemphasized the importance of key developmental programs launched during Modi's first term, including the Affordable Housing for All, Swachh Bharat Mission (Clean India Program), Ayushman Bharat (National Health Insurance), Saubhagya (Universal Electricity Access), and the Ujjwala Scheme (Affordable subsidized LPG cylinders for the poor).

### Select sectoral impact

#### Manufacturing

The budget seeks to promote manufacturing by both large-scale companies and MSMEs through several provisions:

- Investment-linked income tax exemptions and other indirect tax benefits to set up "mega-manufacturing plants" in sunrise and advanced technology areas, including semiconductor fabrication and computer servers;
- Customs duties on certain raw materials and capital goods, including fuel for nuclear power plants, will be reduced to encourage domestic manufacturing;
- A fund for the upgradation and regeneration of MSMEs in traditional industries has been announced to increase their market access; and
- The government has also announced a new program – Scheme of Fund for Upgradation and Regeneration of Traditional Industries' (SFURTI) – to boost cluster-based manufacturing in the country and increase their ability to access global markets.

#### Electronic Vehicles (EVs)

The government announced an outlay of USD 1.4 billion to encourage adoption of EVs and establish the required infrastructure for EVs across the country. GST rates on EVs have been lowered from 12 percent to 5 percent and the government will also provide a USD 2,191 tax deduction for interest on loans taken to purchase EVs.

#### Space Technology

The government will set up New Space India Limited (NSIL) as the commercial arm of the Department of Space. Making use of Indian Space Research Organization research, NSIL will spearhead the commercialization of several space products, including production of launch vehicles, transfer to technologies, and marketing space products.

### Infrastructure

The budget commits to a USD 145 billion investment in infrastructure over the next five years. Several new infrastructure projects have been announced, including:

- **Bharatmala:** Aimed at developing national road corridors and highways, the first phase is completed, and the second phase will begin to develop state highways;
- **Sagarmala:** Aimed at increasing port connectivity, modernization, and port-linked industrialization to improve cross-border trade and domestic transport;
- **Jal Marg Vikas:** This waterways development project seeks to improve navigation on the country's national waterways and make them more accessible to larger vessels.
- **One Nation, One Grid:** The project will increase affordable power connectivity by connecting regional electricity grids to create one national power grid.

### Start-ups and Entrepreneurs

The budget includes several reforms to promote entrepreneurship. This includes easing procedures to reduce scrutiny on conflicts between the income tax department and investors and funds over the angel tax; relaxed conditions to carry forward and set-off of losses for start-ups; and a television program by the national broadcaster to exclusively promote start-ups across India.

### Digital Payments

To further boost digital payments, the government will levy a tax deduction of 2 percent on cash withdrawals exceeding USD 146,110 annually. All business establishments with an annual turnover above USD 7.2 million will be mandated to offer low-cost digital modes of payment to their customers. No merchant discount rate will be imposed on these transactions; the RBI and banking institutions will absorb these costs from the savings that will accrue to them.

### Overview of macroeconomic data

- Gross Domestic Product (GDP) grew at 6.8 percent in 2018-19; it is expected to grow at 7 percent in 2019-2020, largely driven by increased investment and consumption.
- India's foreign exchange reserves were comfortably placed at USD 422.2 billion in June 2019.
- 2018-2019 ended with fiscal deficit at 3.4 percent of GDP and debt-to-GDP ratio of 44.5 percent.
- The fiscal deficit target has been set at 3.3 percent of GDP for the financial year 2019-2020.
- According to the Consumer Price Index, inflation declined for the fifth straight financial year and has remained below 4 percent for the last two years. In 2018-2019, CPI was recorded as 3.4 percent.
- India's external debt was USD 521.1 billion at the end of December 2018, 1.6 percent lower than its level at the end of March 2018.

---

## About ASG

Albright Stonebridge Group (ASG) is the premier global strategy and commercial diplomacy firm. We help clients understand and successfully navigate the intersection of public, private, and social sectors in international markets. ASG's worldwide team has served clients in more than 120 countries.

ASG's [South Asia Practice](#) has extensive experience helping clients navigate markets across the region. For questions or to arrange a follow-up conversation please contact [Uzair Younus](#).