Budget Expectations 2017

Big bang changes are unlikely

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Backdrop of the FY18 Union Budget

Uncertain global environment

- The global economy is likely to be sluggish in 2017 and uncertainty looms over how Trump's policies will unfold.
- The US might follow an explicitly protectionist policy, followed by some countries in Europe (France, Italy)
- Capital raising by companies/banks/government could prove to be challenging.

Domestic slowdown due to demonetization

- Auto sales have come down 18% YoY in December - the steepest fall since 2000.
- Residential sales across top eight cities dropped by 44% Oct-Dec quarter and new launches fell by over 60%.
- Significant job losses and revenue dip in the 34 days since 8 November in the MSME sector

No signs of private capex cycle picking up

- Gross fixed capital formation (GFCF) to GDP during Apr-Sept FY17 fell nearly 4%.
- Capacity utilization in many sectors still very low
- The latest CMIE survey signals a poor investment climate —investment proposals during the Q3 FY17 stood at Rs 1.3 lakh crore vs an average of Rs 2.4 lakh crore for the last nine quarters of the Modi government

Government faces many imponderables

- The impact of demonetisation is not captured by the advance estimates of GDP- complicates the process of budgeting.
- The roll-out of the GST is planned for FY18 - revenue during the year will exhibit an analytical discontinuity with what has gone before.
- The removal of the distinction between Plan and non-Plan expenditure obscures what spending counts as an investment and what does not.

Source: HDFC Bank

The Government's constraints & assumptions : Our Prognosis

- Government is likely to project the effect of demonetisation to be transitory…
- As a result, growth and tax targets for FY18 could be aggressive
- Fiscal deficit target to be guided by FRBM committee that recommends continuing fiscal discipline…
- This rules out a major increase in budgetary spending on either infrastructure or the social sector
- Thus, fiscal deficit could at best be at 3-3.3% for FY18, and not paused at 3.5% of GDP
- Tax gains from demonetisation could be played up along with GST benefits
- Benefits of digitalisation could be an important theme
- Financial innovation such as credit enhancement, recasting of NIIF could be highlighted, with the government acting as an enabler to attract new sources of investment (Pension funds, SWFs).
- Major changes like land monetisation to be approached with caution

Our assessment – some support to the economy but stimulus unlikely to dazzle

Optics of the budget could disappoint– Unlike the last three budgets, that saw new projects like Start Up India, Swachh Bharat and Make in India, ***FY18 budget likely to focus more on effective implementation*** and increased allocation to existing projects .

However, given that five states this year and another seven states next year are going into polls, ***we do expect some popular announcements*** mainly to help the sectors that have suffered in the demonetisation process like MSMEs and rural economy.

Universal basic income transfers for the poor likely to be introduced only on a pilot basis but low-cost housing could get a bigger boost.

The government could ***reinforce its 'black money crackdown' and "digitization" theme*** in FY18 budget.

The government could ***increase service tax rates*** to bring those in line with GST rates and do some ***tweaks in corporate and personal tax regimes.***

Source: HDFC Bank

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FY18 Budget –Key expectations

Rural push

- **A watered-down universal basic income scheme on pilot** basis - could club the cash components of several schemes and transfer the combined amount into beneficiaries' accounts every month.
- Ranking of panchayats on benchmarks(such as status of irrigation and presence of soil health cards) to tailor future assistance.
- Higher allocations to existing schemes and interest subventions for the agriculture sector.
- Initiatives to provide greater access to cashless transactions - to aid farmers purchase seeds, fertilizers and other agricultural inputs.

Affordable housing

- Likely expansion of Pradhan Mantri Awas Yojana and inclusion of people having higher incomes (~Rs 12-18 lakh/year) under the interest subvention scheme.
- **A new scheme that may use money from the demonetisation drive – lower interest rate in the range of 6-7% for home loans up to Rs 50 lakh (to first time borrowers).**

Impetus to the infrastructure sector

- 12-14% higher budgetary allocation to the sector – against last year's allocation of Rs 2.2 lakh crore
- Reduction in Minimum Alternate Tax (MAT) for the infrastructural projects
- Mechanism for online clearance of projects
- A **new credit rating system for infrastructure projects which gives emphasis to various in-built credit enhancement structures –** government could act as a guarantor for some of these projects.

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FY18 Budget –key expectations

Towards a "cashless" economy ➡

- **The threshold for quoting PAN card for cash transactions could be reduced from Rs 50,000 to Rs 30,000 - for merchant transactions, the limit could come down from the current Rs 2 lakh.**
- The government may also announce cash-handling charges for cash payments above a certain limit.
- To keep a track of trail of payments, the government could **make Aadhaar number mandatory for filing of income tax returns** from FY18 onwards and link all bank accounts to the unique identity number.

Tax rate rejig ➡

- **To raise the service tax rate from the existing 15% by at least one percentage point as a precursor to the rollout of GST**
- Further phasing out of various exemptions and reduction in corporate tax rate

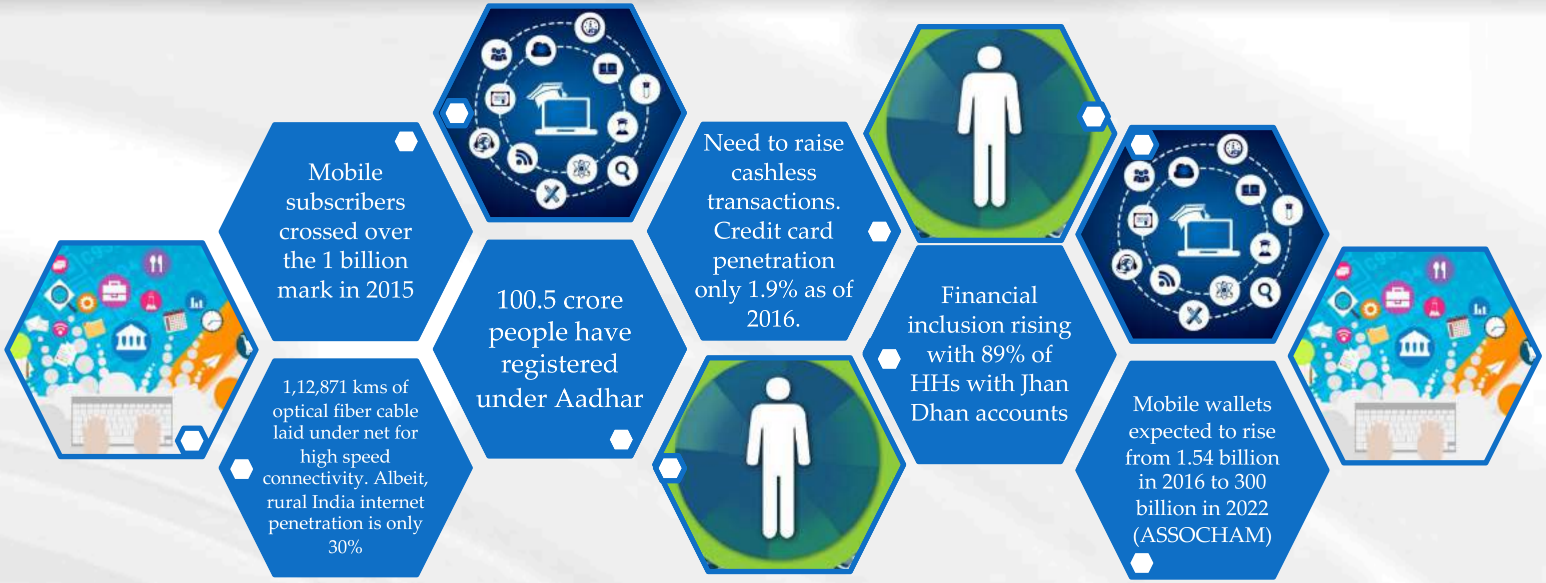
Relief to the common man ➡

- **The base slab for income tax exemption could be increased from the current Rs 2.5 lakh.**
- A restructuring of tax slabs could also be explored - currently, 10% tax is charged on annual income of Rs 2.5 lakh to Rs 5 lakh, 20% on Rs 5 lakh to Rs 10 lakh and 30% on income above Rs 10 lakh. The first two slabs can be widened or taxed at a lower rate.
- Deduction under Section 80C of the I-T Act (i.e. deductions on investment and on specific instruments like PPF) could be enhanced.

Recapitalization of banks ➡

- Allocation could be moderately enhanced from last year's Rs 25,000 crore but government's pressure on banks for independent resource raising could remain.

Pushing the Digital agenda – the 9 pillars could get more support



<u>The government is likely to announce further measures under the nine pillars of digitalisation:</u>

Broadband Highways
Universal Access to Mobile Connectivity
Public Internet Access Programme
E-governance : Reforming Government through technology
e-kranti:Electronic Delivery of services
Electronic Manufacturing
IT for jobs
Information for All
Early Harvest programme

Collection of taxes under GST

Moving towards GST: It is likely that the government will remove certain exemptions and distortions in the tax structure in the Budget and pre-emptively raise taxes such as service tax in line with GST.

GST tax collections to be split 50:50 between centre and states: The proposition for the division of GST rate between the centre and the state is at 50:50. For example, a tax rate of 18% will be split between centre and states as 9% each.

GST Tax slabs for goods: The Centre and State have agreed to roll out the GST from 1 July 2017. The GST council has agreed upon a four slab structure for goods (centre + state) – 5%, 12%, 18% and 28% along with a cess on luxury and sin goods such as tobacco. The lower rate will be for essential items such as unprocessed food items. A fifth rate will also be decided for gold and precious metals which can be 4% or lower.

GST tax slabs for services: For services, the GST council is planning to bring in three different rates: luxury, standard and basic. It is likely that most services may attract a tax of 18% under the GST. Therefore, whether the government raises the service tax rate from the current 15% as a precursor to the roll out of the GST will be watched out for.

Source: HDFC Bank

…transfer to states to rise under GST

GST is overall planned as a revenue neutral exercise: Therefore, GST should not per se result in affecting the tax collections by the government significantly in the medium term. However, the government will have to keep some room to address the distortions that may be felt due to implementation of a new tax structure in the initial year.

Transfer to States will rise: Therefore, Centre's transfers to states will include the compensation for loss of revenue arising on account of GST implementation for a period of five years.

Additional Resources for compensation to states: The GST rate is being set in a way that it leaves some additional resources which can be used for compensation payment to losing states. Therefore, the standard GST rate (centre + state) is the revenue neutral rate (close to 15-15.5%) plus additional rate (like cess on luxury goods, and tobacco) to collect additional resources.

GST likely to be implemented by second half of FY18: The July 1 deadline looks optimistic as while the rates have been agreed upon, identifying the goods under each tax rate remains to be worked out. Further, the list of exempted item remains to be fixed.

Source: HDFC Bank

Fiscal Math: Our Assumptions

The budget is likely to adhere to the path of fiscal consolidation with fiscal deficit at 3% of GDP in FY18

Nominal GDP growth at 10.2% ➡ We assume Nominal GDP growth at 10.2% YoY for FY18. The government could assume a higher growth number.

Budget will account for GST implementation ➡ The budget is likely to account for the implementation of the GST in the second half of the fiscal, resulting in higher transfers to states to compensate for the initial drop in revenue collections under the new tax regime.

Demonetisation to push tax collections ➡ However, spillovers from demonetisation including higher seizures of undisclosed income and collections under income disclosure scheme will cushion tax collections.

Source: HDFC Bank

Assumptions contd.

Tax/GDP ratio to rise by 30bps ➡ Implementation of GST could result in close to 40bps drop in gross tax collections/GDP ratio, while demonetisation spillovers will push up tax collections by 70 bps. Overall, therefore, we expect the GTR/GDP ratio to rise by 30bps. Overall, tax collections (to Centre) expected to rise by 11.5% YoY as compared to 11.2% in FY17.

Capex to inch up in infrastructure ➡ We expect capital expenditure to inch up with rise in expenditure in sectors such as irrigation, urban development, roads and railways.

Borrowings up to INR 6.3 trillion ➡ Gross borrowings are expected to rise to Rs 6.3 trillion from Rs 6 trillion in FY17.

Source: HDFC Bank

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Fiscal Math: Towards Fiscal consolidation

	Levels (Rs bn)			%GDP			%yr		
	FY16 RE	FY17 BE	FY18 F	FY16 RE	FY17 BE	FY18 F	FY16 RE	FY17 BE	FY18 F
1.Revenue receipts	**12061**	**13770**	**15577**	**8.9**	**9.1**	**9.4**	**9.5**	**14.2**	**13.1**
Tax revenue(net to centre)	9475	10541	11755	7.0	7.0	7.1	4.9	11.2	11.5
Non- tax revenue	2586	3229	3822	1.9	2.1	2.3	17.2	11.7	13.3
2.Capital receipts ex borrowings	**442**	**671**	**807**	**0.3**	**0.4**	**0.5**	**-14.1**	**51.8**	**20.2**
3.Total receipts ex borrowings (1+2)	**12503**	**14442**	**16384**	**9.2**	**9.6**	**9.9**	**8.4**	**15.5**	**13.5**
4.Total expenditure	**17854**	**19781**	**21425**	**13.2**	**13.1**	**12.9**	**7.3**	**10.8**	**8.3**
4.1.Revenue	15477	17310	18712	11.4	11.5	11.3	5.5	11.8	8.1
4.2.Capital	2377	2470	2713	1.8	1.6	1.7	20.9	3.9	9.8
Fiscal Deficit	5351	5339	5041	3.9	3.5	3.0	-	-	-
Gross Tax/GDP ratio	-	-	-	10.8	10.8	11.1	-	-	-
Tax Bouyancy(Change in Gross tax/ change in GDP)	-	-	-	2.0	1.1	1.3	-	-	-
States Share/gross tax %	-	-	-	34.7	35.0	36.0	-	-	-
Net borrowings (Rs bn)	4019	4252	4032	-	-	-	-	-	-
Gross Borrowings (Rs bn)	**5850**	**6000**	**6313**	**-**	**-**	**-**	**-**	**-**	**-**
Repayments (Rs bn)	1831	1748	2281	-	-	-	-	-	-
Nominal GDP	135761	150695	166065				8.7	11.0	10.2

Source: HDFC Bank

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