Markets spooked again; but medium term stay positive

“If it ain’t broke too much, don’t fix it” – seems to be the approach of the government. This budget establishes, if any more evidence was necessary, that this government thinks that the slowdown is cyclical and will take care of itself. Markets though had high hopes pinned on the budget, and lack of any movement on any of the major triggers caused an adverse near-term response. LTCG not removed, no sops for specific stressed sectors like NBFC and Real Estate, tax tinkering with some negative impact on Insurance companies - adverse reaction of the market has been an outcome of high datum levels. The higher gross borrowing on account of heavy repayments and switch to higher duration, muted expectation of tax collection on a slower economy are factors could exert moderate pressure on near term yields too. The higher and continued recourse to small saving (INR2.4 tn) for the second successive year also points to the limited financing headroom government is left with in the event of unanticipated fiscal slippage.

However, once the dust settles, positive factors are likely to play out more. Included among them are the fact that the government has after all managed to expand the size of itself by provisioning for an increase in expenditure to GDP ratio both in FY20 and FY21 when GDP slowed down. So even within the limited fiscal space, government has acted as a counterbalancing force. Similar to corporate tax cuts, personal tax rates have been lowered, ushering in a limited, de facto implementation of direct tax code (DTC). Like earlier, this is as much a reform measure as is a stimulus measure and a measure to enhance tax buoyancy in the medium term. However, its acceptability is a complex issue at present as unlike the corporate sector, the impact at the individual level for various tax brackets are somewhat ambiguous making the transition a lengthy and discretionary process. However, its benefit estimated at INR400 bn (or lower depending upon acceptability) is likely to provide some fillip to the consumption sector. This along with expected rural revival on expectation of bumper Rabi crop, better rainfall in the coming season (favourable Indian Ocean Dipole effect) and better farm prices are expected to act as fillip to the consumption sector. Government plans to reap the lowest hanging fruit in the infrastructure sector by monetisation of national highways. All in all, a U-shaped recovery, already on in fits and starts, has been aided.

Figure 1: Headroom for fiscal stimulus has been created in the last two budgets

Figure 2: However, challenging targets on the revenue front to finance expenditure increase

Source: CMIE, Union Budget, Bloomberg, ASKWA Research

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A. Equity market outlook – nothing in it, and that’s not bad

i) Small Fiscal boost is likely to aid the cyclical upturn, aided by low base effect.

ii) Removal of DDT and new infrastructure investment tax sops for Sovereign Wealth Funds (SWF) are big positive for FPIs.

iii) Turnaround of corporate banks and increased profitability may obviate the need for recapitalization which can even be resorted to mid-year, if need be.

iv) Monetisation plan for road sector and tax benefit to sovereign wealth fund positive for infrastructure sector

v) The Finance Minister hinted at a scrap page policy in the works for the auto sector.

B. Bond market moderately positive in the medium term

i) Increase in net market borrowing restricted to only 7.8%, less than the nominal GDP growth of 11.3%.

ii) Enhancement of FPI corporate bond limit to 15% from 9% and opening up of identified G-Secs for FPIs to invest freely are positive for supply-demand dynamics. As is the stated objective of targeting India’s inclusion in global benchmark bond indices.


iv) RBI is likely to resume rate cuts once inflation print stabilises. Besides it is expected to keep liquidity abundant and resort to operation twist like measure to counter adverse market move.

v) Global factors including near term once like outbreak of Corona virus in China and drop in oil price along with bias of Central Banks to ease rates are likely to keep yields low.

Hence, we retain our Overweight Equity and Overweight Fixed Income stance. We expect the medium-term positives to exert a greater impact on the market once the market absorbs the near-term setback out of certain measures in the Budget.

Within equities we retain our tactical focus on midcap, financials space and select global opportunities. Within fixed income, we are focussed on benefitting from duration opportunity by reaping still attractive spreads of AAA in the 3-5 year maturity bucket, and locking in yields across highest rated instruments at the medium end of the curve.

We also remain Overweight on Gold to tread through heightened uncertainty.
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