ASIA

India Budget 2020: A Step in the Right Direction, but a Push Is Needed

February 07, 2020

Sukumar Rajah
Senior Managing Director, Director of Portfolio Management,
Franklin Templeton Emerging Markets Equity

As investors digest the latest initiatives from the 2020 India budget, Franklin Templeton Emerging Markets Equity's Sukumar Rajah shares his analysis on the takeaways. He thinks while it's a step in the right direction, it doesn't tip the overall investment case for India either way.

Resurrecting economic growth is taking centerstage this year for India, as the 2020 budget attempts deliver on multiple fronts. However, the budget announcement delivered on February 1 didn't put forth any immediate measures to support falling consumption.

India Finance Minister Nirmala Sitharaman announced a cut to personal income tax rates, the introduction of a new alternative income tax structure, and trillion-rupee (US$14 billion) fund injections into the infrastructure and agriculture sectors, at the cost of missing the government's deficit goal for a third year. This will push the budget deficit to 3.8% of gross domestic product (GDP) for FY2019-20 from a planned 3.3%. The FY21 fiscal target has been set at 3.5%, which we view as reasonable since there's potential to bring in increased tax revenue if the economic growth picks up. The relaxation of the fiscal deficit target could potentially be a good counter-cyclical tool to support economic growth.

We saw a broad continuity in the government's agenda from the previous year, even though the budget announcement didn't provide much material upside. This includes increasing tax net and compliance; encouraging domestic manufacturing and infrastructure; high divestment targets; and encouraging the flow of foreign capital through maintaining fiscal prudence.

The announcement comes at a time when India's GDP is expected to grow by 5.8% in 2020, a slower pace than the 6.8% growth in 2018 and marginally better than 2019, which was more recently revised downward to 4.8%.[1] There were high expectations for the budget, but given recent weakness in India's economy, the budget largely reflects the government's decision to stay firmly on the fiscal consolidation path without any significant stimulus to the economy beyond perhaps some modest measures to boost income and infrastructure.

KEY 2020 INDIA BUDGET TAKEAWAYS

- An overhaul to the income tax regime. Taxpayers will choose between the existing scheme or the new regime with lower income tax rates but with no tax exemptions.
- Focus on workforce skill enhancement in the long term—it should generate semi-skilled, labor-intensive jobs, particularly within small to medium-sized enterprises. This in turn could generate opportunities in sectors such as health care, and manufacturing and construction in maintaining or building infrastructure.
- Inject 2.83 trillion rupees (US$39.8 billion) into technological developments in agriculture, including

- solar power, cold storage and relieving issues with access to water.
- Transport infrastructure will receive a boost in funding, to the tune of 1.7 trillion rupees (US$23.9 billion). These projects include water, power and renewable energy.
- A 100% tax exemption for sovereign wealth funds of foreign governments that invest in the infrastructure sector before March 31, 2024, for a minimum of three years.

We can see the Indian government is making efforts to boost local businesses by removing the dividend distribution tax at an estimated cost of 250 billion rupees (US$3.5 billion). This could help lift corporate savings, and therefore revive the private capital expenditure cycle, which in turn could attract more foreign investors or international companies.

Start-up firms may also feel the impact as the government announced it would boost financing for small- to medium-sized enterprises in technology or export-oriented sectors.

Overall, we view this budget as an effort to propel growth in the right direction.

However, we think initiatives that would likely boost consumption were largely absent in the budget due to fiscal constraints. We believe the real key to demand stimulation and higher compliance lies in a reduction in the goods and services tax (GST), a tool now considered by the GST council, rather than a much-discussed budget item. If revenue momentum were to increase, we think the GST council will more likely have leeway to reduce GST rates for certain items.

WHAT IS THE GOODS AND SERVICES TAX?

The goods and services tax is levied at every stage whenever a good or service is bought, which should lead to higher output and more employment opportunities.

Our investment case for India very much remains the same—it is a domestically oriented economy driven by internal demand and investment, low export share, favorable demographics, with a stable government who implement reforms targeting long-term sustainable growth. In the near term, we'd expect GDP growth to pick up in 2020, driven by rural income, counter-cyclical growth stimulus and export growth.

As we have observed in the past, corporate earnings growth has moderated in recent years, led by muted demand, a weak credit cycle and a tepid investment cycle. This, along with cheaper valuations in small- to mid-capitalization stocks, suggests to us that we're over the hump. We believe the Indian economy and corporate earnings growth could be set for a gradual recovery over the next one to two years.

To get insights from Franklin Templeton delivered to your inbox, subscribe to the Investment Adventures in Emerging Markets blog.

For timely investing tidbits, follow us on Twitter @FTI_emerging and on LinkedIn.

Important Legal Information

Data from third party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments opinions and analyses in the material is at the sole discretion of the user.

Products, services and information may not be available in all jurisdictions and are offered outside the U.S. by other FTI affiliates and/or their distributors as local laws and regulation permits. Please consult your own professional adviser or Franklin Templeton institutional contact for further information on availability of products and services in your jurisdiction.

Issued in the U.S. by Franklin Templeton Distributors, Inc., One Franklin Parkway, San Mateo, California 94403-1906, (800) DIAL BEN/342-5236, franklintempleton.com—Franklin Templeton Distributors, Inc. is the principal distributor of Franklin Templeton Investments' U.S. registered products, which are not FDIC insured; may lose value; and are not bank guaranteed and are available only in jurisdictions where an offer or solicitation of such products is permitted under applicable laws and regulation.

What Are the Risks?

All investments involve risks, including the possible loss of principal. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Investments in foreign securities involve special risks including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Investments in fast-growing industries like the technology sector (which historically has been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement.

---

1. Source: International Monetary Fund, World Economic Outlook, January 2020.