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Investment Matters

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TO MAKE THE RIGHT
MOVES, MORE OFTEN.

EQUITY OUTLOOK FROM CIO'S DESK

Budget 2013 – The action is outside!

If I were to describe finance minister P Chidambaram's budget 2013 in a few words it would be "Not Bad but Not Great Either". The budget felt well short of the high expectations that were built – given the government's recent actions and his reputation as an astute reformer. Considering the desperate gloom that had engulfed the economy and markets just a few months ago, there was an expectation amongst investors and the business community, that beyond delivering a sensible and a good budget, which was a base case scenario anyways, he is capable of and could deliver some innovative and big idea to turn things around. But that was not to be.

However, he did keep his promise of keeping the fiscal deficit at 5.2% of GDP v/s a promise of 5.3% in FY13 and 4.8% in FY14. This is the single biggest achievement of the budget. The numbers for FY13 are credible and have been achieved by clamping down on expenditures in Q3 and Q4 and successfully divesting public sector undertakings. However, there are few doubts about the 4.8% number for next year. Instead of shrinking the expenditure side, he has actually increased plan expenditure by 29% and total expenditure by 16%. The expectation was that he will control expenditure much more tightly. However, he has increased allocations to most welfare schemes, hiked the defense budget albeit slower than nominal GDP and provided for a small amount for the UPA's Food Security Bill (but kept it open ended for more allocations towards FY14 election time if needed). All of this has been funded by increase in 10% surcharge on corporate tax and the super rich, hiking excise on cigarettes and duties on expensive SUV's, cars and motorbikes coupled with slightly aggressive revenue and disinvestment assumptions. So clearly this is not just a "technocrat FM budget" but a "politically aspirational PM in the waiting" budget!

So why is it that after some politically bold reform moves in the recent past like – hike in retail FDI, where the government pulled out all the stops and staked its political might to get it through parliament, hiking petroleum prices, capping subsidized LPG, egging RBI to come up with guidelines for new banking licenses, increasing passenger freight rates – were the two budgets – railway and the union budget such boring and uninspiring events? Why would the railway minister and the finance minister not capitalize on these opportunities to further push the envelope on reforms?

I think the answer lies in the fact that UPA2's strategy seems to be to not to do any major reforms while the parliament is in session. They may not want to confront the opposition which may capitalize on these as anti people steps and corner the government and disrupt parliament and thereby derail what the government is set out to do. Post the budget the most important reform (if it can be achieved) would be to roll out GST by April 2014 and in the near term the passing of the Insurance and Pension Bills. Let's see if the government can pull though this as it will require a deft political handling to get BJP to play ball.

So while everyone was expecting action in the budget, we believe that the real action lies outside it and mostly when the parliament is not in session. So expect both reforms as well as a continued push to both welfare as well as capital spending to play out simultaneously as we get into the next fiscal. As the Finance Minister Mr. Chidambaram mentioned to a news channel post the budget "we politicians are not so dumb witted to go into an election year with low growth and high inflation". So let the action continue, even if it is done for self preservation!

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DEBT OUTLOOK

Fixed income market was eagerly waiting for the most important event of the year to get the direction going forward. Finance minister presented the Budget 2013-14against a difficult macroeconomic backdrop where Inflation is high, GDP growth is at decade low, Fiscal deficit and current account deficit is again at record high. Fm seems to focus more on fiscal consolidation than anything else.

The FM succeeded in capping the fiscal deficit at 5.2 per cent of GDP in FY13 (achieved by compressing budgeted expenditure by 4 per cent) and hopes to cap it at 4.8 per cent in FY14. Within budgeted expenditure, capital expenditure was significantly cut – by 18 per cent compared to the budgeted figure. The objective of the budget was to ensure that there is no chance of a rating downgrade in the next one year and that has been achieved in our view.

To lower the fiscal deficit to 4.8 per cent of GDP in FY14, the FM is betting on revenue growth of 23.4 per cent and expenditure growth of 16.4 per cent compared to the revised estimates for the current year. With the government's revenue collection falling below the budgeted revenue in four of the past five years, including the current fiscal year, the revenue target for FY14 looks ambitious. To raise Tax revenue FM has brought more services under service tax bracket, increased excise rate for selected sectors and a higher surcharge has been imposed on the rich and on Corporate above a certain threshold. The growth in the total expenditure is estimated to be around 16.39%. Having said that, the moderation in the non-plan expenditure; the boost to plan expenditure and higher allocation to expenditure on the capital account, provides reasons to believe that the budgetary outlay may assist in augmenting demand in the economy.

In order to finance this large total expenditure and still maintain the 4.8% fiscal deficit target, the finance minister will have to work hard to achieve his substantial 23% total receipts growth target. Under receipts the finance minister has pegged reasonably aggressive (though perhaps achievable) targets under disinvestments, spectrum sale, and dividend receipts. Tax revenue is pegged to grow at 19% which currently looks reasonable when compared with 18% growth this year. However, this may become difficult as well if economic momentum continues to slow.

The market was expecting the gross borrowing number to be around Rs. 5, 90,000 crores instead of the stated Rs. 6,29,008.84 crores (This takes in account scheduled repayment of Rs. 95,008.84 Crs. and Rs. 50,000 Crs. towards buyback of Government Securities for better debt management. The net borrowing is placed at Rs.4,84,000 Crs (net borrowing FY13 Rs. 4, 67,384.06 Crs.).

The Q3 GDP growth for FY14 was estimated at around 4.5%, which is possibly the lowest in the decade. With the inflation moderation also better than expected, we believe that the scenario is more conducive for RBI to cut rates. Investors with 1 year+ investment horizon should consider duration funds. Due to tight liquidity and seasonality short term rates have again gone up. 1 year Bank CD is trading at around 9.3-9.4% levels and 1 Year CPs are trading at around 9.90 levels. This make good case for investments in short term funds. We expect liquidity to flow back from April 2013 onwards, which would help these current high rates to cool down. This can be well captured by short term funds.

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