KPMG

India Insights

The Indian economy newsletter - Budget special

February - 2017

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CEO's perspective

With selective interventions, the Union Budget for 2017-18 is pragmatic and stresses on 10 overarching themes to renew growth.[1] The announcements primarily focussed on reviving rural and infrastructure segments, grappling most acutely with effects of demonetisation, which hit demand, disrupted supply chains and hurt capital investments. The forum was also aptly utilised by the government to make the right political noises ahead of key assembly elections.

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Yet, without straining its balance sheet excessively and sticking to the path of prudent fiscal management, the fiscal deficit target of 2017-18 has been maintained at 3.2 per cent of the Gross Domestic Product (GDP) to cover the spending promises.[1] This target is in line with the prevailing expectations, given the additional pain from surging oil prices.

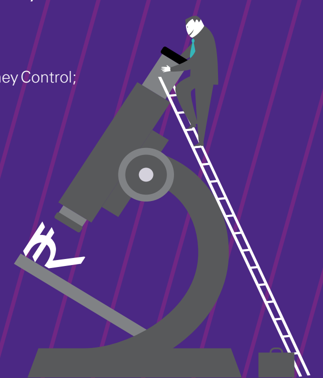
Sector wise, rural, agriculture, real estate, infrastructure, consumer goods, automotive, digital and banking emerged as undisputed winners. The agriculture sector is likely to benefit from a targeted allocation, coupled with focus on farmers income rather than diffused spending on the sector. Together, the two along with allied services account for a large chunk of government capital spending, recording a marked 24 per cent increase over the last year.[2]

Further, the affordable housing sector has been granted infrastructure status, giving them access to foreign funds. This, along with the interest subvention allowed earlier is expected to revive the housing sector.

Increased focus on the transportation sector is likely to induce a higher multiplier effect on the economy, employment and core sectors such as steel, power and cement. Further, no change in capital gain taxes with respect to listed stock and clarifications on Foreign Portfolio Investment (FPI) taxes has gone down well with the industry and market. The reduction of income tax for MSMEs is a welcome move and may boost economic growth.[1]

The proposal to abolish the Foreign Investment Promotion Board (FIPB) during the financial year 2017-18

1. Key Features of Budget 2017-18; Union Budget; 1 February 2017
2. Union Budget 2017-18: Why these experts feel the Budget won't stimulate the economy;Money Control; February 2017



CEO’s perspective

and further liberalise Foreign Direct Investment (FDI) in the coming days, is expected to improve India’s reputation as a business friendly destination.

On the macro front, the Budget proposals are non-inflationary. However, upside risks such as surging oil prices and exchange rate volatility has led the Reserve Bank of India (RBI) to shift its policy stance from ‘accomodative’ to ‘neutral’, leaving no room for a rate cut in the near future.

The focus on growing the country’s digital footprint is welcoming. The reforms will usher a quantum jump in efficiency, enabling mainstreaming of the informal economy as well as inclusive empowerment through technology and innovation.

Proposals to energise youth by imparting market relevant training and setting up 100 international skill centres across the country, is a positive move. The emphasis on science and technology for students, and launch of the Study Webs of Active – Learning for Young Aspiring Minds programme (SWAYAM), could further empower India’s youth for the future.

On the banking front, the government proposes to increase allowable provision for Non Performing Assets (NPA) from 7.5 per cent to 8.5 per cent. This is likely to reduce the tax liability of banks. Another positive announcement for the banking sector was the government’s comparatively tame net market borrowing figure in 2017-18, as compared to the current year.[1]

Overall, Budget 2017-18 is progressive without meddling much into economic areas that have demonstrated relative stability. Based on the three pillars - ‘**Transform, Energise and Clean India**’, the Budget largely focussed on the rural and underprivileged populace, infrastructure, transparency and prudent fiscal management to accelerate economic growth. While the target of achieving fiscal deficit of 3.2 per cent seems to be positive amidst the current slowdown and increasing downside risk to the economy, it might be achieved on the back of rationalisation of taxes, implementation of GST and additional measures to enhance the tax base.

The much-needed emphasis on the weakening capital investment has received a boost, with a 25.4 per cent increase in the government’s capital expenditure. This is expected to crowd-in private investments.[1] While the Budget is overall encouraging, addressing areas that could provide traction to the growth momentum of the economy through multiplier effect, implementation and execution of various announcements hold the key.

1. Key Features of Budget 2017-18; Union Budget; 1 February 2017

Budget sectoral impact

Transport and logistics[1]

The budgetary announcement heralded many positives for the infrastructure and logistics industry, with clear focus on developing highways, railways and rural roads. In the case of railways, the allocation of funds, coupled with proposed initiatives to improve customer safety, station redevelopment, Swachh Rail and bio-toilets are expected to help regain competitiveness and depleting modal share.

Likewise, continued focus on the Sagarmala project, development of Coastal Economic Zones and improving hinterland connectivity, is expected to regain private participation in such projects and provide a fillip to the maritime sector.

The sector, however, expects more clarity on various direct tax issues, such as procedural tax assessment for regular and occasional shipping business. Tax incentives, such as infrastructure status for port support services and extension of tax incentives for all warehouse facilities, would also need to be clarified in the near future.

Healthcare[1]

Several announcements were made with reference to the healthcare agenda in this year's Budget, with a focus on increasing allocation, specifically towards development of healthcare access and delivery for the underprivileged.

Even though the Budget allocation to the sector has increased by 23 per cent over the last year, the long-awaited Universal Health Coverage (UHC) plan remains obscure.

The government also announced additional sanitation drives under the 'Swachh Bharat' initiative and the transformation of health sub-centres to health and wellness centres.

The enhancement of digital payments at hospitals, better clarity, transparency, accountability and audit brings forward a huge potential in tracking patient costs and claims with a health insurance provider. Overall, the Budget emphasised the government's efforts to make drugs and medical devices affordable, however, the long anticipated demand for granting infrastructure status to the healthcare sector, increasing public spend on healthcare, tax holidays/breaks/incentives to the private healthcare sector for expanding infrastructure have not been addressed.

1. Budget 2017-18, Speech of Arun Jaitley, Minister of Finance, 1 February 2017; KPMG in India analysis, 2017

Consumer markets and agriculture[1]

- Higher spend on Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) and rural roads can increase employment opportunities and help create productive assets for rural areas
- Higher credit target for agriculture, computerisation, and integration of Primary Agriculture Credit Societies (PACS) to increase fund flow in rural areas is welcoming. Model law on contract farming is likely to help streamline credit flow
- Focus on irrigation and crop insurance to help mitigate climate vagaries
- A robust market framework for commodities can provide better price signals and benefit farmers, though risk of volatility increases as well.

Financial services[1]

- In order to encourage foreign investments, the abolition of FIPB has been proposed. While a clear policy outline is yet to be revealed, this is another positive step to liberalise FDI policy framework and ease regulatory hurdles. Consideration has been given to de-stressing the banking system from the burden of bad loans. However, the demand of NBFCs for parity in the treatment of income from stressed assets has not been addressed.

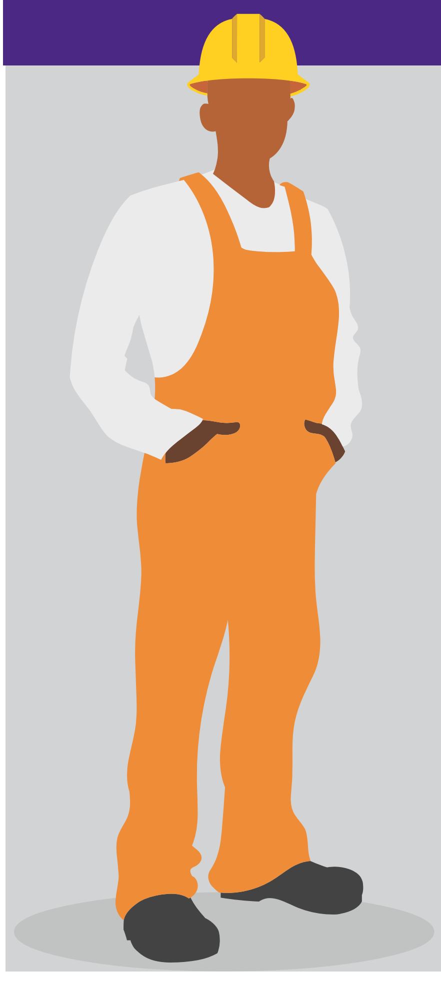
Budget sectoral impact

Energy and natural resources[1]

Overall intent for the energy sector has been progressive and transformational, especially in few key aspects. The proposed creation of an 'Integrated Oil Sector Major' creates an opportunity for India to own and invest in a stable oil supply chain. The focus on renewable energy gained another fillip as an additional 20,000 MW was announced under the National Solar Mission.

Further, the government announced creation of two additional facilities, apart from enhancing the Strategic Crude Oil Reserves, which is expected to increase cumulative strategic reserve capacity.

Halving of Basic Customs Duty on LNG is likely to support stranded gas power plants and could also encourage mid-stream infrastructure creation from LNG terminals to gas pipelines and city gas distribution networks. The FM reiterated the achievement of 100 per cent village electrification by 1 May 2018, which, followed by the household electrification programme, is likely to trigger latent demand for power. Enhanced focus on railways, transforming from a single-solution to a multi-modal end-to-end solution provider, would hopefully address coal transport and pilferage issues faced by power plants.



Building, construction and real estate[1]

The Union Budget 2017-18 was largely in tandem with the expectations, with a targeted push to infrastructure and affordable housing sector.

Affordable housing getting an infrastructure status was one of the biggest developments that came through. Further, bigger unit area now qualifies for affordable housing, making more units applicable for affordable housing benefits. This move is likely to not only push affordable housing in tier II and III cities, but the sector could also attract better investments.

The period of Long-Term Capital Gains Tax (LTCG) for land and immovable assets has been relaxed to two years. This might increase the number of secondary sales in the residential sector. Another positive move was the government's intent to extend its basket of financial instruments to which capital gains can be invested without payment. The curb in cash transactions above INR3 lakh is expected to help stabilise pricing in the secondary real estate market.

1. Budget 2017-18, Speech of Arun Jaitley, Minister of Finance, 1 February 2017;
KPMG in India analysis, 2017

Budget at a glance

1. Farmers[1]

- A sum of INR10 lakh crore has been allocated as credit to farmers, with 60 days interest waiver
- NABARD's Long Term Irrigation Fund augmented by 100 per cent to reach INR40,000 crore
- Setting up of mini labs in Krishi Vigyan Kendras (KVKs) and ensuring 100 per cent coverage of all 648 KVKs in the country for soil sample testing
- Coverage of National Agriculture Market (e-NAM) expanded from 250 markets to 585 APMCs
- Dairy Processing and Infrastructure Development Fund to be set up in NABARD with a corpus of INR2,000 crore.

2. Rural population[1]

- The government targets to bring one crore households out of poverty and make 50,000 gram panchayats poverty free by 2019
- Total allocation for rural, agriculture, and allied sectors is INR1,87,223 crore
- Over INR3 lakh crore to be spent in rural areas every year, for rural poor from central budget, state budgets, bank linkage for self-help groups, etc.
- Target to achieve 100 per cent village electrification by 1 May 2018
- 'Swachh Bharat' mission has made tremendous progress with sanitation coverage going up from 42 per cent in October 2014 to about 60 per cent now.

3. Youth[1]

- Introduction of a system of measuring annual learning outcomes in schools
- 100 India International Skill Centres (ISCs) to be established across the country
- SWAYAM platform, leveraging IT, to be launched with at least 350 online courses
- Skill Acquisition and Knowledge Awareness for Livelihood Promotion programme (SANKALP) to be launched at a cost of INR4,000 crore. It will provide market relevant training to 3.5 crore youth.

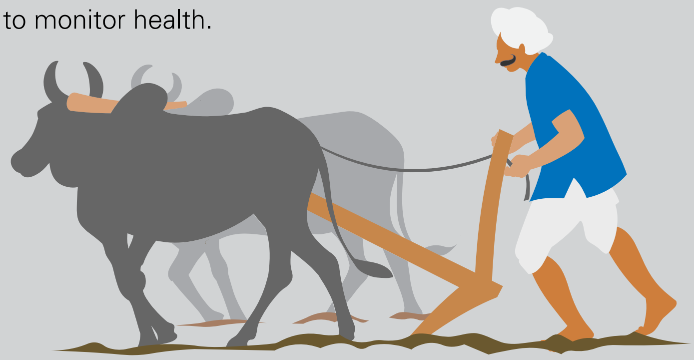
4. The poor and the underprivileged[1]

- Mahila Shakthi Kendras will be set up with an allocation of INR500 crore in 14 lakh ICDS Anganwadi Centres
- Affordable housing has been given infrastructure status
- Create additional 5,000 post graduate seats per annum to strengthen secondary and tertiary healthcare
- Two new All India Institutes of Medical Sciences (AIIMS) to be set up in Jharkhand and Gujarat
- Rationalisation and amalgamation of existing labour laws to foster a conducive labour environment
- Aadhaar-based smartcards for senior citizens to monitor health.

5. Infrastructure[1]

- For the transportation sector as a whole, including rail, roads, shipping, a provision of INR2,41,387 crore has been made in 2017-18
- Total capital and development expenditure on railways has been pegged at INR1,31,000 crore, including INR55,000 crore provided by the government
- A new Metro Rail Act will be enacted to encourage greater private participation and investment in construction and operations
- Select airports in tier II cities will be taken up for operation and maintenance via PPP mode
- High speed broadband connectivity through optical fibres will be available in more than 1,50,000 gram panchayats by the end of 2017-18.

1. Key Features of Budget 2017-18, Union Budget, 1 February 2017



Budget at a glance

6. Financial sector[1]

- Foreign Investment Promotion Board (FIPB) to be abolished in 2017-18 and further liberalisation of FDI policy is under consideration
- Foreign Portfolio Investor (FPI) Category I & II to be exempted from indirect transfer provision
- Shares of Railway PSE like IRCTC would be listed on stock exchanges
- Lending target under Pradhan Mantri Mudra Yojana to be set at INR2.44 lakh crore for 2017-18
- In line with the 'Indradhanush' road map, INR10,000 crore has been allocated for recapitalisation of banks in 2017-18
- Integration of public sector 'oil major' has been proposed in order to match performance of international and private players.

7. Digital economy[1]

- Banks have targeted to introduce additional 10 lakh new POS terminals by March 2017
- Aadhar Pay, a merchant version of Aadhar Enabled Payment System, will be launched shortly
- A mission will be set up with a target of 2,500 crore digital transactions for 2017-18 through UPI, USSD, Aadhar Pay, IMPS and debit cards
- No transaction above INR3 lakh would be permitted in cash subject to certain exceptions.

8. Public services[1]

- The government's e-market place is now functional for procurement of goods and services
- Head post offices will be used as front offices for rendering passport services
- Tribunals to be rationalised or merged, wherever appropriate
- Web-based interactive Pension Disbursement System for defence pensioners will be established.

9. Prudent fiscal management[1]

- Allocation for capital expenditure stepped up by 25.4 per cent over the previous year
- For the first time, a consolidated Outcome Budget, covering all ministries and departments, is being laid along with the other Budget documents
- Total resources being transferred to states and the union territories with legislatures is INR4.11 lakh crore, against INR3.60 lakh crore in BE 2016-17.

10. Tax administration[1]

- India's tax to GDP ratio is not favourable
- The holding period for computing of long term capital gains from transfer of immovable property has been reduced from three years to two years
- Minimum Alternate Tax (MAT) credit is allowed to be carried forward up to a period of 15 years instead of 10 years at present
- In order to make MSME companies more viable, income tax for companies with annual turnover upto INR50 crore is reduced to 25 per cent.

1. Key Features of Budget 2017-18, Union Budget, 1 February 2017

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