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Flows into Equity could Slow Unless Earnings Drive Markets Higher

Expert Take

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Every Budget is a statement of sources and uses of funds and inevitably reflects the context, priorities and trade-offs involved in this exercise. This year's Union Budget has focused its attention on the rural economy, on farmers, on the poor, on small businesses and on employment. The focus on the MSP should boost farmer incomes as desired. The grand healthcare scheme is expected to impact 10 crore families, making it one of the biggest schemes in the world. In addition, there is focus on gas connections, electricity, housing and rural infrastructure. All in all, Bharat has expectedly and deservedly received significant focus.

Some of the funds to finance this will come from taxes and higher cesses on individuals and larger businesses and partly through higher custom duties on some elements of the consumption basket of the well to do. A more equitable India is certainly desirable. In furthering this cause, it would have been good to see a greater focus on disinvestment and on widening the tax base.

The Budget has forecast a real growth of 7.2-7.5% for next year. This pick-up in growth will have to come from consumption demand, especially from rural markets, the broader government spend and to some extent from SMEs, import substitution and exports. Oil prices and the monsoon are going to be two elements to watch out for. The mix of government expenditure seems pro revenue expenditure and less tilted towards capex. The previous year budgeted capex was ₹3 lakh crore against which ₹2.8 lakh crore is likely to be achieved this year. The provision for next year is ₹3.09 lakh crore, which is a modest increase. Capital formation might remain muted in the coming year.

The fiscal deficit both for FY 18 and FY19 came in slightly higher than expected, though the FY18 slippage was expected given the impact of GST. The higher projected fiscal deficit, the view that indirect tax estimates seem a tad optimistic, the greater thrust to consumption, the impact of a higher MSP and the uncertainty around oil has got bond markets worried. Yields have already shot up 15-20 bps in response. While this raises the cost for borrowers and creates losses for existing investors, new money could well flow in as a result of these higher returns. Oil prices, general inflation and collections from GST going forward would drive rates. The opening up of 'A' rated securities to a broader investor base could lead to a narrowing of spreads in this category and a widening of the bond market.

Equity investors were dealt an LTCG card after 14 years. While the grandfathering ensures there is no retrospective impact, it probably caps the market for some time. Given LTCG is applicable on gains from current prices, the estimate of collections might therefore not be as expected. With STT intact and no indexation benefits, the flows into equities could slow unless earnings drive markets higher. The booming IPO market could also moderate.

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