Modi 3.0: Budget 2024 – A continuum with a few twists

The first budget of Modi3.0 did not create any wow moments as many had predicted, but was a practical budget, which we believe, will deliver on its larger purpose to bring down cost of capital in the economy. The budget aims to achieve this objective by consolidating government finances by lowering the fiscal deficit and debt to GDP levels. In fact, the budget provides a glide path for all these initiatives, and is conservative in its assumptions, which gives immense confidence on the future trajectory of the economy and country at large.

The budget, has been about minor incremental tweaks in taxes and rules, aimed at bringing parity to all asset classes both financial and hard assets like real estate and gold. The larger theme of this government is about continuity and consolidation, so we believe this budget is a reflection of that, directionally the budget continues to be on the path to fiscal prudence, capex spending. Increased focus on employment generation through soft skilling policies and employment related incentives for the private sector is interesting. Most importantly the budget is devoid of any consumption boosters like subsidies or doles, which is laudable, despite the political pressures to do so.

Our major observations on the budget

Conservative assumptions- increases credibility

The assumptions taken into account in the budgets are extremely conservative, which is even lower than the market estimates. Nominal GDP growth is assumed at 10.5%, much lower than estimates of 11-12% by external agencies. Direct tax and GST collections growth numbers are also in the range of 10%, despite a buoyant economy. Despite this, the fiscal deficit is projected to be 4.9%, which is highly achievable. Further the government is also indicated that they will reign in government debt in order to manage debt to GDP levels in the future, this goes a long way in bringing down cost of capital for the economy, which seems to be the main focus of the government. **The biggest beneficiary of a low cost of capital is risky assets - equity.**

Tax Changes - Simplification and parity of asset classes augur well for the long term - despite short term impact - equity still remains attractive

Tinkering in tax rates, by marginally increasing long term capital gain tax for equity from 10-12.5%, increase short term capital gain tax from 15% to 20%. Reducing the tenure for long term taxation from 3 years to 2 years and reducing the LTCG from 20 to 12.5% for listed bonds, unlisted equities, REITS. By doing this the government has standardized capital gain tax for most of the financial assets under a single rate of 12.5% for long term and 20% for short term. We believe that this enhances the attractiveness of investing into equities for the long-term. Besides making fixed income alternatives like listed bonds, REITS more attractive, but FD's and debt mutual fund investing still remain unattractive on a post-tax basis.

Real estate long term capital gain tax has been reduced from 20% to 12.5%, but indexation benefit has been withdrawn, which means that investors can no longer adjust the purchase price of their investments for inflation while calculating capital gains for tax purpose. The impact of these changes for legacy real estate investments is mixed depending on tenure and level of appreciation. But as per experts it is positive for new home buyers and fresh real estate investments. This is encouraging for the overall economic growth especially when the real estate cycle seems to be on the upswing. This will positively impact a number of housing and allied sectors and produce a multiplier effect on the economy.

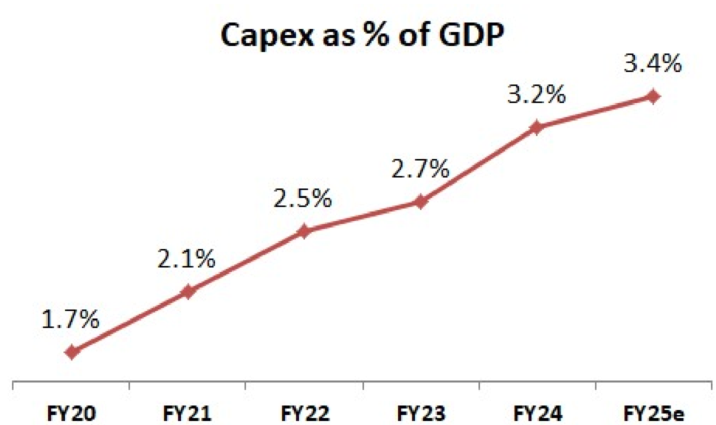
Capex focus remains - despite lower fiscal deficit targets

The government should be lauded for sticking to its path of asset creation over revenue expenditure. Capex as % of GDP is at 2 decades high. Since FY19 average growth in capex has been much higher than revenue expenditure growth. Capex to revenue expenditure ratio has improved from 0.15 in FY19 to 0.27 in FY24. This prudent approach has helped the government maintain fiscal discipline while retaining the spending momentum. The beneficial impact of this is lower inflation as supply and productivity is enhanced by asset creation, and the resultant lowering of cost of capital should encourage private investments, thus creating a virtuous cycle, although the government policy remains counter cyclical. **This to our mind is striking a perfect balance and helps consolidation of recent macro positives and sustain long term growth trajectory.**

Other positives

- The conservative estimates in tax receipts and calibrated spending means government borrowing is expected to be much lower than earlier expected.
- Non tax revenues assumptions like disinvestment and dividends from PSU's, RBI are fairly low. This might lead to some positive surprises which can lead to more capex spending.
- The schemes to promote employment generation through Employment Linked Incentives, Direct Benefit transfer, EPFO contributions, leaves the onus on private sector which we believe is smart. Scope for government to directly create employment is fairly limited and fraught with inefficiencies.
- Even political compulsions have been dealt with efficiently by proposing asset creation in the respective states and not encouraging handouts.

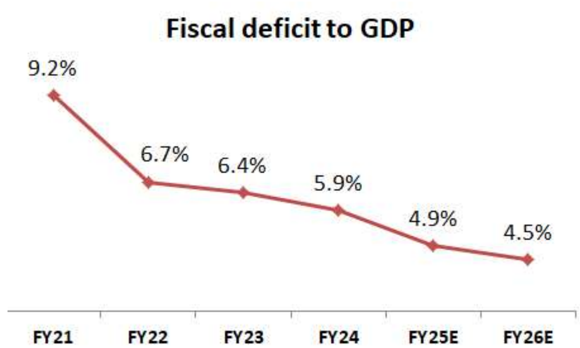
Key snapshots of the budget

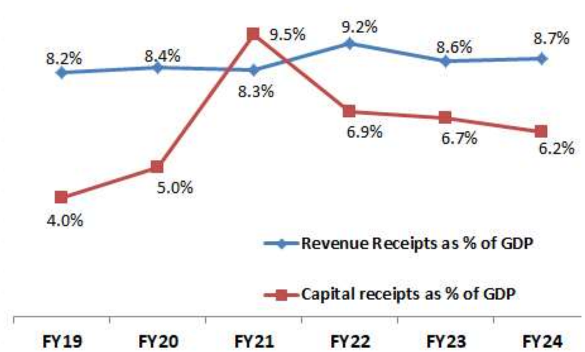


Tax change Implication- on Asset classes

- Short term equity trading more unattractive
- Listed bonds, REITS, Gold, International Fund of Funds, Foreign Equities more attractive.
- Debt mutual funds and FD's- no change
- Real Estate a mixed bag, taxation depends on extent of appreciation and length of holding.

Despite all of these changes, we feel listed Indian equities still remain the most attractive even on a tax perspective, given the growth and liquidity prospects.





Implications

Equity remains the most attractive asset class

In our opinion, this budget's proposals will have a positive effect on equity, as the policy focus will aid coporate earnings growth and also enhance India's attraction as an investment destination, notwithstanding the increased LTCG taxation. On the contrary higher short-term taxes and increase in STT has rendered trading and speculation less attractive, which will only encourage equity investments for the long term. One should bear in mind not to focus too much on taxation, as investments depend on capital appreciation and growth, taxation impacts are only incidental in the long-term.

NRI's and PIOs

As mentioned earlier, this budget doesn't dampen the attraction of Indian equity, in fact, it only enhances its prospects. Also, the tax changes might not have too much bearing for NRI's investments as despite the current changes, the overall taxation is still lower than their respective host countries, barring a few geographies which are tax free. There is no change in any other provisions related to access of investments to and from India. We also feel that the stable macros will lead to more capital inflows into the country which will lead to a stable rupee or even a possibility of appreciation against all major currencies. This will make post tax returns on Indian investments more attractive. The simplification of taxes is an added benefit.

Investment strategy and Portfolio positioning

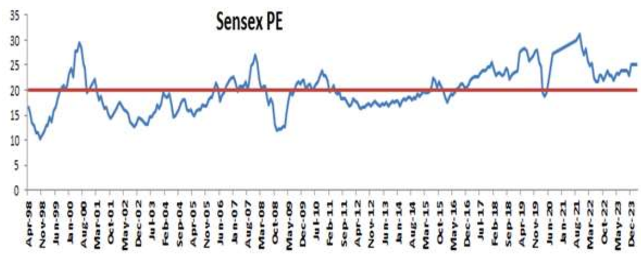
As mentioned throughout the note we remain positive on Indian equity and this event has no material change in our portfolio positioning. We continue to remain overweight on equity, but incremental investment flows should be calibrated, through SIPs and STPs. The budget has also made alternatives to equity like bonds, REITS, Gold and hybrid funds more attractive, which gives us more options to adjust portfolios in case any untoward risks arise.

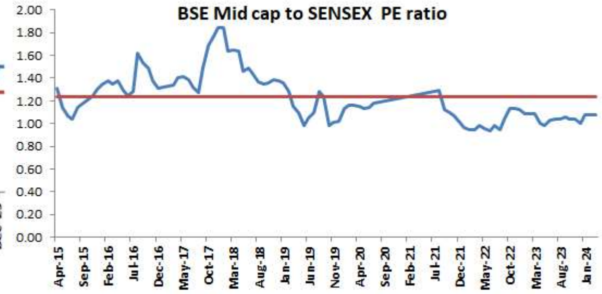
Valuation and Outlook

Market valuations are marginally higher than historic averages, but we feel that there will be a new normal in terms of lower cost of capital over the next 3-5 years, due to prudent macro management by the government by not over extending the fiscal stimulus and reigning in government borrowing, market valuations can remain elevated or higher than historical averages.

In terms of portfolio positioning, we will still have reasonable exposure in quality mid and small cap portions of the market as they don't seem very stretched on an aggregate basis. We will prefer portfolios which are exposed to the domestic capex cycle but will take exposures selectively in healthcare, pharma and consumption as we see relative value in those pockets as well.

In conclusion stay invested, focus on long term wealth creation through equity, we will look to diversify away from it when the situation demands. As of now let's stay put and enjoy the ride!!!





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