Date : 17-Mar-2012 Edition : Mumbai Page No.: 5 Page Name: n.a. Size: 297.42 sq. cm

Sector: Banking and Finance Circulation: 420000 AVE: INR 855090.06 Frequency: Daily

News monitored for: Kotak Investment Banking

DNA

Another missed opportunity

Indranil Pan
Chief economist, Kotak Mahindra Bank

With the back against the wall, the finance minister (FM) did bite the bitter pill of increasing the taxes. As expected, the excise tax and the service tax rates were hiked by 2% from 10% to 12%.

But this failed to provide any comfort as expenditure, especially the Plan expenditure, was increased very significantly. But, going beyond the numbers, there was much hope that the Budget would do much to change the investor perception on India by driving ahead some of the pending key reforms. This was especially true as this Budget was perceived by the market as almost the last chance to announce major policy changes, as the FY2013-14 Budget would be the last full Budget before the general elections in 2014. And this hope was belied.

Now for the hard numbers. The FM aims to bring down the fiscal deficit to 5.1% of gross domestic product (GDP) in FY2013 from 5.9% in FY2012. He has also attempted to cap the total subsidy outgo to 2.0% of GDP. Back-of-the-envelope calculations, however, indicate that it could be hard to achieve both of the above, if not impossible.

The government has assumed a nominal GDP growth of 14.0%, with a 7.6% real GDP growth. This may be difficult to achieve as the headwinds to growth remain strong. With a 6.6% growth in GDP, one can look forward to only a 12.6% nominal growth, thereby risking a miss on the tax revenue targets. Crucially, in India, there is still a very heavy reliance on the manufacturing sector and there appears little hope that this sector would see any sharp reversal soon.

Thus, in all likelihood, tax collections could come under pressure. Additionally, the reliance on one-off revenue receipts continues, with receipts on account of auction of telecom spectrum and disinvestment cumulatively amounting to 0.7% of GDP. In the absence of these receipts materialising, as was the case in FY2012, the fiscal deficit target is likely to see a commensurate slippage.

To us, the bigger risk continues to be on the expenditure side, on account on the subsidy burden. Capping the subsidy burden at 2.0% of GDP is likely to be a distant dream (budget estimate is at 1.9% of GDP). As has been the practice in previous years, the government has made no provisions for payment to oil marketing companies (OMC) for the under-recoveries for FY2013, and the ₹40,000 crore fuel subsidy is the government's share of OMCs' losses for the last quarter of the financial year that would soon come to an end.

And, given the political ramifications that unfolded after passenger fares were hiked only minimally in the Railway Budget, it could be difficult for the government to immediately think of any increase in the administered fuel prices. The extent of subsidies thus will continue to be large - ₹12/litre on diesel, ₹28.66/litre on kerosene and ₹439/cylinder for LPG. My calculations suggest that at $110 a barrel average global crude oil price, and assuming modest pass-through, the government's share in total losses by OMCs could be an additional 0.5% of GDP. In my view, the year FY2013 could end with a GFD/GDP closer to 5.4-5.5% with deficit rising from ₹5.22 lakh crore in FY2012 to ₹5.40-5.55 lakh crore in FY2013. And this is not a fiscal consolidation that has happened.

To a certain extent, the Budget also builds in a negative sentiment on the monetary policy side, where pretty soon the market could be pruning its expectations of significant easing from the RBI. With the rupee liquidity constraints expected to continue, the large borrowing requirement from the central government is likely to lead to crowding-out of the corporates from the domestic market.

This essentially means that even if the RBI reduces its repo rate, there is unlikely to be any significant pass-through of this to the borrowing costs of the corporates. For FY13, the shape of the Indian economy is looking thus: investments will remain constrained; growth underperformance will continue; inflation and interest rates fail to come off to comfortable levels; and the rupee also stays on a depreciation bias as flows are hampered due to investor sentiment failing to pick up.

Views are personal