

## Economic Analysis

# India| FY17 Budget – A tight balancing act

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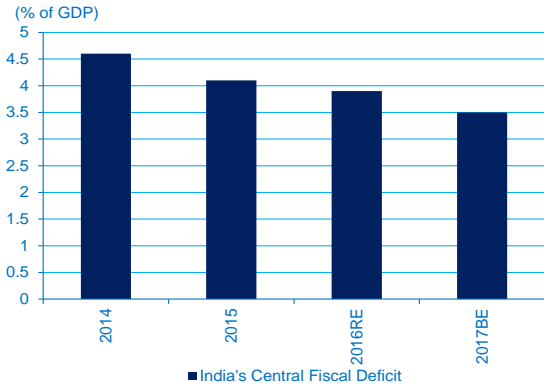
India's FY17 (year ending March 2017) Union Budget reiterated its commitment towards quality fiscal consolidation by aiming to reduce its fiscal deficit to 3.5% from 3.9% of GDP in FY16 and set a 3.0% target over FY18 and FY19. The deficit correction plan offset higher farm, rural and social sector outlay, increase in capital expenditure, central government employee pay hikes, revenue losses from direct tax proposals and bank recapitalization with net gains on indirect tax proposals, higher subsidy savings, and disinvestments. At a time when India wades through a challenging global backdrop and an uneven balance of growth at home, we believe India's new budget has rightly focus on measures aimed at boosting a weak rural economy while playing a balancing act between quality fiscal consolidation and targeted stimulus aimed at productive spending. On the flipside, the new budget was less forthcoming with regards to the implementation status of difficult yet crucial reforms such as the Goods and Services Tax and the Land Acquisition Bill, the progress on which is critical for India to deepen confidence of long-term foreign investors and bridge the funding gap to plug its infrastructure deficit. India's progress in achieving its 3.0% fiscal deficit target over the next two years will also be closely watched, especially if it undershoots its 11% nominal GDP growth target for FY17.

**Rural economy, infrastructure development and financial reforms assume top priority:** Broadly, India's new budget echoed three key focus areas – 1) Strengthening India's weak rural economy, which has suffered from back-to-back droughts 2) Stepping up infrastructure development and productive investment spending and 3) financial sector reforms. At a more granular level, the budget announced measures aimed at enhancing farmer welfare through enhanced market access and added interest subvention benefits; boost youth employment and skill development particularly on the digital front and tax incentives for employers, increased outlay for social sector and healthcare programs particularly for women through new health protection schemes, higher infrastructure outlay with a focus on irrigation, roads, ports and railways, progressive changes in foreign direct investment policies in insurance and stock exchanges, a bankruptcy resolution code, introduction of a new Act to improve transparency in RBI's decision making, recapitalization of weak public sector banks, and expanding the scope of direct benefit transfer scheme.

**To refrain from enacting retrospective taxation in future – Good news for foreign investors:** The Modi government would not create a retrospectively a fresh tax liability. For past cases, a one-time settlement scheme has been announced which provides dispute resolution opportunity. Furthermore, measures leading to simplification and rationalization of taxation while reducing the cascading effect of taxes and voluntary resolution of pending tax cases would help boost investor confidence of doing business in India.

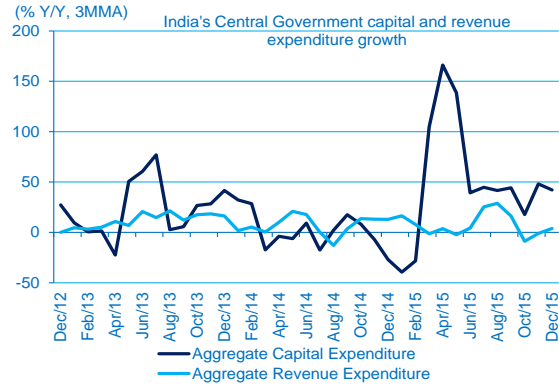
**Key takeaways for RBI from the Budget:** RBI's current stance remains accommodative although it maintained status quo at 6.75% repo rate in its last policy meeting. With regards the budget, RBI sought structural reforms that boost growth while controlling spending in order to create space for monetary policy easing while also ensuring that RBI's 5% CPI inflation target for March 2017 is achieved. Implementation of the 7<sup>th</sup> Pay Commission Recommendations (7PC) poses upside risk to RBI's inflation trajectory through its direct impact on rental housing and second round effects on inflation expectations. We believe that such a one-time shock is unlikely to have a long lasting impact on India's inflation trajectory; and that prospects of a normal monsoon and a favorable commodity-currency interplay characterized by low oil prices assume higher priority in RBI's policy toolkit going forward. The government's commitment to quality fiscal consolidation helps partly offset inflation pressure emanating from the 7CPC implementation. In this context, we maintain our expectations of a cumulative 50 bps of additional policy easing by the RBI with a high likelihood of 25 bps intermeeting rate cut by the RBI before its next meeting on April 5<sup>th</sup> 2016.

**Figure 1**  
**India's FY2017 national budget reiterates commitment to quality fiscal consolidation**



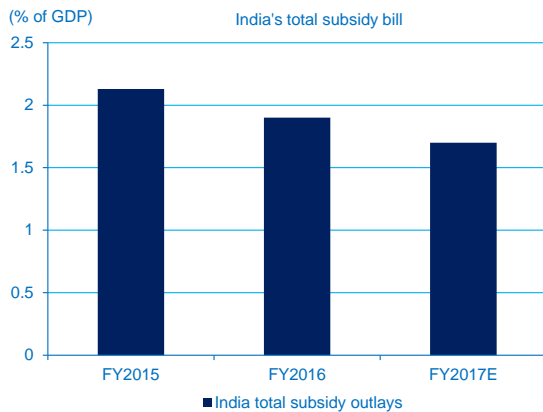
\*RE: Revised Est; BE: Budget Estimate. Source: BBVA Research, Government of India

**Figure 2**  
**... Focus remains on boosting productive public spending – Higher public capex for FY17**



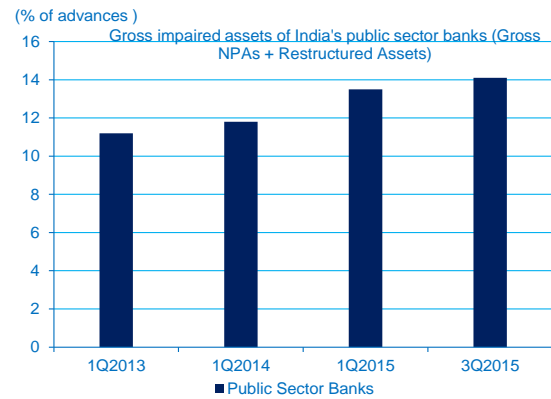
Source: BBVA Research, Government of India

**Figure 3**  
**Lower international commodity prices alongside higher excise taxes on fuel help cut subsidy bill**



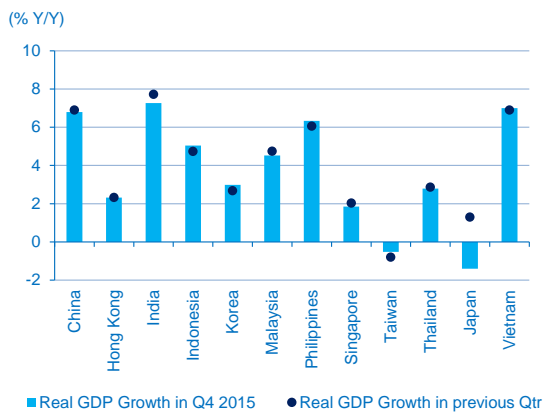
Source: BBVA Research, Government of India

**Figure 4**  
**India's banking sector weakness - drag on growth**



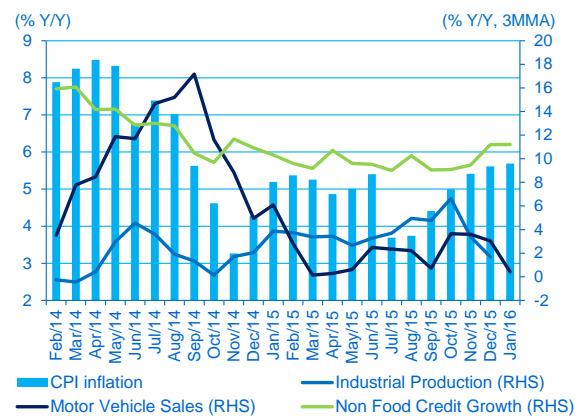
Source: BBVA Research, Government of India

**Figure 5**  
**India's real GDP growth tops the region...**



Source: BBVA Research, Government of India

**Figure 6**  
**... but growth not firing on all engines**



Source: BBVA Research, Government of India

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