India Flash

India's FY14 Union Budget – credible and pragmatic

India's new budget for FY14 (year ending March 2014), presented today, delivered on three counts: 1) it delivered a credible fiscal consolidation path, 2) it focused on the quality of deficit reduction and 3) it balanced austerity with populism without undermining economic growth. The government announced the FY13 fiscal deficit was within the targeted 5.3% of GDP (at 5.2%), with a promise to reduce the deficit to 4.8% of GDP in FY14 and to 3.0% by FY17. On the expenditure front, the budget sees a net reduction in subsidies, with lower fuel subsidies offsetting higher food subsidies. On the revenue front, a modest expected increase in net tax collections (from 7.4% of GDP in FY13 to 7.8% in FY14) is envisaged amid an improving growth outlook. Meanwhile, the budget envisaged a greater push towards privatization of state-owned firms in FY14; targeting an ambitious USD 10bn in divestment receipts compared to USD 4.4bn in FY13.

- **Key downside: limited progress on tax reforms:** The lack of focus on key structural tax measures such as a firm roadmap for implementing the Goods and Services Tax (GST) and the Direct Tax Code, which aim to widen the tax base and improve tax buoyancy, remains an issue. This, coupled with absence of dramatic policy reforms to revive investments, dampened local equity markets today (Sensex: -1.3%).

- **Budget to benefit infrastructure and financial sectors:** We expect the new budget to augment recent policy efforts to boost infrastructure development, given the announced measures to 1) ease funding for infrastructure companies, 2) allow for the issuance of tax free bonds, 3) set up a regulatory authority to expedite road projects, and 4) provide tax concessions for manufacturing sector. Meanwhile, measures to boost domestic financial savings, attract greater foreign capital, boost insurance penetration and raise Rs 140bn in capital in domestic public sector banks bodes well for India's financial sector.

- **Risks still biased to the upside:** Given existing headwinds to growth and an uncertain financial and commodity price outlook, risks of overshooting the deficit target remain high. Slower than expected growth would jeopardize revenue collections, while a spike in energy prices would affect subsidies. Furthermore, overspending in light of upcoming general elections in 2014 would renew the threat of a sovereign ratings downgrade.

Chart 1
Credible fiscal consolidation a key for FY14 budget

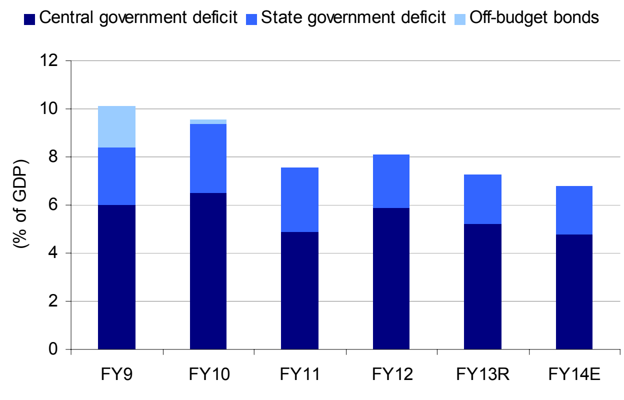
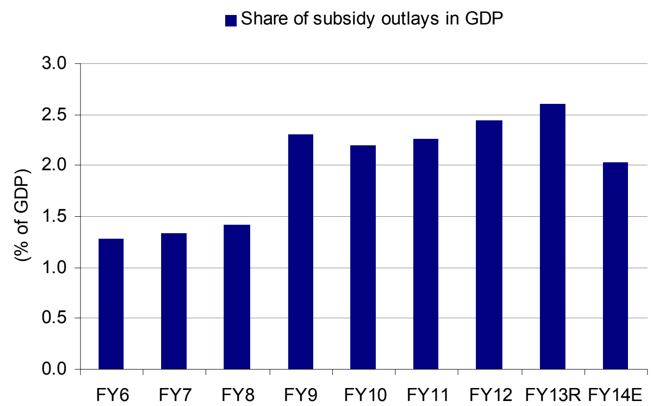


Chart 2
Budget focus on reducing subsidy spending



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