SUMMARY

- India Budget: Rural priorities dominate
- Roadmap for consolidation of Public Sector Banks
- Index of Industrial Production remains negative

India Budget: Rural priorities dominate

Presenting the Modi Government's third budget, Finance Minister Arun Jaitley listed nine pillars that will 'transform India'. The pillars were tax reform, fiscal discipline, infrastructure investment, ease of doing business, agriculture, the rural sector, the social sector, education and job creation. This underlines the government's commitment to fiscal discipline, the stimulation of private investment, and domestic consumption. By continuing with his stated fiscal consolidation roadmap (3.9% of GDP in fiscal year 2016; 3.5% in fiscal year 2017), the budget surprised the markets – which rallied 6.3% within a week, the highest weekly gain in seven years. Some of the long term implications of the budget are below:

Drought alleviation measures were expected, given that India is reeling with effects of two consecutive bad monsoons. Jaitley set out an ambition to double agricultural incomes by 2022. For example, he plans to link the guaranteed rural employment scheme MGNREGA to creating productive assets and gave it a record high allocation of £3.8bn as well as creating a Long Term Irrigation Fund of £2.1bn, improved crop insurance for farmers and more funding for local bodies. Jaitley also proposed to improve health insurance for a large cross-section of the population in addition to expanding the program offering generic drugs at low prices, at 3,000 new generic medicines stores across the country.

Infrastructure Investment – has been a key part of the effort to revive investment including from private players. The government has set a target of 2019 for full road connectivity for eligible habitations, earmarking £27bn, including a contribution from states, for village roads. The government will allocate £55bn for road construction with National Highways Authority of India (NHAI) adding another £15bn via bonds, in total bringing road spending to £97bn. A series of measures for modernising ports and building new ports and for developing 160 non-functional airports across the country at a cost of £5m-£10m each were also announced.

Roadmap for consolidation of Public Sector Banks

Stressed assets in the public sector banks including non-performing assets (NPAs) and restructured loans, stood at 14% of total assets in September, compared to 4.6% recorded by private banks. The cumulative value of NPAs in listed public sector banks stood at over £40bn by December. Given pressure from the Reserve Bank of India to recognise bad assets in balance sheets, NPAs may yet rise further. Another £10.4bn in loans to state-owned power distribution companies may also have to be classified as bad loans.

Recapitalization costs have amounted to 0.5% of GDP over two decades. In the Budget, £2.6bn was allocated each year for bank recapitalization.

In August, the government announced a seven-point action plan, Indradhanush, to increase professionalism and draw fresh capital into public banks. The Bank Board Bureau (BBB) is a new mechanism to professionalise the administration of banks. The government also plans to reduce the number of centrally owned Public Sector Banks to around 10, from 27 currently. The budget revealed that the government will reduce its stake in public sector housing finance bank IDBI to less than 50%, as a pilot for operational freedom of public sector banks and to reduce administrative and fiscal pressures on the government.

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Dispute Resolution for Tax issues featured. Those firms battling retrospective taxation claims have been offered a deal to pay the tax due without any penalties or surcharges provided they do not pursue further legal appeals. For other tax dispute cases, a scheme to pay 30% tax along with a penalty and surcharge of 7.5% each to settle the case has been proposed.

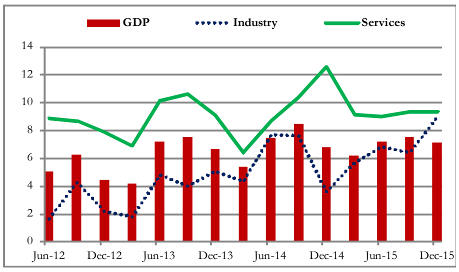
FDI Announcements: The finance minister proposed 100% FDI in asset reconstruction companies under the automatic route. Foreign investment of up to 49% in the insurance and pension sectors will no longer require prior government vetting while similar rules will be extended to more non-banking financial company (NBFC) activities. Overseas investors will be allowed to own 100% stake in businesses marketing food products produced in India, but with clearance from the Foreign Investment Promotion Board. .

INDUSTRIAL PRODUCTION REMAINS NEGATIVE

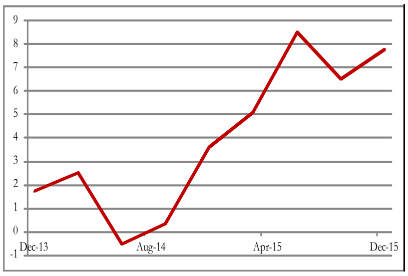
Industrial production contracted by 1.5% (y/y) in January - its third straight fall - due to poor performance in manufacturing and lower off-take of capital goods. The decline was primarily on account of a massive drop in output of capital goods, which contracted by a massive 20.4% compared to growth of 12.4% in the same month a year ago. The manufacturing sector, which accounts for a large part of the index, declined by 2.8% against growth of 3.4% in January 2015. However, there were some bright spots. The mining sector showed some improvement, with growth of 1.2% compared to a contraction of 1.8% in same month a year ago. Power generation accelerated by 6.6% compared to 3.3% last year. Consumer goods output remained stagnant, which was more encouraging than last year's 1.9% contraction. Consumer durables, an important consumption indicator, showed growth of 5.8% compared to contraction of 5.7% during the same month last year.

GROWTH: *Industrial Production remains in negative zone, on lower capital output.*

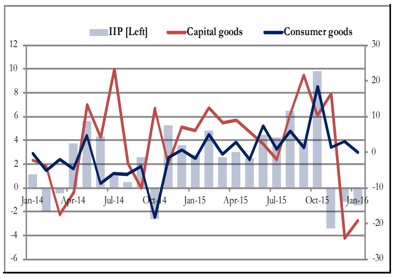
GDP



Projects Under Implementation



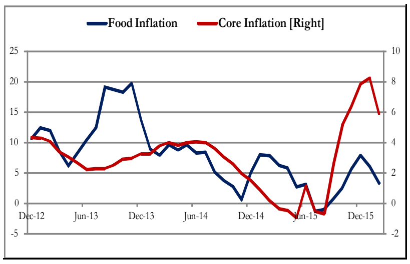
IIP/Capital/Consumer Goods



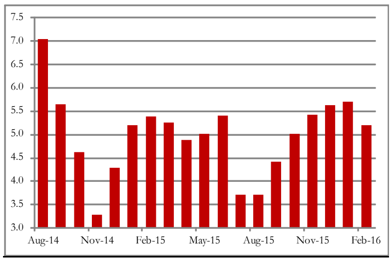
INFLATION: *Wholesale and retail inflation falling on account of food prices.*

Wholesale Price Index (% y/y)

Food vs. Core Inflation (% y/y)

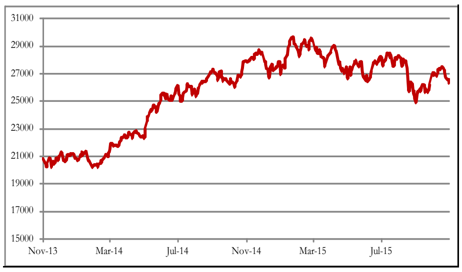


Consumer Price Index (% y/y)

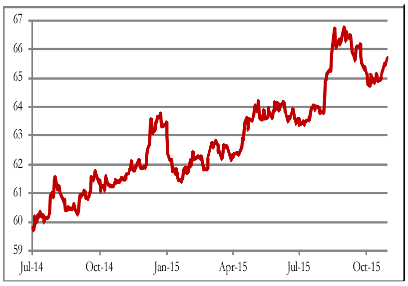


MARKETS: *Financial markets rallied by 6%, giving thumbs-up to budget.*

SENSEX



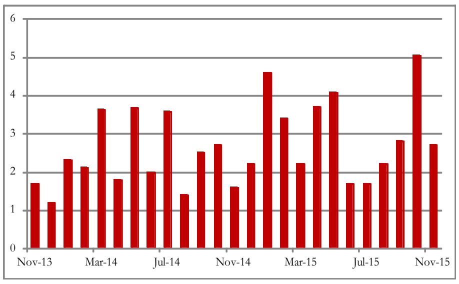
USD/INR



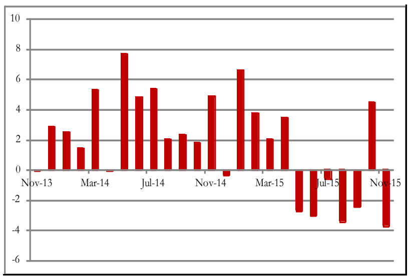
10yr Govt. Securities yield (%)

EXTERNAL: *FIIs trim exposure.*

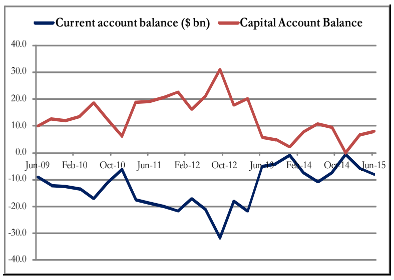
FDI ($ Bn)



FII ($ Bn)

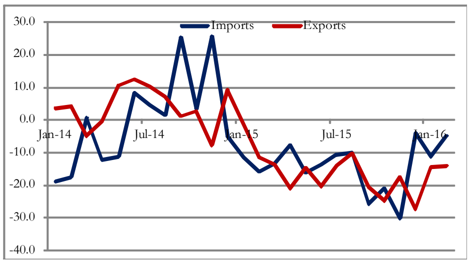


Current vs. Capital A/c ($ Bn)

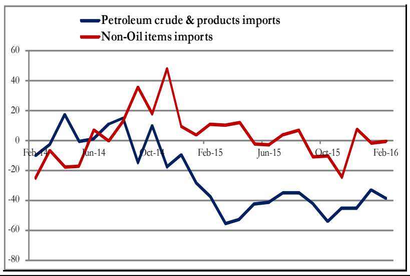


TRADE: *Imports on increasing trend.*

Export/Import Growth (% y/y)



Imports- Oil and Non Oil (% y/y)



Trade Balance ($ Bn)