

Special Coverage: India Budget: Focus on job creation and fiscal discipline

Key takeaways

- ◆ The first budget under the Modi 3.0 government focused on balancing fiscal discipline, as well as driving both near-term and medium-term growth initiatives. In addition to fiscal prudence and capex, there was also increased focus on job creation, upskilling and providing credit to small firms.
- ◆ Projected FY25 fiscal deficit is now down to 4.9%, and FY26 fiscal deficit target remains at 4.5%. The government also announced lower gross and net borrowing of INR 14tr and INR 11.6tr, respectively. The capital expenditure was unchanged compared to the interim budget at INR 11.1tr (17.1% y-o-y increase).
- ◆ The Union Budget was largely positive for the outlook for Indian equities - fiscal consolidation should support investor confidence, welfare measures should boost domestic consumption and continued high-quality capex and construction spending should boost long-term growth potential and job creation. We retain our preference for Financials, Consumer Discretionary and Industrials. The combination of manageable borrowing needs and strong foreign inflows should lead to favourable supply-demand dynamics for Indian government bonds. Impending RBI rate cuts along with strong inflows should help drive the yields lower over the next 12 months. We remain bullish on the Indian government bonds.



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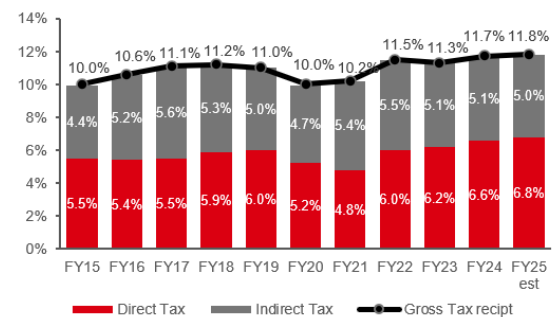
What happened?

- The nine priorities announced by Finance Minister Nirmala Sitharaman for the next five years include (i) productivity and resilience in agriculture; (ii) employment and skilling; (iii) inclusive human resource development and social justice; (iv) manufacturing services; (v) urban development; (vi) energy security; (vii) infrastructure; (viii) innovation and R&D, and (ix) next generation reforms. Some key highlights from our perspective are as follows:

Fiscal discipline: Projected FY25 fiscal deficit is now down to 4.9% (from 5.1% announced in the interim budget) and FY26 fiscal deficit target remains at 4.5%. The reduction was enabled by splitting the excess dividend from the RBI equally between fiscal consolidation and higher current expenditure. The fiscal deficit for FY24 was also revised down from 5.8% to 5.6%.

Lower borrowing: The government announced lower gross and net borrowing of INR 14tr (vs 14.1 previously) and INR 11.6 tr (vs INR 11.8 earlier) respectively. As a result, net borrowing is projected to fall 1.5% y-o-y against a backdrop of 10.5% expected nominal GDP growth, strong foreign demand and tax buoyancy.

India's tax revenue as a % of GDP is rising steadily



Source: Budget documents HSBC Global Private Banking and Wealth as of 23 July 2024. Past performance is not a reliable indicator of future performance.

Focus on job creation and upskilling: A slew of employment and skilling programs at a cost of INR 1.48trn to benefit potentially 2 million youth over the next 5 years, and a scheme to provide 1-month's wage in form of cash transfers (up to INR 15,000 in 3 tranches) to anyone newly entering the workforce, were announced in the budget.

The capital expenditure was kept unchanged at INR 11.1tr (17.1% y-o-y increase). The government also announced plan to build 30mn houses across rural and urban India.

Support for MSMEs (Micro, Small and Medium Enterprises): The government announced a host of measures which include increasing the limit of loans to INR 2mn (Mudra loans) to small firms and providing a collateral-free credit guarantee scheme for purchase of machinery.

Tax changes: Both short-term and long-term capital gains tax rates were revised higher to 20% (from 15% previously) and 12.5% (from 10% earlier) respectively. The Securities Transaction Tax (STT) on derivatives (futures and options) was also increased. Personal income tax buckets were revised higher and standard deduction was raised, which could lead to tax savings of up to INR 17,500 per year.

Investment implications

- Although Indian equity markets were negatively surprised by the increase in short and long-term capital gains tax, and the increase in Securities Transaction Tax (STT) on futures and options, we believe the Union Budget was largely supportive for the medium-term outlook for Indian equities.
- The budget struck a delicate balance between achieving fiscal prudence, supporting long-term economic growth and investor confidence. The measures are also likely to boost consumption for the **consumer discretionary and consumer staples sectors**, while increased spending on high-quality capex as well as housing and construction is positive for **Industrials. Financials** are also likely to see strong credit demand which should translate into healthy loan growth.
- Overall, we believe the measures announced in the budget complement the strong fundamental drivers of Indian equities, which include **robust economic growth, strong earnings growth, and sticky domestic investor base**. These positive factors should help Indian equities outperform other Asian markets over the next 3-6 months despite their elevated valuations.
- The combination of manageable borrowing needs and strong foreign inflows should lead to favourable supply-demand dynamics for Indian government bonds. Foreign investors have bought around USD12bn equivalent of Indian government bonds since September 2023. Various market estimates also point towards USD35-40bn inflows due to inclusion of Indian bonds in two global bond indices. Although the prudent projected central government borrowing requirement should bring further comfort to the RBI, the stubbornly high food inflation leads us to change our expectation of the first RBI rate cut from 3Q to 4Q 2024, with cumulative 0.5% rate cuts till 1Q 2025. Impending RBI rate cuts and strong inflows should help drive the yields lower over the next 12 months. We remain bullish on Indian government bonds.
- Recent inflows into Indian equities and bonds, coupled with improved balance of payment picture, have helped India's FX reserves to swell to USD667bn. Further inflows, stable oil prices and RBI's proactive management of INR volatility should lead to stable USD/INR, with modest INR appreciation potential towards the end of 2024.

Consensus 12-month forward P/E ratio and EPS growth estimates

	P/E Ratio	2024 EPSg	2025 EPSg
MSCI India	25.8	31.5%	18.7%
Financials	17.9	24.8%	23.4%
IT	29.3	7.6%	9.9%
Energy	17.3	56.9%	7.2%
Consumer Discretionary	32.8	144.2%	14.7%
Industrials	45.2	71.7%	23.6%
Consumer Staples	54.3	22.4%	15.0%
Materials	25.1	4.9%	35.1%
Healthcare	34.7	34.8%	16.2%
Utilities	21.1	36.5%	10.0%
Communication Services	46.7	118.4%	52.5%
Real Estate	67.4	107.1%	26.8%

Source: Bloomberg HSBC Global Private Banking and Wealth as of 23 July 2024. Past performance is not a reliable indicator of future performance.

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