



Mirae Asset - flash

India Budget

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- The 2016-17 Union budget is a move in the right direction, focusing on adherence to fiscal discipline, reviving rural India, and process simplification & institutionalization.
- On the ground, India's consumption-driven economy remains robust, and the "Make in India" campaign has been successful in attracting FDI.
- India remains one of our favorite markets in the region. Our major comfort is that both Modi's Government and the RBI are taking steps to strengthen the institutional framework and long term foundation of the economy.
- We maintain a bias towards domestic cyclical beneficiaries from structural trends such as consumption growth, urbanization and financial inclusion.

A move in the right direction

We see India's 2016-17 Union budget, announced on 29th February 2016, as a move in the right direction to take the country to the next level of growth. Key positives from the budget include adherence to fiscal discipline, reviving rural India, and process simplification & institutionalization. We believe the budget has mitigated downside risks, while providing a much-needed boost to parts of the economy. Below are some of the highlights from the budget:

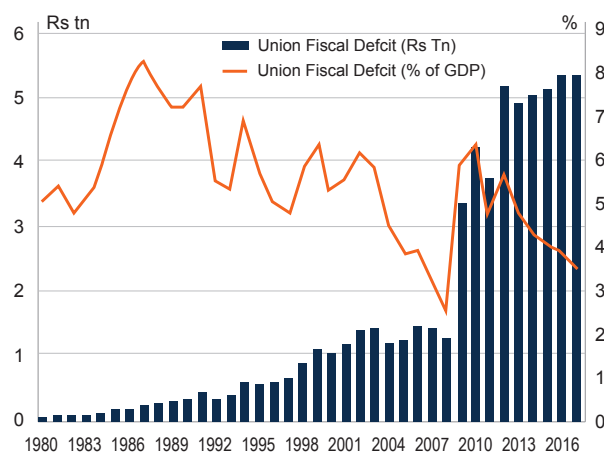
Fiscal prudence

The 2016/17 Union budget continues with the fiscal consolidation roadmap, staying on track with a 3.5% fiscal deficit target in the coming year. This helps build policy credibility and create an environment conducive to future rate cuts by the RBI. In addition, this improves the country's macro stability, which should be welcomed by global investors. We expect the RBI to cut rates by 50bps in the coming six to nine months.

Rural and agriculture push

Rural India is a big focus in the budget as it has been under a lot of stress given disappointing rainfall over the past two monsoon seasons. To develop rural infrastructure, the government is putting in place measures, such as a long term program of irrigation to improve

3rd lowest fiscal deficit in 40 years



Source: Budget documents, Credit Suisse, Feb 2016

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productivity, investment in storage facilities, road construction, village electrification, modernization of land records, e-market platform to nationalization farm product market etc. Putting a focus on rural India also bolsters Prime Minister Modi's political capital.

Direct benefit transfer

The government intends to conduct pilots for fertilizer subsidies after the successful implementation of direct subsidy transfer in LPG. This has the potential for substantial savings by plugging leakages traditionally associated with "middle-men" in dispensing subsidies.

Focus on job creation

The government will pay the employer contribution to the Employees' Provident Fund for all new employees. In addition, tax deduction for hiring new employees has also increased.

Infrastructure and investments

The government will allow 100% FDI in marketing of food products produced and manufactured in India. There is also a substantial increase of 20-25% in road and railway spending.



Source: Firstpost

Taxes

Contrary to market expectations, capital gains tax on equities remains unchanged. On the other hand, the proposed infrastructure tax of 1% to 4% on passenger vehicles may have a negative impact on the auto sector in the near term. A "cash for clunkers" scheme will likely come in the near future whereby four-wheelers over fifteen years of age could be scrapped for a 10-15% discount on new vehicles, a move likely to have a dual benefit of boosting domestic demand while taking old polluting vehicles off the road. A one-time tax amnesty scheme is also launched to improve tax compliance, bringing money from outside the system into the system.

On the ground, India's consumption-driven economy remains robust

Despite the presumed waning of Modi's magic, we find India even more interesting from an economic and stock picking angle than ever. With oil prices below USD 50 per barrel, domestic air travel and retail growth at 20% and gasoline demand also growing at almost 20%, India's economy continues to look healthy.

At the corporate level, we continue to see weakness in areas such as public sector banks, metals and capital goods companies – we do not have exposure in these sectors. On the other hand, consumer and pharmaceutical companies generally reported strong quarterly numbers. Margin expansion continues in domestic companies such as consumer and autos, in part benefiting from lower oil price.

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Recently we spent a week meeting companies across various cities in India. While urban demand remains healthy, rural demand has come down from twice that of urban demand to similar growth levels. Rural demand has been impacted by falls in agricultural prices and poor monsoons over the past two years. The current budget, with its focus on improving rural infrastructure, success of financial inclusion scheme and e-procurement should go a long way towards improving rural productivity.

Consumer aspirations are rising across the country with product categories such as smartphones, health & fitness and branded goods increasing their share of the wallet. In a scenario where unlisted companies in e-commerce are capturing part of the growth from the brick and mortar retailers, a better proxy for consumption growth remains consumer focused/retail banks.

Volume growth across most consumer companies has been mid- to high-single digit in the past quarter. It was heartening to see our portfolio companies at the forefront of product and consumer connection innovation. On the media front, digital media continues to be the fastest growing advertisement platform in a country with 350mn smartphones and 150mn Facebook users.

(yoy growth)	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15
India New Car Sales	2%	18%	6%	9%	22%	11%
India Gasoline Consumption	10%	13%	10%	25%	14%	17%
India Domestic Air Travel	17%	30%	19%	16%	20%	26%
(yoy growth)	F2014	F2015	F1Q16	F2Q16	Oct-15	Nov-15
India Retail Credit	13%	16%	17%	18%	17%	18%

Source: Bloomberg, Mirae Asset, as of 7 Jan 2016

While concerns over non-performing assets (NPAs) of corporate banks, particularly public sector banks, have raised doubts over the economic recovery, we believe the RBI is taking a conservative approach in asking the banks to recognize stress in commodity sectors which have been hurt by global deflation. Retail sector NPAs are still below 1%, the consumer is relatively unleveraged and the domestic employment scene remains vibrant. The positive impact of the government's infrastructure spending is slowly working through the economy, resulting in higher cement and commercial vehicle demand.

The "Make in India" campaign, with the aim of attracting FDI by streamlining approvals, is having a positive impact. Indeed, FDI was up 40% during the April-December 2015 period compared with a year earlier. As generally happens in large countries such as India, states with progressive chief ministers like Andhra Pradesh, Chhattisgarh & Maharashtra are taking the lead in infrastructure spending and attracting new investments. The silver lining is that in an environment of a demanding voter base, the good work of few states is quickly replicated by others. Another recent positive is "Uday", a scheme launched by Union Government to reduce the cost of funding for the financially stretched State Electricity boards. This is provided they agree to a time-bound plan to reduce distribution losses and improve collection efficiency; nearly fifteen states governed both by the ruling party and the opposition have come on board.



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Investment strategy

India remains one of our favorite markets in the Asia region, where it continues to stand out in a growth-constrained world given its superior demographics, under-leveraged households and competitive corporates.

Our major comfort is that both Modi's Government and the RBI are taking steps to strengthen the institutional framework and long term foundation of the economy. It is true that measures such as the Unique Identification (UID) program "Aadhar", financial inclusion, road and railway build-out, digitization of land records, e-procurement or tackling asset quality issues in banks upfront, are less growth-stimulating than a fiscally-induced consumption hand-out, but they go a long way to improving capital allocation and productivity in the economy.

We maintain a bias towards domestic cyclicals, benefiting from structural trends such as consumption growth, urbanization and financial inclusion.

- Autos are one of the featured sectors in our India exposure. Some of the auto stocks have corrected in recent months, so valuations are becoming more attractive. While the proposed infrastructure tax of 1% to 4% on passenger vehicles may have a small negative impact in the near term, the sector remains very attractive when taking a medium term view – India's passenger car market is only around 2.5mn units vs. 22mn units in China.
- Banks are another preferred sector within our India exposure. In particular, we see consumer banks as a proxy to consumption growth in India, backed by strong credit growth of the under-leveraged Indian household. We are also seeing value in private sector corporate banks, which have lower exposure to the resource sector and have relatively healthier balance sheets compared to public sector banks.
- Outside domestic cyclicals, we seek to balance our exposure with high quality exporters in the IT services and pharmaceutical space.

Since the beginning of the year, we have witnessed a large "risk-off" sentiment, driving heavy outflows from India, resulting in India being one of the worst performing markets year-to-date. Fundamentally, however, we have not witnessed any material deterioration in macro conditions since the start of the year. The fragile sentiment in the region has been primarily due to the macro tail risk from China – namely the Chinese currency. As the RMB continues to show resilience, coupled with supportive policies by Chinese authorities, such as the recent RRR cut, we expect to see an improvement in sentiment in the region and a return to fundamentals in equity markets.

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