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UNION BUDGET: 2021

Analysis

February 2021

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

Baroda MUTUAL FUND

Equity Market Outlook

01 February 2021

The budget this year was much awaited as Finance Minister had a difficult job of maintaining the recovery momentum and growth vs maintaining fiscal balance. However, it looks like that the Union Budget for FY 2021-22 continued from where it was left (Atamnirbhar Bharat - 1, 2 & 3 and Production Linked Incentive Schemes (PLI) announced last year to combat the pandemic led slowdown).

Equity market performance around Budget

Table 1: Nifty performance around budget (%)

Year	1m before	Volatility*	3m after	1 yr .after
2012	-3.9	2.6	-4.9	10.4
2013	-5.9	3.1	7.2	10.3
2014 (Interim)	-3.0	0.7	18.6	45.1
2014	-1.2	3.3	3.6	10.5
2015	-0.6	2.1	-5.3	-21.0
2016	-7.6	3.8	16.7	21.7
2017	6.6	2.1	6.9	26.4
2018	5.5	2.2	-2.7	-1.1
2019 (Interim)	0.9	1.6	7.6	7.1
2019	-1.8	1.6	-4.2	-10.2
2020	-5.1	3.3	-15.5	16.9
2021	-2.7	4.7	???	???

* Volatility on budget day defined as - (High-Low)/Close | Source: Bloomberg

Budget Proposals Growth Orientation

- We believe the budget is in right direction as economic growth will take care of debt servicing. Primary focus of budget is on economic growth and increasing employment by way of higher spending in Infrastructure, construction, agriculture, and rural segments.
- Privatization & monetization of assets will help bring in more funds and change the trajectory of working of various PSU organizations.
- Higher health care, agriculture and social spending will improve the standard of living of people and prevent people from falling in poverty.

- Some positive announcement welcomed by markets were increasing FDI in the insurance sector to 74%, creating an Asset Management company to manage stressed assets. There were no large, tax (direct or indirect) increases which is positive for equities. However due to higher fiscal deficit and higher borrowing program, interest cost will rise and lead to increase in the cost of capital.
- Fiscal deficit target of 6.8% for FY22 is clearly growth positive vs. consensus expectations of 5.5%. The disinvestment target of Rs1,75,000 crores seems optimistic.
- It proposes a strong boost to spending on various infrastructure segments like Roads, Railways, Urban development, Shipping, water, and affordable housing. This will help in employment generation as these industries are more labour intensive.

Sector wise budget announcement and its impact on sector:

Sectors	Budget Announcement	Impact	Our view
Auto	Voluntary scrapping of vehicles more than 15 yrs old	Positive	Positive for CVs as the long awaited policy has been announced. Currently, its voluntary given the conditions, but it will be refined as we move ahead.
	Higher spending in Infrastructure, rural, agriculture .	Positive	Positive for CV, 2 wheelers, tractors on long term basis due to increase in income in these geographies
	Allocated Rs18,000crs for public bus transport	Positive	Positive for CV transport industry due to higher demand for buses.
Industrial Mfg, Infrastructure	• Increase in total capital expenditure by 34% vs FY21(BE) and 26% vs FY21 (RE) to Rs 5.54 lakh crores • Hike in Customs duty on Solar invertors from 5% to 20%. • Phased manufacturing plan for Solar cells and modules.	Positive	Positive for Industrial manufacturing companies and construction companies
Metals	• Exempting duty on steel scrap and CVD`s on few steel products • Reducing custom duty to 7.5% on semi, flats, non alloys and stainless steel upto March 2022 (1 year) • Increase in infra spending by 34% yoy to Rs 5.54 lakh crores.	Marginal negative for steel prices, positive for overall steel demand	• Marginally negative for Long product players • Marginally Negative for Steel prices (2.5-5.0% lower duty now; but majority of imports are already coming from FTA countries which attracts zero custom duty). • Meaningful increase in spending is likely to drive steel demand

Sectors	Budget Announcement	Impact	Our view
BFSI	Allocated Rs 20,000 crs for PSU recap.	Positive	Capital infusion is likely to help the PSU banks in meeting growth and provision requirements. The amount could have been bigger. However, the listed PSU banks can tap capital markets.
	Listing of LIC	Positive	Likely to provide alternate investment option in insurance space and meet disinvestment target.
	Taxation of ULIP amount on non-death maturity on premium above 2.5 Lakhs	Negative	Likely to reduce the tax arbitrage between AMC and insurance. Will reduce traction in ULIPs and direct that flow towards AMCs.
	Privatisation of one insurance and 2 PSBs	Positive	Likely to generate additional source of funds and improve performance of these companies.
	FDI limit in insurance increased to 74% from 49%	Positive	Will help insurance co. in meeting capital requirements and bring necessary global expertise.
Consumer Goods	• Withdrawing exemptions on Basic Custom Duty (BCD) for mobiles & charger components to aid local manufacturing • BCD on compressors of refrigerators and ACs increased form 12.5% to 15% • No increase in duty on cigarettes • Alcoholic beverages - BCD of 50% and Agriculture & Infra Development cess (AIDC) of 100% • For gold and silver 12.5% BCD has been reduced to 7.5% and AIDC cess applied of 2.5% taking the total duty to 10% (from earlier duty of 12.5%)	Positive	Positive for cigarette companies, contract manufactures, jewellery companies, neutral for alcoholic beverage companies
Cement & building materials	Continued thrust on Infrastructure Spends – Specific mention of spends in Eastern States Extension of additional deduction of interest from income tax computation for loans relevant to purchase of house under affordable housing schemes	Positive	Positive for overall demand for cement and building material companies

Sectors	Budget Announcement	Impact	Our view
O&G	• 100 more districts to be added in CGD network in 3 years. • BPCL disinvestment to be done in FY22. • Setting up of independent gas distributor.	Neutral	CGD addition is on expected lines and sentimentally positive for CGD sector. BPCL disinvestment is largely on expected lines. Further clarity is required on gas transport operator. If transmission lines are required to be separated to create a common entity then the same can be negative for gas transmission companies. If there is only legal separation then its neutral for transmission.
Telecom	Revenue estimate cut from Rs1.33trn to Rs337bn in revised budget estimate for FY21. FY22 revenue estimate pegged at Rs540bn.	Positive	Revised estimate FY21 for telecom is lower and probably does not factor receipt from spectrum auction to be held in March 2021. FY22 budgeted estimate is also low and hence in all likelihood 5G auction likely to be delayed This is positive for cash starved telecom sector.

Source: Source: CEIC, Union Budget Documents, Baroda Mutual Fund Research Bloomberg

Conclusion

- Clearly the expectations of equity markets were low. Going by the past data, the market has just seen one of the worst performances ahead of Union Budget in last 10 years. This denotes that the market was approaching the budget on a cautious note.
- No major tax hike, which was a big positive that cheered up the markets. The set of proposals were clearly very positive for economy, financial, rural & agriculture and infrastructure sectors.
- Post the festive seasons we are seeing some green shoots in high frequency macro data.
- From here on, equity markets will focus on more rational factors, actual economy, earnings, and execution and try to grapple with risk emanating from global factors like new strain of Covid-19 and liquidity reversal.
- NSE Nifty 50 Index at 14281 trades at 21.4x FY22 earnings with estimated earnings growth of 35% in FY22.
- We believe that the Indian equity investors would do well to stick to their asset allocation and continue their faith in market by way of regular investment.
- Risk Factors which are likely to impact the equity markets are Withdrawal of liquidity, Tapering of stimulus, US G. Sec yield, inflation, commodity prices and Geo- political issues.

Debt Market Outlook

- The Budget is a growth-oriented budget with focus on Infrastructure and Health care.
- The fiscal deficit projected at 9.5% and 6.8% for FY21 and FY22 respectively, both were higher than market expectations. The deficit is expected to come down below to 4.5% by 2025-26.
- The fiscal deficit for FY22 is projected at 15.06 lakh crores vs 18.48 lakh crores in the revised fiscal deficit for FY21.
- The total gross and net borrowings were projected at 12lakh crores and 9.67 lakh crores respectively which are high than market expectations.
- The net tax revenue is expected to grow at 15% to 15.45 lakh crores. The tax revenue growth assumption seems reasonable with expected nominal growth in GDP of 15.4% in FY22.
- The disinvestment revenue is estimated at 1.75lakh crores. If the government is able to achieve LIC IPO then this target can be met.
- The total expenditure is at 34.83 lakh crore with increase in capital expenditure and food subsidies.
- The Budget is negative for the Bond market as it is growth oriented with high capital expenditure and higher fiscal deficit. The deficit is also likely to remain high for next three years.
- The government is clearly focusing on growth with loose fiscal policy and expecting the growth to increase in medium-term. The better growth prospects should address the fiscal issue over medium term.
- The bond market to be under pressure due to higher supply of government securities and high fiscal deficit. Due to loose fiscal policy RBI maybe cautious on inflation . We expect the yields to trend higher. RBI's Open Market Operations (OMO) and ample liquidity should support the market at higher yield level.

Source: Source: CEIC, Union Budget Documents, Baroda Mutual Fund Research Bloomberg