Economics

DBS Flash

India: Helpful steps to reverse cyclical slowdown; more to come

Economics/Growth/Monetary/Rates/India

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- *The government has announced several sector specific measures to combat economic weakness and poor investor sentiment*
- *As expected, the poorly received tax surcharge on portfolio investors has been removed*
- *Other steps include supporting auto, MSMEs, corporates, non-banks, and capital markets*
- *The fiscal impact of these measures is likely to be modest*
- *Optimistic revenue projections remain a worry*
- ***Implications for forecast**: June quarter GDP will mark a slowdown from March quarter's 5.8% YoY*
- ***Implications for investors**: Relief gains are likely in bond and equity markets. Global factors will keep USDINR supported*

In a bid to revive growth, the Indian government announced several sector specific measures. This marks a coordinated policy response, after the central bank lowered rates by 110bps so far this year (see here and here), in response to a slowdown in the past four quarters and growth slipping to 5.8% YoY at the start of this year. 2Q19 data due end of this month is likely to mark further slowdown from 1Q and stay sub-6%.

Apart from the much-awaited removal of the tax surcharge on portfolio investors, steps included supporting auto, MSMEs, corporates, non-banks, and capital markets. Highlights are as below (full list is available here):

Auto sector

Government to purchase new vehicles and replace older ones, one-time registration fees stand deferred, vehicles under the previous emission standard BS-IV purchased until March 2020 will be allowed to stay on the roads.

Taxation

Removal of the tax surcharge on portfolio investors and domestic investors which was imposed in the July's Budget. Withdrawal of enhanced surcharge on long-term and short-term capital gains on equities.

MSMEs

Unify the definition of MSMEs amongst various ministries, GST refunds to be expedited and banks to streamline settlement of loans.

Infrastructure

Credit enhancement for infra and housing projects, delayed payments will be fast-tracked, and an organisation will be formed for credit enhancement of infra projects.

Banks

Capital infusion of INR700bn announced in the Budget for banks will be expedited, and banks plan to announce repo linked products, while also fully passing the benefits of rate cuts.

Non-banks

Liquidity support of INR200bn for housing finance companies. Banks to collaborate with banks to work on loans to MSMEs and micro finance institutions, amongst others. This is in addition to support extended at the August rate review, which will provide priority sector status to bank loans extended to non-banks for financing agriculture, small businesses and home buyers within specified limits. Separately end-use restrictions for external borrowings by non-banks were also relaxed.

Capital markets

Plans to develop the credit default swap market, market dynamics will dictate rates, tranche and timing of offshore sovereign bond issuance. Move to attract offshore rupee investors/ markets to domestic exchanges

Policy implications

Policy intervention is directed at breaking the cycle of weak sentiments amplifying weak activity. These measures are timely as the government looks to reverse the cyclical slowdown in certain sectors that are under stress. With most of these steps concerned with streamlining existing measures, clearing credit blockages and expediting already announced measures, fresh fiscal costs will be limited. The Finance Ministry estimated that the tax withdrawal will amount to tax foregone to the tune of INR14bn (0.01% of GDP), not posing an additional challenge to fiscal consolidation plans.

Nonetheless, optimistic revenue projections are a worry for fiscal targets. As a percentage of GDP, gross tax revenues are pegged to rise to a decade high of 11.7% vs 11% in FY19, while net collections are seen at 7.8% vs 7% year before. Achieving this in an environment of slowing growth will be an uphill task, rendering the projected nominal GDP growth as a challenge. To make up for this shortfall, cess and surcharges have been increased (falls under the revenue pool that is not shared with states), record high divestment target and increased reliance on dividends from PSUs and the central bank. GST implementation had pre-assumed tax buoyancy and revenue neutrality, which are still to play out with the current system.

Medium-term policy framework

% of GDP	RE FY19	Actual FY19	BE FY20	Projections FY21	FY22
Fiscal deficit	3.4	3.4	3.3	3.0	3.0
Previous			*(3.4)*		
Revenue deficit	2.2	2.4	2.3	1.9	1.7
Primary deficit	0.2	0.3	0.2	0.0	0.0
Gross tax revenue	11.9	11.0	11.7	11.6	11.6
Non-tax revenue	1.3	1.3	1.5	1.4	1.4

Source: Budget documents, DBS

The Finance Minister plans to announce two more tranches of support measures over the next fortnight. Taking a leaf of these recent measures, we reckon that the focus will be on finetuning measures along with an accommodative monetary policy, while steering clear of broad-based fiscal stimulus. The latter, nonetheless, could come into play if growth risks turn starker in second half of the year and into 2020.

While these measures will help improve sentiments and buoy economic activity, we continue to see 30-40bps downside risks to our full-year growth forecast. 2Q19 GDP due this week will mark a slowdown from March quarter's 5.8% YoY, as consumption contracted, weak private and public investments (due to elections) and sub-par services sector. 3Q growth is also likely to stay weak but stabilise as government spending resumes after the elections. An accommodative monetary policy stance accompanied by a jumpstart in the transmission process is also expected to lower lending rates. Despite a better 3Q, evolving trends lend downside risk to our forecast.

For monetary policy, limited fiscal implications from the latest fiscal measures keep the door open for further easing. The latest RBI minutes from the August review saw the committee members accord high priority to limit weakness to growth and to jumpstart transmission. We retain our call for another 15-25bp cut at the October meeting, on the back of a weak 2Q GDP outcome later this week. Challenging global conditions and a dovish FOMC might also add to the case for the RBI to take a growth supportive stance, though admittedly it will be a close call. Further easing will need to be balanced with preserving policy space after frontloading rate cuts this year.

Relief gains are likely in bond and equity markets on positive domestics, but gains in the latter will be restrained by an escalation in the trade war rhetoric. Absence of an aggressive stimulus program, while the central bank remains focused on policy transmission, will restrain a sharper rise in yields. Global yields also look set to remain low for longer. USDINR, meanwhile, continues to watch CNY movements and broader dollar bias, which at this juncture points towards further INR weakness owing to a weak global environment.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).