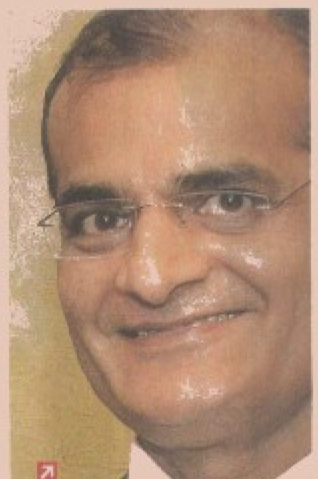
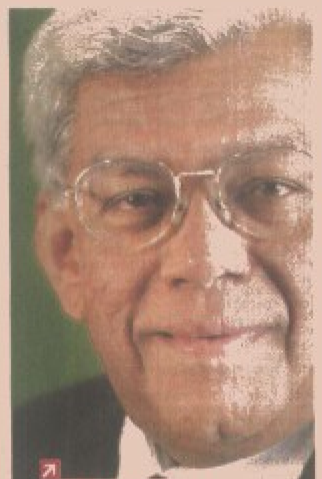
FM: Country Roads, Take Me Home

FM's professed adherence to the fiscal path of 3.5% deficit target has economists, marketmen and corporate bosses singing his paeans. While the focus on agriculture and farmer welfare in a year of five state polls is understandable, some do fault the FM for not addressing the concerns of cos and markets. Excerpts from a discussion on ET NOW:

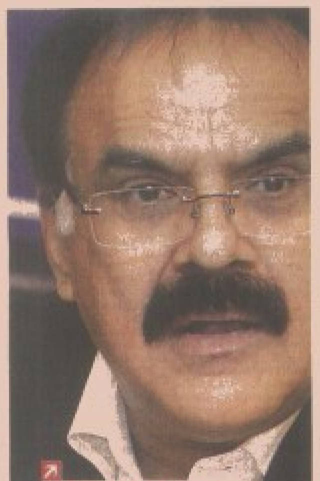
SANJAY NAYAR
CEO, KKR INDIA



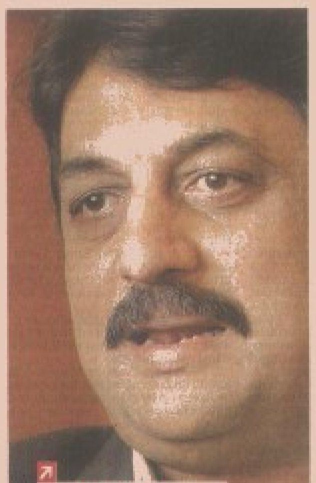
RASHESH SHAH
CEO, EDELWEISS GROUP



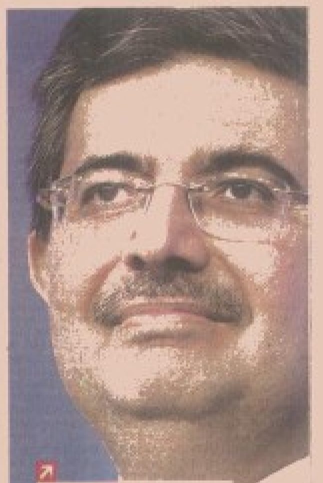
DEEPAK PAREKH
CHAIRMAN, HDFC



ARVIND MAYARAM
FORMER FINANCE SECRETARY



SHANKAR SHARMA
VC, FIRST GLOBAL



UDAY KOTAK
VC, KOTAK MAHINDRA BANK

Swaminathan Aiyar: By sticking to the fiscal deficit target of 3.9-3.5%, it looks like the government means business. Again, sticking to capital gains period is another plus. Further, committing to the no-retrospective taxation policy, while hoping the current hassles are sorted out, is a positive. Now, what I think are wrong: Mere tinkering of corporate tax, like the cut to 29% for some minor sectors, doesn't help when the target is 25%. The reduction should have been more aggressive. Again, if you keep increasing tax on long cigarettes and not on beedis, what on earth are you trying to do? If smoking causes cancer, are you trying to say we are going to save only the rich from cancer? Instead, why the devil do you not legalise betting and impose a tax on it? There are some tournaments coming up and you missed a golden chance.

ET NOW: The market reaction is not good. Can you give a quick word on long-term capital gains tax not being tweaked?

Madhusudan Kela: I would say the overall budget is very constructive. The government has adhered to the fiscal path of 3.5% which is very credible. There is a lot of emphasis on minor items. There is a huge outlay on the rural side which has been increased by 20-21%. There is also a huge emphasis on the infrastructure side. So I would say today's market reaction should not be attributed as a really bad budget. Having said that, there are a few incremental negatives from the capital market.

ET NOW: With the 3.5% deficit target, the FM has managed to stabilise the bond market but clearly the equity markets are not happy?

Rashesh Shah: It is always a trade-off. If finance minister Arun Jaitley kept the bond market happy, the equity markets will be unhappy because they wanted to see a lot more investments, a lot more spending by the government, and it is not happening. So overall, I would say it is fairly good for the economy. There may be a few things the market is concerned about but I have always believed that FIIs are selling because of global issues, because of their own or over-allocation to India and it is going to go on for the next few months. Overall, we should not see the market as a reflection of what has come out but what foreign investment is going to be in future.

ET NOW: On the bank recapitalisation number, were you expecting a bigger number?

Madhusudan Kela: The expectation was at least ₹35,000 crore. They have provided ₹25,000 crore. However, the FM has said that if needed, they will provide more.

ET NOW: What about PSU banks?

Nilesh Shah: I think there is disappointment on the PSU bank front because ₹25,000 crore is something which is slightly below what the market expected. The big takeaway is fiscal consolidation. Sticking to that path is very positive for the bond markets. That is very positive for banks in general.

ET NOW: How are you reading the budget from a market point of view?

Sanjay Nayar: I do not think the markets really matter immediately. I was quite impressed on the balance. There is a clear focus on what they believe is rural, social and infra. I do not know the fine print of how they are going to raise all the money. It clearly looks they are taxing the rich, taxing the luxury — which is not wrong — and I think STT going up three times is obviously a big deal. But at least they have laid out very clearly what they believe, and I think that is what matters. The rest is up to them to really execute and I think it should help agriculture productivity and should help the demand. So hopefully, we will see some revival of rural demand.

ET NOW: Is a fine print beginning to emerge as a divestment target at more realistic levels?

Arvind Mayaram: I do not know how you would differentiate between the strategic sale being easier and divestment being difficult. I am not very clear and sanguine on that part. But obviously, the experience shows large numbers like ₹69,000 crore and ₹70,000 crore are not being met every year. So to that extent, it is more realistic to see a number that is closer to something achievable.

ET NOW: Will you be a buyer now in this market considering that in the run up to the Budget, the participants have been nervous?

Madhusudan Kela: We have to buy gradually because as such there is nothing really negative in the markets as Rashesh Shah was saying. The problem with the market is selling by FIIs. Once this ebbs, the market will take a constructive note of the positives, which are being delivered in the markets. The verdict is today, the moment I see a reversal of FII flow, markets will turn positive.

ET NOW: It does not seem like it is going to be peaceful because, like Madhu said and like the point you reiterated earlier, it boils down to the global growth slowdown and India is going to fall prey to all the FII selling that we have been witnessing.

Shankar Sharma: I do not think that is a very accurate assessment. Yes, there are big global problems that we all know has been there from 2008 but India has been an outlier (in a good sense) for a long time. I mean, almost seven years post that, India has been an outlier in a lot of senses based on pure fundamentals. Now, in the past year, or year and a half, the hype is dying and it is now being replaced by the cold reality that this government has no magic wand despite all expectations that fund managers and analysts had. It is back to a normal, run-of-a-mill kind of government that we saw in UPA II. Inflation is down so much that nominal GDP is now only 5%. In this situation, can you expect 17-18% earnings growth? I do not think that is going to happen. Yes, India has been more troubled in the past month because the hype has been now ebbing away and that is a real problem which we must contend.

ET NOW: Let us talk about the big picture. There was some concern on the fiscal deficit target and if the government will relax it. On one hand, it is sticking to the target of 3.5% for the next fiscal and on the other, it is constituting a panel to review the FRBM Act. What is your assessment of what they have done on the fiscal deficit target? Was the government in need to please both camps by doing this?

Deepak Parekh: I do not think Jaitley has erred because he kept insisting, and I entirely agree, that financial prudence is absolutely necessary. You cannot spend more than what you earn. The finance minister also stressed the point that he has not compromised on any project nor has he compromised on any development plan of the government, but stuck to the 3.5% deficit that he committed to last year for the current year. So, I think he has done the right thing rather than spending a lot of money on development projects and suffering a year or so later with excessive debt and excessive leverage.

ET NOW: Alright. Jaitley keeps his weight and he stays within the 'Lakshman Rekha' as far as the fiscal deficit is concerned. But we have seen emphasis on boosting rural economy. What is the acute distress in the rural economy, according to you?

Deepak Parekh: The thrust of the finance minister's Budget this year has been rural, agriculture and social sectors and he has emphasised these three sectors at length. What this does to the economy is that it brings more money to the farming community where almost 70% of the people are residing and it gives more power to the farmers. It educates people more because of job creation in social sector, health, education — the three sectors he has emphasised significantly. A large part of his Budget speech included farmer welfare, rural sector, job creation and skill development. I think the emphasis has been right.

ET NOW: Does it seem like a more balanced Budget? Are the numbers adding up or are you concerned by the fact that you have taken a lot of tough measures as far as taxes are concerned?

Jahangir Aziz: I have still not seen the details and the devil is always in the details. But on the face of it, I think that sticking to 3.5% was an extremely important signal. I am sure Jaitley was under tremendous pressure: there was pressure from the market and I am sure there was pressure from the government to breach it on the pretext that global growth is slowing down. A 3.5% fiscal deficit target will push the RBI to cut rates as early as probably this week by at least 25 bps.

ET NOW: You are happy with the government sticking to its fiscal target, but how can you explain the market reaction?

Uday Kotak: One should look at the market from the context of the global situation at present. You've had a sharp drop in China and other markets which is reflecting on India. However, I am excited about the '3.5% discipline' the finance minister has shown, which will reflect in equity markets sooner rather than later. I also expect the RBI to show responsiveness to the government's discipline. When I look at the budget, I see a significant amount of purpose and direction in it. The challenge now is how well we execute it. Frankly, when you maintain a 3.5% discipline on the fiscal, you end up with some taxes, whether dividend distribution or others. Individuals may not like these taxes but this is the price we should be ready to pay to get India's fiscal house in order.

ET NOW: You maintain that 3.5% is important, and at the same time you talk about reviewing the FRBM Act. What should markets make of this?

Uday Kotak: First of all, for 2016-2017 he is sticking to one number: 3.5%. In future, he may come down to 3%. He may give a range of 3-3.2% but we are on the path to a superior fiscal environment and that is a big positive. At the same time, from what I have understood from the speech, he is looking to increase spending on infrastructure that India needs right now. The allocation is positive as long as we can get the execution right as well. In this balance between fiscal consolidations, ensuring India spends more on infrastructure and getting the house in order, there will be some trade-offs, but I think I can live with that.

ET NOW: The markets have stabilised, we have recovered from the day's low and the event risk is over but the market volatility was extraordinary.

Rashesh Shah: It just goes to show that the Indian equity market is fairly resilient. I think what we saw earlier was more due to global market cues. Overall, you see a lot of good things for the economy. When I was trying to write down the positives and negatives about the Budget, there was a long list of positives and a very small list of negatives. The 3.5%, the government agreeing to go below or at least contemplating going below 50% in some government-owned banks, the HRD deduction, the REIT, the DD exemption are all good things for the economy and for investors in the long-term. I am happy to see that markets have come back to stability again and as the days go by, we will see a more balanced approach rather than just trying to keep the equity market happy.

ET NOW: As the government is, for now, sticking to its fiscal roadmap, do you expect the central bank to act quickly? Could it move earlier than expected?

Uday Kotak: I would hope to see a March cut if the central bank acknowledges that the government has shown discipline. This is something which is being reflected in bond markets and bond yields.

ET NOW: While the government has stayed away from retrospective tax in the past, it now seems like an open-and-shut case. Is it a done deal?

Mukesh Butani: Jaitley has tried to bring together the retrospective law, the recommendations of the retrospective committee and the verbal assurances that were given by this government that it does not believe in retrospective laws. What he is saying now to companies is that you can come forward and settle. If you take away the BIPA cases and the tax disputes lying in various courts, you can come, pay the taxes, and avail exemption in interest and penalty proceedings. That is how he wants to settle it, saying that he wants to put a full stop to this whole controversy.

ET NOW: What's your take, Arvind Mayaram?

Arvind Mayaram: This discussion took place even in 2014. In 2013, the discussion was if you pay the principal, we do not pay the penalty and interest. However, the question that Vodafone was raising was that it is a matter of principal. I don't think this is going to be a simple matter. But the other point is that if retrospective taxation is on the statute and if you don't remove it, no amount of administrative measures, whether you raise the matter from the committee level to revenue secretary or cabinet secretary level can stop an income tax officer from starting a new case.

ET NOW: So the solution will be to axe the retro tax, which has not been done?

Arvind Mayaram: At some point this year I was hoping that they may remove it. Until then, the sword will keep hanging.

ET NOW: Do you think you are disappointed that on the consumption side, he has not done much? In fact, some of his moves could be counterproductive like increasing cess on diesel vehicles, on petrol cars. There is an agri cess coming...

Sanjay Nayar: There could be some positive effect of some of the stuff Jaitley has done on the middle class and on the rural side. The kind of focus they have put on villages and on ease-of-doing business, ease-of-compliance and presumptive tax on small businesses, SMEs and retail could lead to a trickledown effect on better consumption, maybe even more savings. It is not evident but I think it could. He has not given a specific tax boost, which could be coming indirectly into a lot of these things.

ET NOW: A bit of volatility in the market: we saw a kneejerk cut and now, we are seeing a bit of a recovery in our markets. How are you reading the Budget in balance?

Prashant Jain: It is a very good Budget and I do not think we should judge it by the kneejerk reaction of the market. The fiscal deficit target is very good, fiscal prudence has been maintained, it should lead to lower interest rates, the impact of which is very important. To maintain the fiscal deficit, the taxation is increasing from higher income groups and from some luxury products, which is good. The thrust on DBT continues: fertilizers on a pilot basis are being moved to DBT. Like how the LPG had been moved, kerosene should be moved. If fertilizers are moved over time, this can lead to a rationalisation of subsidies. So, I am quite happy with the Budget.

ET NOW: Just what we did not need when we are trying to kick-start demand in the auto sector was an additional 2.5% cess on diesel. Do you feel the Budget is a bit of a disappointment for the sector?

RC Bhargava: Yes, this was unexpected and because it was supposed to be linked to pollution. There is a very poor understanding of what pollution problems in Delhi are and what causes them as particulate emissions in Delhi are the main problem. A study by IIT Kanpur says cars constitute only 2% of the particulate load in Delhi's air. Now, if 2% is the load, why are cars being targeted when you are also saying that we must spend all the money required to get to Euro VI by 2020? It's a little hard to follow.

ET NOW: Are you disappointed that we have not seen a sharper cut in corporate tax which corporate India would really have liked to see or is this better?

Sanjay Nayar: I think it is a trade-off between exemptions. You cannot have it both ways. I think one would have hoped we had a speedier glide path downwards but then there is enough lobbying from various sectors not to cut either the R&D side or the depreciation side. I think they tried to keep it as constant as possible. So frankly it is not that significant a move.

ET NOW: There is a concerted rural push in this Budget. Do you think it is a bit of a political recalibration of this government?

Swaminathan Aiyar: No. Every Budget wants to give a rural push. The fact is — at the end of it — much more depends on the monsoon. The Centre needs to focus early on the corporate tax, income tax and infrastructure.
The emphasis on fiscal prudence and on making the tax administration much easier are important. I would not emphasise on infrastructure spending again but as I said the tax administration reforms are extremely positive. The one thing that was too incremental was the reduction in corporate tax. If you are trying to get it down to 25%, two Budgets from now, what you have done this year is too little.