

VIEWPOINT: India Budget Gap Aim, Fiscal Consolidation At Risk As Revenues Weak, Societe Generale's Kundu Says

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MUMBAI (Dec 18) -- India's federal government is unlikely to meet its fiscal deficit aim of 3.9% of gross domestic product this year and may delay its fiscal consolidation roadmap for the next year, as it struggles to boost tax collection and sell stakes in state-run companies, Kunal Kundu, India economist at Societe Generale, said.

"We do see a challenge in terms of the fiscal deficit," Kundu told NewsRise. "We expect it to be wider than what the government expects. Disinvestment is not moving anywhere, overall tax revenue will undershoot."

An impending wage hike for millions of government employees and failure to meet divestment targets could derail the budget deficit aim, pegged at 3.5% for the next fiscal year. Growth in Asia's third-largest economy also needs to gather pace, as private investments haven't yet shown signs of a pickup despite the central bank's 125 basis points interest rate reduction since January. Prime Minister Narendra Modi's government is also struggling to enact key legislations because of a lack of majority in the upper house of parliament.

Last month, India's 7th Pay Commission recommended a 23.55% increase in average remuneration of government staff, which, if accepted, will cost New Delhi 1.02 trillion rupees in the next fiscal year starting Apr.1. Meanwhile, this year's disinvestment revenue is likely to be less than a third of the budgeted aim, as volatile stock markets would likely stall 'big-ticket' deals, a senior finance ministry official said on Dec. 3.

"The fiscal consolidation path that has been laid out... that timeline would need to be extended," Kundu said. "What would be crucial is how the revenue streams stack up and how the government is able to spend on infrastructure. Private investment remains muted, corporates are still on a wait-and-watch mode."

India expects a 'marginal shortfall' of about 300 billion to 400 billion rupees in the targeted 6.95 trillion rupees in total direct tax collections this year, Revenue Secretary Hasmukh Adhia said on Dec. 15. However, an increase in indirect tax collections might help bridge that gap, he said.

Under the medium-term fiscal consolidation plan, India aims to narrow its budget deficit to 3% of its gross domestic product by Mar. 31, 2018.

Meanwhile, India's ability to overcome challenges hindering economic reforms will take the centre stage in determining the pace and volume of foreign investments, now that the Federal Reserve's much-anticipated rate hike left markets unscathed, Kundu said.

"When it comes to the Fed and the impact, I don't think that would be a big driving factor of flows into the country at this point in time," Kundu said. "Investors would like to see action on the ground."

The Fed raised the range of its benchmark rate by 25 basis points to between 0.25% and 0.50%, signaling the beginning of an end to a surge of liquidity that emerging markets experienced in recent years. Fed Chair Janet Yellen has stressed that further rate increases will be gradual and dependent on incoming economic data.

While the Fed may raise its interest rate three times next year, India's domestic policy issues, depreciation of the Chinese yuan and slowdown in global growth and oil prices will influence India's macroeconomic fundamentals going ahead, Kundu said.

Overseas investors have purchased a total net \$2.76 billion worth of domestic shares so far this year, against a net purchase of \$16.12 billion in 2014. Their government and corporate bond purchases so far this year amount to \$9.15 billion. Net foreign direct investment into India in April-October was \$21.99 billion, against \$18.66 billion in the corresponding period of the previous year. India's central bank expects the economy to expand by 7.4% in the year ending Mar. 31.

The Reserve Bank of India will hold rates through 2016, even if the central bank is likely headed to slightly overshoot its inflation target of 5% in March 2017, Kundu said.

"The 50 basis-point cut that the RBI went in for was basically a signal to the government to now get their house in order, which is crucial," he said. "How they manage their reforms process is crucial. At this point in time, I do not see scope for any easing in 2016."

The opposition Congress party's lawmakers have been stalling proceedings of both houses of parliament following a court case on alleged graft charges on the party's top leaders, which the Congress calls politically-motivated. The government will have to find "alternative methods" to proceed with the Goods and Services Tax, if the opposition to the legislation continues in parliament, Finance Minister Arun Jaitley has said.

"We were getting some good noises before the GST stalled – which raised hopes of many people," Kundu said. "But again things are stuck. The economy cannot afford this kind of a situation."

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