MarketWatch

SHIKHAR BALWANI'S THIS WEEK IN INDIA

Feb. 28, 2010, 10:24 p.m. EST

Budget not a 'game changer'

Commentary: Market stages relief rally, but questions remain

By Shikhar Balwani

MUMBAI (MarketWatch) -- Progressive, growth-oriented, realistic and prudent -- these are some of the terms that have been used to describe India's federal budget since Finance Minister Pranab Mukherjee ended his budget speech Friday.

It's evident that, even without offering any big bonanzas -- except for the hike in tax exemptions for individual taxpayers -- the budget has pleased a lot more people than it has disappointed. Read full story on India's new budget.

As for the Indian equity market, not much has changed except that the apprehensions surrounding the withdrawal of the fiscal stimulus are now gone.

The 1.1% gain for the Bombay Stock Exchange's benchmark 30-stock Sensex on Friday was more of a relief rally on the lack of any negatives from the budget, but does not really provide a clear direction for equities.

For now, trade in global markets and various monthly economic indicators that will be released over the next few days are likely to determine the course of Indian equities until the fourth-quarter corporate earnings season kicks off in early April.

The Budget's Impact on India

Is this the budget India needs? India bureau chief Paul Beckett speaks to Avantha Group Chairman Gautam Thapar.

The government's intent to roll back some of its costly spending shows that the process of unwinding the huge accommodative stance has begun. The aim to cut the fiscal deficit to 5.5% of gross domestic product for the year that starts April 1 -- trimming from this year's 16-year high of over 6.5% -- and plans to cut further to 4.8% the following year, have soothed many an economist.

Still, with gross market borrowing set at 4.57 trillion rupees ($99.5 billion) against this year's record 4.51 trillion rupees, the 11.08 trillion-rupee new budget is still 8.4% bigger than this fiscal year's. Moreover, with this being a primary estimate, it will be crucial to see if the government can stick to these borrowing levels.

"Net borrowings of the government [at 3.45 trillion rupees], even on the lower end of market expectations, remain at an elevated level. With the likely pick up in credit growth in FY11, there will be pressure on the interest-rate spectrum," says Edelweiss Securities.

The pressure on interest rates will not just be from the heavy borrowing program, but also from inflation, which is already a major concern for the government and the central bank.

India's headline inflation rate rose to 8.56% in January from a year earlier, while wholesale food prices rose 17.58% in the week ended Feb. 13.

And Mukherjee's move to levy an excise duty of one rupee per liter on gasoline and diesel has already led to a hike in fuel prices, which will further fan inflation. The government raised the price of gasoline by 6%, and diesel -- the primary fuel to transport commodities -- by about 8%, effective Friday midnight.

Kaushik Basu, chief economic adviser to the government, has said the move will boost wholesale prices by 4 basis points in the near term.

"Inflation is likely to increase at the faster pace from here on, due to higher fuel prices and higher disposable income (due to the tax reliefs) as indicated in the budget FY11. We expect inflation to touch around 10% by next month and remain in double digits for few months," said Mumbai-based Khandwala Securities.

Pending reforms still pending

That said, the budget is another missed opportunity by the government to decide on the fate of some long-pending (really long) reforms, such as easing norms for foreign direct investment in the insurance and retail sectors.

The delay in execution of such reforms has, in the past, been blamed on the strong opposition from the anti-reform left-wing parties that formed part of the coalition government. However, even as the current coalition excludes the left, these reforms have continued to be on the back burner.

Some may still argue that the budget need not necessarily be the only platform to push forward reforms, but it remains to be seen if any progress is made on this outside of the budget.

Also, while the finance minister said the government aims to implement the Direct Taxes Code Bill of 2009 -- which proposes lower taxes for individuals and corporates -- effective April 2011, there was no mention on whether the DTC will be put into practice in its current form or will be amended.

"The DTC has been the subject matter of criticism from all quarters, including the revenue authorities themselves, and we believe that the government should refer the matter to an independent commission, comprising of experts in the field of public policy, law, economics, accountancy and legislative drafting," said law firm Nishith Desai Associates.

The recent lukewarm response to power producer NTPC Ltd.'s follow-on offer makes it particularly interesting to watch whether the government is able to meet its target of mopping up 400 billion rupees by selling stakes in state-owned enterprises, such as Steel Authority of India Ltd. (OTHER:SLAUF) and NMDC Ltd. -- an amount higher than the 250 billion rupees it aims to raise through such share sales in the current fiscal year.

One cannot help but think that Mukherjee hasn't just managed expectations, but has also set new expectations for the days to come.

Yet the case here is not to disregard the proposals made in the budget. The roadmap toward fiscal discipline was widely called for, but while the intent is all good, its execution, while accelerating growth and also taming inflation, is a bigger challenge. ■