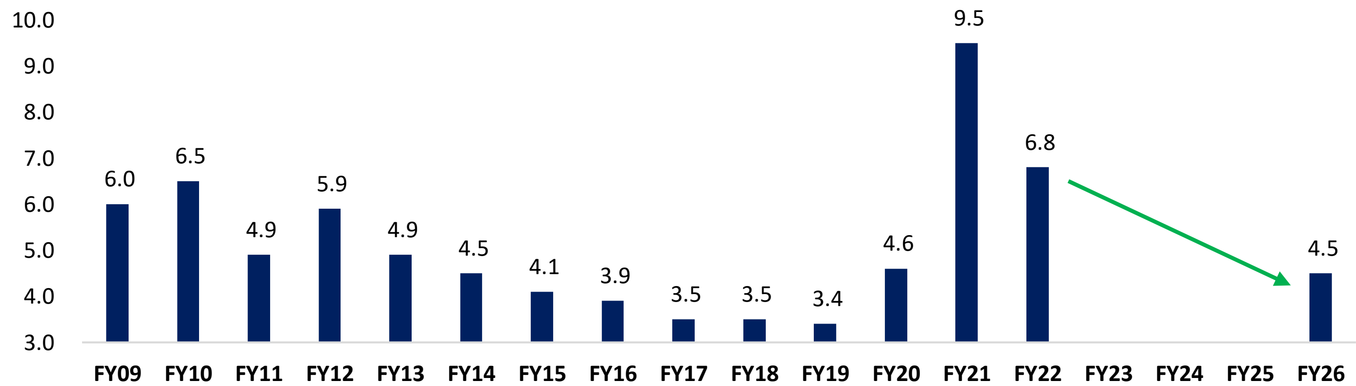
Union Budget 2021: No Compromise, only Maximise

In our December 2020, AAA Insights, titled "2021: Embrace Optimism", we had mentioned that the Indian economy is poised for faster growth as 1) the pain of structural reforms is behind us 2) Indian government's efforts to revive the Indian manufacturing sector through various initiatives like PLI scheme are impressive 3) Faster formalisation & digitization of the economy and 4) a more robust banking system further accelerates the pace of normalization. To this end, we observe that Union Budget 2021 has shown the government's strenuous efforts to stay the course in each area.

Focus on spending to accelerate growth

The government has relaxed its FRBM commitments, as it aims to reach a fiscal deficit 4.5% of GDP by FY2026 – this is a significant step as the government was always walking the fiscal prudence path till last year. As the major world economies have been on a spending spree, Indian government has rightly used the budget as an opportunity to push the spending accelerator. Govt has planned to utilise the additional fiscal space for capital expenditure as it has budgeted a 13% increase in capital expenditure (Direct+IEBR) to Rs11.4 tn for FY22. These measures will provide crucial support for faster economic growth.

Annexure1: GFD/GDP (%) - Fiscal consolidation path

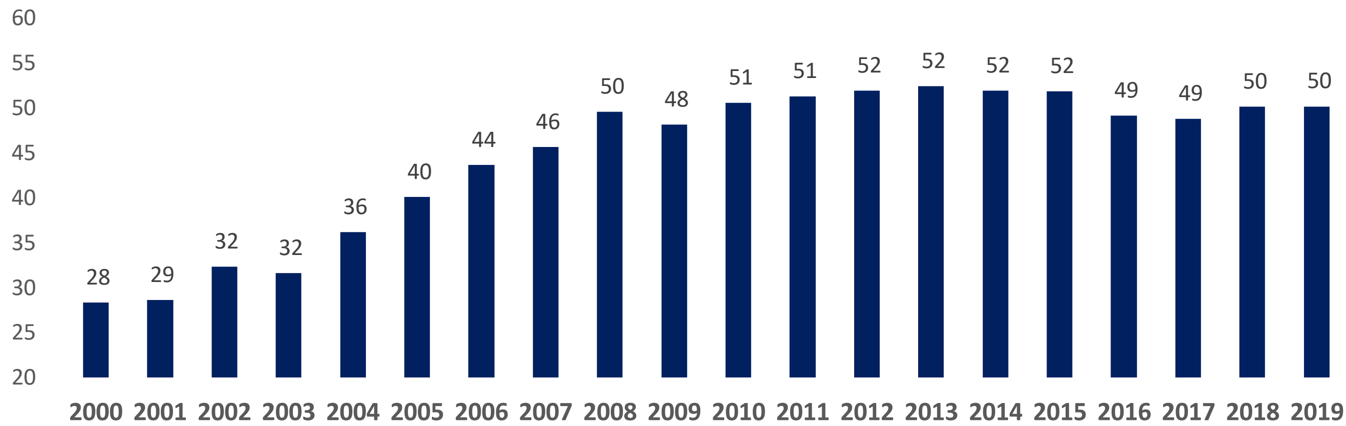


(Source: AAA Research, CEIC, India Budget)

Bad bank to revive credit growth

India's credit to private sector as remained flat since last 10yrs because of bad loans pilled up in bank balance sheet (refer to Annexure2). This restricted lending ability of banks due to capital requirements and also made then overly cautious on new lending. The creation of Asset Management / Asset Reconstruction company when the banking sector was expecting a post-pandemic hike in stressed assets, is a move in right direction. Taking over bad loans and capital infusion enhances the ability of banks to lend to productive sectors of the economy to spur growth.

Annexure2: Domestic credit to private sector by banks (% of GDP)



(Source: AAA Research, World Bank)

PLI incentives: a sharp turn in India's industrial policy

Production-Linked Incentives (PLI) scheme is potential game changer for the Indian manufacturing sector. The PLI scheme will lead to following: 1) reduce India's import dependence for critical components, 2) strengthen cost competitiveness in global supply chain and 3) encourage global players to set up large scale manufacturing in India.

The Government will provide Rs2tn of incentives over 5 years for 13 sectors - 8.6% of India's Manufacturing GDP (Refer Annexure3). To illustrate, through Mobile PLI scheme, from a current value addition of 10-15%, the government hopes that domestic value addition reaches 35-40% by FY27. The PLI Schemes can generate US$144bn in incremental sales by FY27 i.e. ~1.7% of FY27 GDP.

Annexure3: Sector wise PLI scheme

PLI Sector (Rs bn)	PLI amount (5 Years)	Imports Annual	Exports Annual	Net Imports Annual	Basic principle
Mobile	410	74	272	-198	Export boost
Pharma- KSMs*	69	68	24	44	Import substitution for security
Medical Devices	34	237	104	133	Import substitution for cost
Battery	181	4	1	3	Export boost
Automobiles	570	371	1,184	-813	Technology transition
Pharma Drugs	150	165	1,155	-990	Export boost/Import substitution
Telecom	122	140	20	120	Import substitution for security
Textile	107	81	1,098	-1,017	Export boost
Food Processing	109	19	68	-49	Export boost for surplus food
Solar Panels	45	194	21	173	Import substitution for cost/security
White Goods	62	410	100	310	Import substitution for mfg. boost
Specialty Steel	63	4	1	3	Export boost
Computer	50	224	1	223	Import substitution for cost

(Source: AAA Research, Ministry of Commerce)

DFI for Infrastructure

With an aim to improve the funding for the country's infrastructure sector, the Union Budget has allocated Rs 20,000 crore for the Development Financial Institution (DFI), with an ambition for the lender to have a portfolio of Rs 5 lakh crore within three years. This initiative will go a long way as DFI will act as a provider, enabler, and catalyst for long term infrastructure financing.

Asset monetisation (Disinvestment & Strategic Sale)

Resisting the temptation to hike taxes, the finance minister banked on disinvestment and asset monetisation to increase government's revenue. National monetisation pipeline will be launched, with a dashboard to track the progress and provide visibility to investors. The government plans to monetise operating public infrastructure assets in areas like road, transmission line, freight corridor, airports, Central Warehousing Corp, and sports stadiums.

The government has approved the proposed policy for disinvestment in all non-strategic and strategic sectors. BPCL, Air India, Shipping Corp, Container Corp and other disinvestments are aimed to be completed in 2021-22. The Budget proposes taking up 2 PSU banks and one public sector insurance company for disinvestment. The government is also targeting to bring the LIC IPO in 2022.

This should help the government to fund the ambitious capex plan without putting the additional burden on the taxpayers.

Our Investment Strategy/Market outlook:

3QFY21 corporate earnings is turning out to be a positive surprise - 27 Nifty companies reported 30% earnings growth in 3QFY21 while 178 BSE500 index companies reported 47% earnings growth (yoy basis). The growth centric budget further raises our confidence on the growth prospects for the year ahead. We believe that with strong earnings growth and continued government efforts to revive Indian manufacturing sector, market has a long runway ahead. We remain positive on market and recommend investors to use correction as an opportunity to add to equity asset class.

Key risks: Effectiveness of the covid19 vaccine, reduced policy support by global governments and central bankers, rising commodity prices leading to higher inflation, and geopolitical shocks.

AAA PMS Performance

Compounded Annual Returns (%)	1 Year	2 Year	3 Years	5 Years	10 Years	AAA IOP SI*	AAA FOCUS SI^
AAA IOP PMS (Fixed Fee)	**16.0%**	**13.7%**	**3.3%**	**13.1%**	**17.7%**	**18.0%**	**NA**
AAA FOCUS PMS (Fixed Fee)	15.8%	16.8%	5.8%	14.0%	NA	NA	12.7%
BSE 500 Index	14.9%	12.2%	5.4%	12.4%	9.7%	9.3%	8.3%
BSE Midcap Index	16.9%	11.4%	1.4%	11.7%	10.2%	9.6%	9.2%
BSE Smallcap Index	22.6%	13.7%	-1.3%	10.6%	7.8%	8.0%	7.6%
Nifty	14.0%	12.2%	7.3%	12.5%	9.5%	9.2%	7.9%
SENSEX	13.7%	13.0%	8.8%	13.2%	9.7%	9.3%	8.2%

*(23 Nov 2009 – 31 Jan 2021) ^ (17 Nov 2014 – 31 Jan 2021) (Performance after all expenses).

Note: Returns of Individual clients may differ depending on time of entry in the Strategy. Past Performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. Performance related information provided herein is not verified by SEBI.