

# Lower tax rate, repo cut, GST to guide growth

While markets remained under pressure throughout 2016, these events may have an impact on foreign investment flows

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THE YEAR 2016 was an eventful one for the financial markets. While it started with a crash in the Chinese market, it also saw the impact of the first US Federal Reserve (US Fed) rate hike in a decade in December 2015.

Towards the middle of the year, the global markets witnessed Britain's exit from the European Union and the year ended with results of the US elections where the electorate chose Donald Trump as their next President.

In India, the Reserve Bank of India (RBI) continued with its repo rate cut and reduced it by another 50 basis points (bps) during the year. Further, as the year came to a close, the economy faced the challenge of demonetisation after the government decided to withdraw almost 86 per cent of old currency notes out of circulation on November 8. While the stock markets remained under pressure throughout the year and the calendar year gains for Sensex stood at mere two per cent, there are several events that would be closely watched in 2017 and that may potentially have an impact on economic growth, movement of foreign portfolio investors (FPIs), and equity and debt market movements.

Some of the key events that are likely to influence the market movement in 2017 are:

## Budget 2017-18

There is a likelihood that the government may go for lowering direct tax rates or increasing the exemption and deduction limits to leave some more income at the hands of individuals.

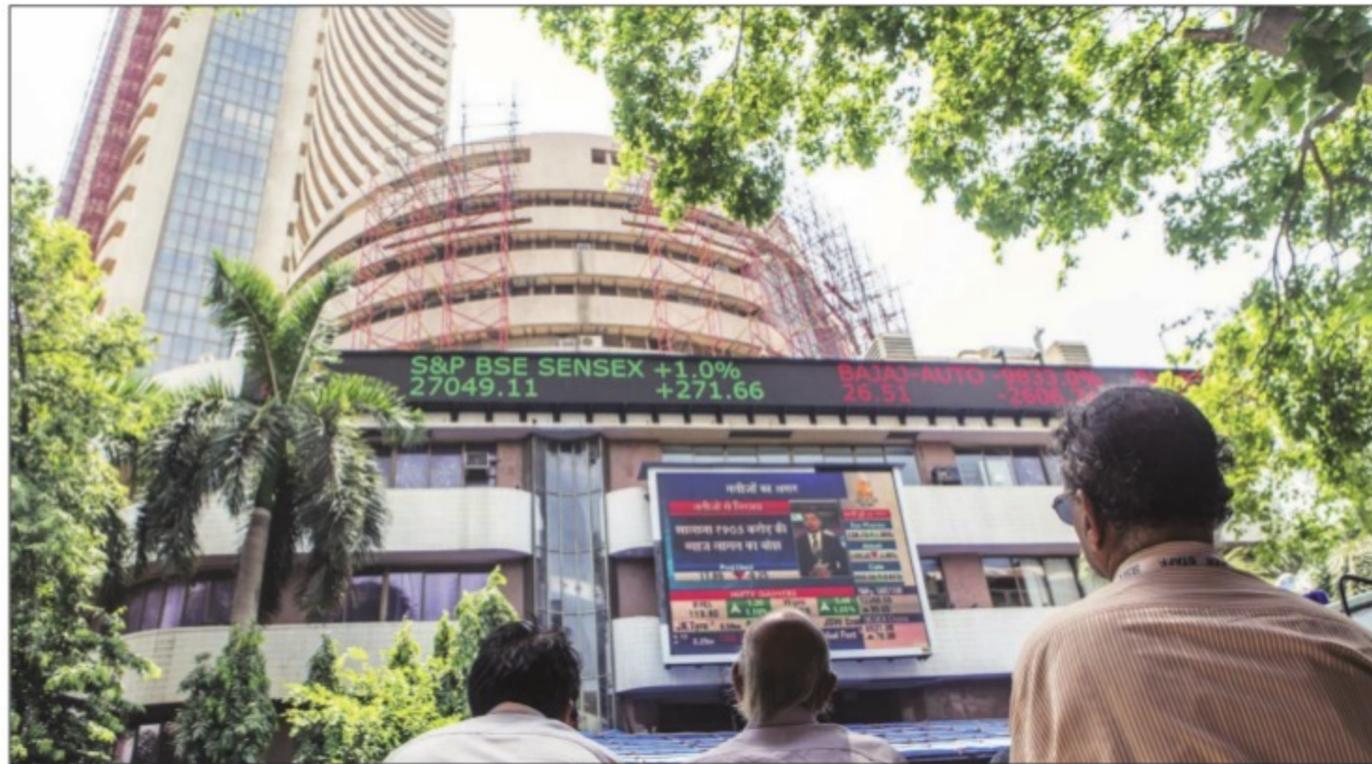
A couple of days ago, finance minister Arun Jaitley had said that the economy needs a broader base and a lower level of taxation. As his statement came a few weeks before his Budget speech, scheduled for February 1, it has led to broader speculation that the government would do some tweaking on the direct tax front.

While this may come as one of the biggest benefit for all individuals paying income tax and it may result into a higher net monthly income for them, experts say that it is important for individuals to channelise that additional income at hand into savings. **"When tax cuts take place, the additional income needs to get translated into higher savings and investments. Normally, when income rises on account of tax cuts, it automatically gets utilised towards higher spending, however, people should immediately have a strategy to save and invest that money,"** said Vishal Dhawan, CFP and founder, Plan Ahead Wealth Advisors.

Another aspect that the investors will anxiously be looking for in the Budget is any announcement on the treatment of long-term capital gains tax in the equities market as Prime Minister Narendra Modi's statement last month had raised concerns on it. The PM had said that entities and individuals who profit from financial markets need to "make a fair contribution to nation-building through taxes" as their tax contributions continue to be low.

## Rate cut by the RBI

In the last two years, the RBI has brought the repo rates down by 175 bps from 8 per cent in January 2015 to 6.25 per cent now. While this has resulted into a near 100 bps decline in the home loan interest rates, the interest offering on fixed deposits of banks



Fund managers and analysts say that the US Fed hike in 2017 may put the Indian currency along with those of other emerging economies under pressure and may cause volatility. *Express File Photo*

has come down by up to 200 bps, resulting into lower earnings on fixed income instruments.

As the Consumer Price Index (CPI)-based inflation continues to tread in the RBI's comfort zone and is expected to remain at lower levels, economists and market experts say that the repo rate may go down by another 50-75 bps in 2017. If that may benefit the loan seekers by reducing their equated-monthly instalment (EMI) expense, the conservative investors who primarily invest in small saving instruments and fixed deposits of banks would be at a loss as their interest earnings will only fall.

While the rate cut of 175 bps have not been able to spur investments in the economy on the back of low demand, it remains to be seen if 2017 will finally see a rise in capacity utilisations for firms across sectors and encourage them to invest in line with a cut in interest rates.

## Rate hike by US Fed

After its first rate hike in a decade in December 2015, the US Fed increased the rates again in December 2016. While that was largely anticipated, what seem to unnerve the market participants was US Fed's expectations as it said that board members expect interest rates to be raised three times in 2017. Fund managers and analysts say that the hike may put the Indian currency along with those of other emerging economies under pressure and may cause volatility. So, while there are some concerns on the three expected hikes in rates by the US Fed in 2017 but largely domestic markets will follow internal growth expectations and economic fundamentals, and there is a sense that the US Fed action may have a temporary impact on India, which is relatively better positioned among emerging economies.

On the other, since rate hikes symbolise the strength in the US economy, it may benefit certain sectors in India that have significant exposure to the US market.

## Demonetisation impact on growth

For now, demonetisation seems to have slowed the pace of economic activity and consumption on account of limited availability of cash. The benefits of the demonetisation move, however, are expected to unfold in 2017 as the government may receive a substantially high tax revenue on account of tax disclosures under Pradhan Mantri Garib Kalyan Yojana (PMGKY). While the government stands to gain on revenue front and will

have more money at its disposal to fund growth, experts say that it remains to see how the government decides to utilise the additional revenue. Experts say that this should help cushion the government's FY17 fiscal deficit target.

There are some who believe that the government may also benefit on account of the de-legalised currency that is neither exchanged nor deposited with banks as RBI's liability goes down by that amount and it can be transferred to the government. This can help reduce the fiscal deficit of the government. However, it needs to be seen as to how the government utilises the money that comes to it.

Another benefit of demonetisation is the expected reduction in cost of funds for banks. A sharp rise in bank deposit after the demonetisation is set to reduce the cost of funds for banks and improve their ability to pass on the benefits of lower rates to their customers.

## Crude oil prices

Lower crude oil prices have been a big bonus for India, which is a big oil importer. India's net oil imports, which averaged around 5 per cent of the gross domestic product (GDP) in 2014, fell to around 3 per cent of the GDP in 2015, on the back of collapse in oil prices. While it came as a huge advantage for the economy, the steady rise of the Brent crude oil prices in 2016 from a low of around

\$26 per barrel (bbl) to around \$54 per barrel now (on the back of Opec deal to reduce output), may take away a part of the advantage that the economy witnessed. The lower crude oil prices reduced the subsidy burden for the government. A report by ICRA, released in December, said that the gross under-recoveries (GURs) on subsidised domestic LPG and PDS kerosene are expected to increase by Rs 12-15 billion for FY17 with every \$5 per bbl sustained increase in crude oil prices for the rest of FY17.

ICRA said, "With crude oil prices of \$50-60 for the balanced months in FY17, ICRA projects the government oil subsidy burden to be around Rs 170-190 billion (Rs 17,000-19,000 crore) for FY17, which would be well within budget allocation of Rs 270 billion (Rs 27,000 crore) for the current fiscal." Some experts, however, say that the crude oil price rise in 2017 needs to be watched closely as a substantial rise may hurt Indian economy and investors.

According to the existing under-recovery sharing formula, the government bears domestic LPG subsidy up to Rs 18 per kg (Rs 255 per cylinder) under the Direct Benefit Transfer for domestic LPG and kerosene subsidy up to Rs 12 per litre.

The Organization of the Petroleum Exporting Countries (Opec), on November 30, 2016, agreed to cut total crude oil production of its member countries by 1.2 million barrels per day (mbpd) from January 2017. The decision by Opec has led to spike in global crude oil prices by around 15 per cent. The deal by Opec also includes coordination with Russia, a large crude oil producer but not an Opec member.

The ICRA report pointed that any further rise in crude oil prices and sustainability at higher levels would depend upon actual cut in production by different Opec members and Russia up to their commitment levels.

## GST roll-out

In 2017, the initially targeted deadline of April 1, 2017, for the roll-out of the Goods and Services Tax (GST) comes to an end. While that seems challenging, it is plausible that the indirect tax regime may be rolled out in

## THE GST FACTOR

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the middle of the year 2017. In December, finance minister Arun Jaitley said that since GST is a transactional tax, it can be introduced anytime between April 1-September 16, 2017, though the intent of the government is to introduce GST as early as possible.

Aimed at removing inter-state barriers to trade and integrating India into one common market, the destination-based tax will subsume all central and state indirect taxes and levies, including excise duty, additional excise duties, service tax, additional customs duty, surcharges and cesses, value-added tax (VAT), sales tax, entertainment tax, central sales tax (levied by the Centre and collected by states), octroi, entry tax, purchase tax, luxury tax, and taxes on lottery, betting and gambling and is expected to add at least two percentage points to the GDP growth of India. A higher growth will not only prop up economic activity but will also be positive for equity markets.

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The timeline of the GST roll-out will be intricately linked to the decision of the GST Council, wherein the Centre and the states are in a deadlock regarding the division of control over tax assesses of VAT, excise and service tax after the implementation of the GST. The government is constitutionally mandated to implement GST before September 16, 2017.

While the three Bills relating to GST, namely, the Central GST (CGST) Bill, the Integrated GST (IGST) Bill and the Bill for compensating states for revenue losses following the implementation of GST have missed the initial deadline of passage in the winter session of Parliament, all the draft Bills are likely to be presented in the budget session of Parliament. Subsequently, states will have to pass their state GST Bills in their respective Assemblies.