INDIAN BUDGET: CONVERTING PROMISES INTO POLICIES

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India has been a hot market in 2014, as investors anticipated the election of business-friendly prime minister Narendra Modi.[1] If Election Day was the most important day of the year, perhaps the second most important day was the release of the annual budget on July 10. The budget showcased major initiatives the government will focus on over the coming years. The budget favors incremental reforms. There were only six weeks between Modi's election and the release of the budget, so it's not clear how much he was able influence its contents. The market certainly has high expectations for Modi, and we need to see his rhetoric turn into actions. But initial signposts look to me to be heading in the right direction. India's finance minister, Arun Jaitley, outlined targets to reign in India's government debt, encourage foreign direct investment (FDI) and ramp up infrastructure expenditure. Below are some key reform proposals and the sectors that might benefit: • **Ramping Up Local Investment Efforts:** In the area of infrastructure build-out, the Indian government reaffirmed its commitment to step up efforts to expand rural electrification, irrigation and affordable housing. o **Bank Lending Incentives:** To encourage banks to extend loans related to infrastructure projects, the Reserve Bank of India (RBI) will exempt banks from CRR (cash reserve ratio) and SLR (statutory liquidity ratio) requirements in relation to funds deployed for use on longer-term infrastructure projects. This measure already went into effect and should have an immediate impact to ease the burden of infrastructure loans, which have long-term horizons and were hard for banks to hold on their balance sheets with the capital requirements. o **Smart Cities:** To spur real estate growth, the Indian government announced a slew of measures, including developing 100 smart cities, extending incentives for housing loans and upping the allocation for affordable housing in the budget. These smart cities will be equipped with high-tech communication capabilities and next-generation infrastructure in order to facilitate rapid urbanization and job creation in India. o **Reform Beneficiaries:** The beneficiaries of this infrastructure build-out are notably the banks (Financials sector), real estate (Financials sector), infrastructure (Industrials sector), and power (Energy sector) industry groups. • **Encouraging FDI:** Given how much capital India needs to raise to build out its economy, liberalizing previously protected sectors of the market is highly encouraging. Beyond the budget proposals, more will need to be done across the board to attract foreign capital. o **Liberalizing Defense and Insurance:** The government upped the cap on FDI from 26% to 49% in two major areas of the Indian economy: defense and insurance. Freeing up these areas of the economy not only facilitates equity investments, it also helps with technology transfers. o **Building Out Railway Infrastructure:** In a separate railway budget, proposals were made to introduce FDI and promote private-and-public partnerships to build out railway infrastructure in India. o **Industry Beneficiaries:** These policies, if implemented properly, can buoy the insurance (Financials sector) and infrastructure (Industrials sector) industry groups in India. • **Fast-Tracking of Projects:** The Indian government has conveyed a sense of urgency in accelerating project execution by committing to an 8,500 km build-out of national highways, awarding 16 new port/harbor projects and completing the master planning of three smart cities and seven industrial smart cities, all during the current financial year. As a result of a pickup in investment demand, banks, infrastructure and power companies will stand to benefit. • **Reigning in India's Government Deficits:** Fiscal consolidation is a strong takeaway from the Indian budget. The government intends to reduce its deficit from 4.1% to 3% by 2016–17, and an important step in achieving its target is to deregulate diesel and gas prices and reduce subsidies in the current fiscal year. As a result of deregulation, the oil and power (Energy sector) companies may stand to benefit from a continued hike in diesel and gas prices. • **Overhaul of Complicated Tax System Still Pending:** One of the policies much discussed ahead of the budget was a reform of the tax system, which is quite complicated and includes both state and national taxes. A comprehensive goods-and-services tax (GST) that was alluded to would apply one national tax and remove the ability for states to levy their own taxes. This is one big policy that I hope to see come to fruition over next few years, as it could encourage a more efficient allocation of resources in the economy. While this budget has no single magic bullet that will accelerate growth in India, it does address many of the key issues India faces. When markets appreciate as much as India has in a short period of time, I believe it becomes more important to employ a disciplined investment approach that focuses on relative valuations. The WisdomTree India Earnings Index will rebalance its holdings—as it does annually—in September. The tilt to low price-to-earnings (P/E) ratio stocks at the last rebalance has been one of the prime drivers of returns this year. With Modi improving sentiment and valuations, I believe that India remains an attractive place to invest, and the steps taken in the budget reaffirm this outlook. [1]Source: WisdomTree, Bloomberg; India ranks eighth out of the 23 countries in MSCI Emerging Markets Index.

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Government deficit : A status of financial health in which expenditures exceed revenue.