Good MornING Asia - 4 February 2019

Thinner market liquidity and busier central banks will define trading in Asia this week. The Lunar New Year holiday in most countries reduces liquidity. Four regional central banks hold policy meetings, with the key question being whether those of India and the Philippines will ease policy or stand pat. Gong Xi Fa Cai!

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- **General Asia:** The positive vibe from the dovish undertones of select FOMC members will likely be countered by concerns about a slowing Chinese economy with the government moving quickly to stimulate the economy through tax cuts. With China and select other Asian markets shuttered, those trading will likely adopt a wait and see approach.
- **Malaysia:** Finance Minister Lim Guan Eng expects inflation to accelerate to 1.6-2.0% this year (from 1.0% in 2018) on rising global uncertainty. We think most of the increase will likely to come in the second half of the year when the GST elimination moves out of the base. However, the US Fed policy pause together with the trade war risk will likely be associated with a softer USD and strong Asian FX including the MYR, which could dampen the inflationary pressure. Our 2019 average inflation forecast is 1.6%. We expect change to the BNM policy this year.
- **Thailand:** Concerns about strengthening THB hurting growth are on the rise as strong currency doesn't align with economic fundamentals as local research, Teerana Bhongmakapat, former dean of economics at Chulalongkorn University, pointed out. We expect the BoT policy statement this week to shed light on this issue. We expect no policy

change, though we are reviewing our USD/THB forecast for a re-test of the 33-level following a change in Fed policy.
- **Indonesia:** Inflation continues to be benign in Indonesia, with the January reading for price gains slipping to 2.82% with food and clothing being the main reasons for the slight gain in prices. The January reading was lower than market expectations for a 3.0% increase, pushing investors to soak up bonds on expectations that the central bank will likely refrain from further rate hikes in the near term. With the IDR posting the second-best performance for the year among most Asian currencies, Governor Warjiyo may have the leeway to keep rates untouched for now.
- **Philippines:** Bangko Sentral ng Pilipinas (BSP) deputy governor Guinigundo dampened hopes for an early policy reversal from the BSP as the central bank looks to allow recent aggressive tightening measures to take hold. Market consensus had been building for a cut to the reserve requirement ratio and even the BSP's policy rate given tight liquidity conditions and slowing growth. The BSP meets on the 7th with the market expecting no adjustment to the policy at their first meeting for 2019.

What to look out for: US data dump, ASEAN central bank meetings

- US GDP and core PCE (4 February)
- Philippine inflation (5-6 February)
- Australia policy meeting (5 February)
- US ISM non-manufacturing PMI and retail sales (5 February)
- Thailand policy meeting (6 February)
- US Trade balance (6 February)
- Indonesia 4Q 2018 GDP (6 February)
- Philippines policy meeting (7 February)
- India policy meeting (7 February)
- Bank of England meeting (7 February)

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Indian budget: Politics outweighs fiscal discipline

The interim budget seems to be the last attempt by the Modi government to lure voters, pushing long-term sustainability of public finances in the...

Source: Shutterstock

The knee-jerk reaction to the budget saw local financial assets - equities, bonds, and the rupee – gaining some ground. But the gains were pared as the budget news fully sank in with the 10-year government bond spiking 12 basis points to 7.61% and the rupee losing 0.3% against the USD to 71.3.

We don’t see the pressure on Indian financial assets abating anytime soon and maintain our view of the USD/INR rate rising above 73 in the near-term.

The budget

As expected, the growing discontent among low and middle-income voters and small businesses nudged the government to push for its re-election agenda harder today.

The budget for the full year (financial year starting 1 April 2019) unveiled by interim finance minister Piyush Goyal was high on social spending and tax cuts but low on revenue-boosting measures, while the long-term goal of cutting down the fiscal deficit to a comfortable 3% level will likely remain on paper.

The budget didn't fall short of big-bang (vote-seeking) spending measures, especially for farmers and low-income voters

Despite being an interim budget, the vote-on-account, as the convention for a government heading into an election goes, it didn't fall short of big-bang (vote-seeking) spending measures, especially for farmers and low-income voters. Meanwhile, a surge in government spending in the current financial year caused yet another breach in the fiscal deficit, above the original target set for the year. This is despite the projection of strong revenue growth promised in the original budget.

3.4%

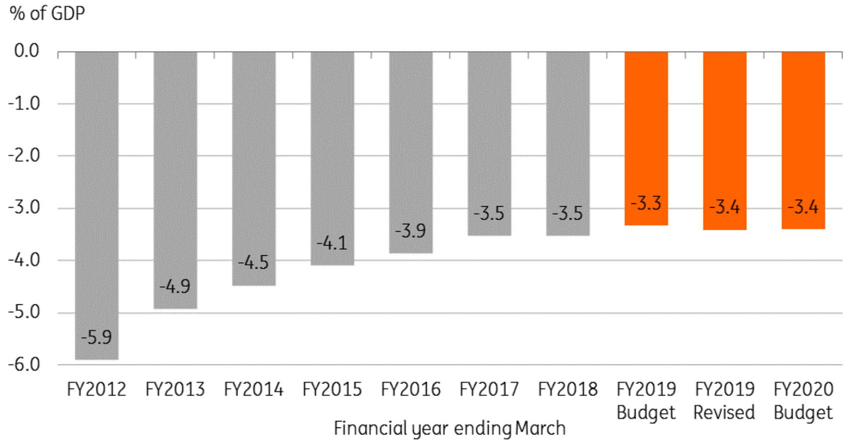
Fiscal deficit budget for FY2019

To be maintained at the same level in FY2020

Key budget highlights

- The fiscal deficit was projected to be 3.4% of GDP in FY19, an upward revision from the 3.3% original projection. It is projected to remain at 3.4% in FY2020.
- INR 750bn ($10.6bn) support package for farmers comprising of assured income of INR 6,000 per year for 120m of farmers with land holding under two hectares. 2% interest subvention to those pursuing animal husbandry and fisheries.
- INR 190bn for rural roads program in FY2020 - an unchanged amount from the allocation in FY2019. Increase in allocation to Rural Employment Guarantee program by INR 50bn to INR 600bn for FY2020.
- A pension plan for the organized sector. INR 3trillion for defence spending.
- Personal income up to INR 500,000 exempt from income tax. Increase in the standard deduction for income tax to INR 50,000 from INR 40,000. Increase in the limit on tax deduction at source (TDS) from INR 10,000 to INR 40,000.
- Easing of tax rules for property - income tax exemption on a second residential house and considerations for easing of goods and services tax (GST) burden for homebuyers.
- FY20 net borrowing set at INR 7.04t with a planned reduction in the debt-to-GDP ratio to 40% by FY2025 from estimated 49% for FY19.
- Strong nominal GDP growth of 12.3% in FY19 and 11.5% in FY20.

Lack of fiscal consolidation



Source: CEIC, Government Budget Statistics

What we think about the budget?

The government is clearly ramping up spending to enhance its chances for re-election. Although the revised fiscal deficit of 3.4% for FY19 is below the 3.5% consensus estimate (ING's 3.6%), it's hardly a recovery from the 3.5% of GDP deficit in FY18. And it is still a deficit overshoot for the second consecutive year.

Moreover, the 3.4% deficit target for FY2020 shows no intent of fiscal consolidation, which casts further doubts on the government's medium-term plan to cut the deficit to 3% by FY2021.

The assumption of 20% revenue growth in the current fiscal year looks optimistic given the year-to-date (April-November 2018) growth of 'only' 3.4%. The expectations of sustained strong revenue growth, about 15%, in FY2020 also remain at risk as the political uncertainty and the global economic slowdown weighs on domestic businesses and India's GDP growth. On our forecast GDP growth is likely to dip below 7% in the next financial year.

> *The real question is will these populist measures will help the incumbent government remain in power for a second term?*

The government's view of the economy remaining on a solid growth path and turning into a $5tr economy in the next five years and $10tr in next eight years appears to be ambitious as a large number of young people struggle to find jobs. The latest reports of a 45-year high unemployment rate of 6.1% in the last year is a shot in the arm for the government that's basking in the glory of an economy being among the fastest-growing economies in the world.

The INR 750bn farmer support package may look like a big initiative on the part of the government, though the INR 6,000 ($85) per year assured income to a farmer isn't going to be much of a boost to his living standard, and that could undermine the drive to double farmers' income by 2022.

The INR 7.04tr borrowing plan for FY2020 beats the consensus view of INR 6.4tr. A sharp, 31% rise over revised INR 5.35tr borrowing in the current fiscal year will not only pressure the borrowing costs higher but also be a significant crowding out of private investment. Moreover, it will sustain government debt-to-GDP ratio at the current high level, without much assurance about the plan to bring it down to 40% by 2025.

Loose fiscal policy may support growth, though not without its inflationary side-effects. This means the central bank (RBI) will have to tread a cautious path on the monetary policy. We aren't forecasting the RBI to move rates this year, but, with the ongoing pressure from the government to pursue growth-friendly policy, we wouldn't be taken aback if the central bank cuts rates at as early as next week.

Finally, the question is whether these populist measures will help the incumbent government to remain in power for a second term? This hinges on whether the measures will actually be implemented in time for elections, or whether they just remain announcements. A voter will want to see real benefits before he votes.

Budget in figures

Financial year ending March 31 INR bn	FY2016 Actual	FY2017 Actual	FY2018 Actual	FY2019 Budget	FY2019 Revised	FY2020 Budget
1. Revenue receipts	**11950**	**13760**	**14352**	**17257**	**17297**	**19777**
(% YoY)	**8.5**	**15.1**	**4.3**	**20.2**	**20.5**	**14.3**
2. Tax revenue (Net to Centre)	9437.7	11013.7	12426.6	14806.5	14844.1	17050.5
3. Non-tax revenue	2512.6	2745.8	1925.2	2450.9	2452.8	2726.5
4. Capital receipts a/	**5958**	**6011**	**6624**	**7165**	**7276**	**8065**
5. Recovery of loans	208	178	156	122	132	125
6. Other Recepits	421	477	1002	800	800	900
7. Borrowing and other liabilities b/	5328	5356	5465	6243	6344	7040
8. Total Receipts (1+4)	**17908**	**19771**	**20975**	**24422**	**24572**	**27842**
9. Total expenditure (10+13)	**17908**	**19793**	**21427**	**24422**	**24572**	**27842**
(% YoY)	**7.6**	**10.5**	**8.3**	**14.0**	**14.7**	**13.3**
10. On revenue account; of which	15378	16930	18790	21418	21406	24479
11. Interest payments	4417	4807	5292	5758	5876	6651
12. Grants in aid for creation of capital assets	1318	1657	1954	1954	2003	2007
13. On capital account	2530	2863	2637	3004	3166	3363
14. Revenue deficit (1-10)	**-3427**	**-3170**	**-4438**	**-4160**	**-4109**	**-4702**
% of GDP	-2.5	-2.1	-2.6	-2.2	-2.2	-2.3
15. Effective revenue deficit (14-12)	**-2110**	**-1513**	**-2484**	**-2207**	**-2106**	**-2695**
% of GDP						
16. Fiscal deficit [9-(1+5+6)]	**-5328**	**-5378**	**-5917**	**-6243**	**-6344**	**-7040**
% of GDP	**-3.9**	**-3.5**	**-3.5**	**-3.3**	**-3.4**	**-3.4**
17. Primary deficit (16-11)	-911	-571	-624	-485	-468	-389
% of GDP	-0.7	-0.4	-0.4	-0.3	-0.3	-0.2

a/ Excluding receipts under Market Stabilisation Scheme
b/ Includes drawdown of Cash Balance
Source: Government Budget

Source: Government Budget Statistics

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