

## Budget fails to meet business expectations

Source: *The Financial Times*  
July 6 2009

Indian business leaders on Monday were underwhelmed by a budget that for the corporate sector seemed to raise more questions than it answered.

The budget was preceded by the release of the customary, pre-budget finance ministry “economic survey” that seemed to promise some long-awaited reforms, such as greater foreign investment in retail, insurance and defence and the sale of stakes in state-owned enterprises.

But these did not materialize on Monday. Instead, finance minister Pranab Mukherjee sent markets tumbling by announcing a budget with a sharply higher budget deficit of 6.5 per cent of gross domestic product but no clarity on how this would be financed other than through government borrowing.

“The equity and bond markets have reacted to a high fiscal deficit as it has implications for monetary policy and the interest rate environment,” said Alroy Lobo, chief strategist and global head, equities asset management, Kotak Asset Management Company.

One economist in Delhi encapsulated the disappointment surrounding the budget in more blunt terms. “Not everybody can claim to have dropped a market by 1,000 points in a day,” he joked.

Bankers and investment houses in Mumbai are already concerned that Delhi’s efforts to service its ballooning budget deficit through debt-raising are crowding out private sector borrowing and investment. Up to 50 per cent of India’s savings in the banking system is channeled to the government through mandatory lending or through treasury bill sales, driving up the cost of capital in the market.

“The government is the largest user of domestic savings,” said Rashesh Shah, chairman of Edelweiss Group, a Mumbai investment house.

This borrowing and the deficit also could have implications for interest rates and inflation that could lead to tighter monetary policy later in the year some warn.

“In the near-term, financing of the government’s programmes without distorting market interest rates remains a key challenge to be addressed,” said Chanda Kochhar, chief executive officer of ICICI Bank, India’s largest private sector lender.

She called for greater clarity on the government’s plans to raise money from the sale of stakes in public sector companies and how it would manage its borrowing programme.

Jahangir Aziz, chief economist for JP Morgan, said the budget fiscal deficit target was higher than many analysts had anticipated.

But he said he expected the government to push through with reforms, particularly those that had already been prepared during its previous term, such as on pensions and other areas.

“There was huge disappointment because the market had very unrealistic expectations. As these reforms start unfolding I expect there will be positive surprises down the road,” Mr Aziz said.

The budget contained a fiscal stimulus directed towards infrastructure and the rural sector that was intended to maintain medium-term growth, Kotak’s Mr Lobo said.

“He’s trying to do something to make sure India’s on a good growth track on a medium-term basis,” said Mr Lobo.

The other important signal in the budget was the government’s commitment to establishing a unified goods and services tax regime for the nation, a measure that would replace a plethora of inefficient taxes at the state and central level.

“From a fiscal reform perspective that will be the single most important reform India has seen for many, many years,” said Bobby Parikh, managing partner of professional services firm BMR Advisors.