Financial Inclusion, Make in India & Historic GST Bill – Seems like a trifecta to revive the Indian Economy

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Reform, Perform & Transform were the words that Prime Minister Modi used to declare his intentions for reviving Indian economy on the Independence Day this year. And if you take a closer look at this current Indian government they have made their intentions clear in putting PM Modi's grand vision to work. Any major macro economic changes in the country are only possible with effective fiscal & monetary policies in place. One one hand India has visionary in PM Modi who enabled India to dream of Clean India, Skill India, Financial inclusive India & Make in India, On Another hand India had the great reformer and strategist for the last three years through RBI Governor Raghu Rajan.

Governor Rajan took over when Indian currency was considered as a part of the unenviable club of fragile 5, but when he is leaving, rupee is one of the best performing currencies. Indian bonds which were under pressure due to loss of control on inflation, crossed above 9 per cent. Inflation is under control. When Rajan took the helm in September 2013, the economy was declining at an annualized rate of 2 percent on quarter, consumer prices were soaring 9.8 percent, the rupee was down 16.6 percent from the year earlier, and the current account deficit was estimated at 4 percent of GDP. He is now leaving an economy growing at a rate of 9.6 percent, inflation is down to 6.01 percent, and the estimated current account deficit is about 1 percent of GDP.

Financial Inclusion through JAM (Jan Dhan-Aadhaar-Mobile) is set to revolutionise the Indian Banking sector

In the last Budget, Finance Minister Arun Jaitley announced the JAM (Jan Dhan-Aadhaar-Mobile) Trinity, through which the government envisages it will revolutionise the way Indians transact. Further, recently, the Reserve Bank of India introduced the unified payment interface (UPI), which will enable all payments to be made through an SMS. As every purchase is made through Aadhaar enabled phones on the unified payment system, a zillion gigabytes of data will be available to banks on the spending habit and indeed the lifestyles of their customers.

The father of Unique Identification Authority of India (UIDAI), Nandan Nilekani, believes

"There will be a shift in business models and banking system from low volume, high value, costs and fees to high volume, low value, costs and fees. Not just this, Jan-Dhan, Aadhaar and Mobile (JAM) will lead to a dramatic upsurge in accessibility and affordability of credit."

Extending the argument forward, brokerage Credit Suisse estimates " that total consumer loans will rise from USD 600 billion today to USD 3 trillion in 10 years –that opportunity will be shared by the savviest public and private banks, the new banks and new age non-bank finance companies".

Over 1 billion Indian residents now have Aadhaar, an online biometric identity. The Government promoting financial inclusion through Jhan Dhan Yojana, has led to over 200 million new bank accounts being opened. With RBI giving licences to over 20 new banks, including small banks and payment banks, the competitive intensity of the sector is set to increase. One can visualise a future where every adult Indian has an Aadhaar number, a smartphone and a bank account. Already over 280 million Indian residents have an Aadhaar linked bank account and around 1 billion DBT (Direct Benefit Transfer) transactions have happened, whose value is in the billions of dollars.

India's financial landscape is set for a dramatic transformation with the advent of instantaneous, cashless, paperless, presence less financial transactions.

Enablers in place: Advent of Unified Payment Interface (UPI) and adoption of the Aadhaar (1 bn-plus enrolled), has created a backbone for instantaneous, inter-operable, cashless financial transactions. The Indian payment system will now leapfrog to digital where cost of transactions will be near zero, customer ownership will rest with best interface providers and incumbency of deposits will be challenged.

New business models will emerge: Business models will be redefined and unserved markets open up as financial providers move from being data poor to data rich. We estimate the consumer and SME loan market will grow from US$600 bn to US$3,020 bn in the next ten years. As barriers of access and reach break a digitally empowered customer with instantaneous authentication through Aadhaar, inter-operable payments and app-based delivery of services will be able to compare and contrast products from multiple providers.

Historic GST & it's Impact on Make in India

The reforms that Goods and Services Tax (GST) is going to bring in, like the ease of starting business, elimination of dual taxation, simpler process, reduction in logistics cost etc. The rollout of GST will be a very positive development from an equity market perspective. The market will view the development as the ability of Prime Minister Modi led NDA government to push forward important reforms. Whilst the market had to a large extent priced in the anticipation of the passage of the GST Bill, a timely implementation of GST could spike a further rally. However incremental gains in equity markets will be a function of corporate earnings growth, which over the long run will benefit from a streamlined taxation system, like the GST.

The roll out of GST will benefit the economy, Indian corporates, the consumer and the Indian equity market. A National Council of Applied Economic Research (NCEAR) study suggests that GST could boost India's GDP growth by 0.9-1.7 percent.

Dual monitoring and real time matching of each supplier and purchaser will reduce tax evasion. Withdrawal of various exemptions, presently offered on Central and State government taxes will reduce the annual tax revenue loss to the exchequer of upto ~AU$66 bn. The additional tax revenue will improve India's tax to GDP ratio and fiscal health significantly.

Under the new indirect taxes regime, which is likely to take effect from 1 April 2017, levy on manufactured goods will come down while consumers may end up spending more as service tax burden would go up as GST is a consumption-based tax.

According to HSBCS the efficiency gains of the GST regime are potentially immense:

- India's current tax system is origin-based (producer-driven) rather than destination-based (consumer-driven). Incomplete input tax offsets leads to the piling-up of numerous taxes, resulting in 'tax cascading', which the GST can help eliminate;

- the GST intends to unify tax rates across goods and services, reducing distortions in economic decisions;

- by removing taxes on movement of goods and maintaining a uniform tax rate, the GST has the potential to make India one common national market. This will be positive for the government's 'Make in India' project by eliminating the negative protection, which favours imports over domestic manufacturing;

- As each person in the value chain who gets input tax credit has an incentive to ensure that the previous person has paid taxes, the GST mechanism can lead to better tax compliance and a broadening of the tax base.

Impact on	Short term	Medium term
Growth	Could be disruptive, depends on pass-through and effective tax rate	Clearly positive: likely to add 80bp to GDP growth, of which 50bp would come from higher investment
Inflation	Negligible below 18% GST rate; high but one-off at 18%+ GST rate	Lower inflation over time
Fiscal	Uncertain: Any surprise to be borne by the centre	Revenue-enhancing by improving tax buoyancy and tax base
Foreign inflows	Likely to rise on the back of improved sentiment for reforms	By improving the 'ease of doing business', positive for FDI inflows
Jobs		Jobs enhancing for manufacturing and services

Source: HSBC estimates

With its power to boost 'Make in India' by eliminating negative protection, and improvements in the 'ease of doing business' environment, which could attract investors (both domestic and foreign), the GST could be jobs enhancing in the manufacturing sector. A uniform tax across the country will improve the ease of doing business in India. Competitiveness of manufacturers will increase (providing a boost to the Make in India program) as the cascading effect of taxes will be eliminated and input tax credit will be available across the value chain. Further, lower tax rates will also lead to volume gains.
India will be a single market where companies will be able to move and sell their products freely (earlier this was a logistical nightmare) across states, increasing the overall activity in the economy.

In conclusion, With various reforms and a strong growth expectations across multiple other sectors, Indian economy is set to grow significantly in the years to come

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