Insight

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Two huge wins for India’s growth plans

18 November 2016

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Narendra Modi, Prime Minister of India

Two frequently asked questions about India are whether corruption can be reduced and whether the GST plans can ever be realised in this country of huge cultural disparities. We are pleased to report that progress is being made on both matters.

Corruption control

At 8pm on November 8, 2016, the Modi Government announced a bold move to scrap the legal tender status of high-denomination Indian Rupees (INR) 500 and INR1,000 currency notes (about A$10 and A$20 respectively). This unprecedented action was widely welcomed in India.

Indians will have 50 days between November 10 and December 30, 2016, to deposit discontinued INR500 and INR1,000 notes at designated banks and post offices after showing proof of identity. There will be penalties and tax charges if the amount of cash held cannot be explained. Smaller denomination notes can be readily obtained and new INR500 and INR2,000 notes will come into circulation. There are no changes to online, credit card, cheque or any other plastic money transactions operating through a bank account.

Of cash in circulation, 87% is in INR500 and INR1,000 notes. A large part of this cash is generated by economic transactions that are not reported to tax authorities and so it has now been rendered worthless. Three objectives are likely to be achieved: control corruption and terrorism financing, remove fake currency from circulation and make it easier to do business.

This measure will also help improve the ratio of tax collection-to-GDP and could ideally help to lower existing tax rates eventually or assist social and infrastructure activities. Any asset price deflation in gold, land and property – the largest assets by value where unaccounted wealth is deployed – could help moderate inflation or eventually direct cash to the share market or bank deposits which require proof of identity. The black-market economy could itself be in the region of 30% of GDP, so the Indian economy could benefit from higher reported GDP rates of growth when the unreported part of the economy is recorded in official statistics, tax collections grow and government revenues increase.

At this stage we cannot see any disruption to genuine taxpaying consumers who will find ready liquidity. As the Government has stated: ’This is a once-in-a-lifetime opportunity to set things right‘. Mutual funds, insurance companies, wealth management businesses and banks would be the major beneficiaries.

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Goods and Services Tax

On November 3, 2016, at the fourth meeting of the GST Council – comprising state finance ministers and the union finance minister – a consensus on a five-slab structure was reached. This is a huge simplification from the nearly 100+ tax rates that exist today. The council has moved product categories to the nearest tax slabs and so implementation by July 2017, or earlier, appears more certain now.

The new GST structure is likely to be non-inflationary as most of the items in the CPI basket will be taxed at a rate which is very close to current levels. The intention of the Government appears to be to move most of the consumer durables from a 30-31% tax bracket down to at least 28% and if possible, further down to a lower 18% bracket.

Given that tax rates will be mostly unchanged, the positive growth impact will be felt through better tax efficiency. GST rollout is now going to depend on technology preparedness and familiarisation with the new GST structure among both the tax payers and tax collectors. The pace of decision-making, on the part of the Government, is indeed encouraging and a clear positive move for investors and for the share market.

Fiducian India Fund Performance

	6 Month	1 Year	2 Years	3 Years	5 Years
Fund Returns[1]	22.4%	5.6%	15.3%	35.0%	19.9%
Index Return[2]	12.1%	-1.5%	7.0%	20.0%	9.3%
Excess Return	10.3%	7.1%	8.3%	15.0%	10.5%

	2011	2012	2013	2014	2015
Fund Returns[1]	-33.7%	30.8%	15.4%	74.8%	6.1%
Index Return[2]	-38.2%	21.9%	7.6%	41.2%	1.0%
Excess Return	+4.5%	+8.9%	+8.3%	+33.5%	+5.0%

* Note: Performance figures are calculated using month-end exit prices, after fees and reflect the reinvestment of distributions. The fund's future performance may bear no relationship to its past performance

[1] Returns as at 30 September 2016

[2] S&P BSE 100 (AUD)