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Corporate Tax cut euphoria over! Nifty gave up 50% of gains from September 20

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On September 20, Finance Minister (FM) Nirmala Sitaraman delivered a pleasant surprise to India Inc. by slashing corporate taxes in order to bolster the sagging Indian economy.

Much to the surprise of bears, the stock market which was reeling under pressure till then, witnessed a huge short-covering rally, which led to massive up move on the bourses.

The massive upmove was never recorded in recent history with a gain of around 10 percent in benchmark indices in just two sessions.

In haste, everyone concluded that this move is likely to put more money in the hands of corporates which will kick start the virtuous cycle going forward and the demand is going to pick up, which will keep the economy on roll once again.

At this point in time, the million-dollar question that remains to be answered is…. “Is there any historical evidence to suggest that this kind of tax cuts will eventually get converted into growth?”

Unfortunately, there is no clear answer to the question as historical evidence is missing. However, some insights are available from the recent American experience which indulged in this kind of bold experiment.

In 2017 Donald Trump, the president of the USA, passed a major piece of legislation – The 2017 Tax and Jobs Act, which delivered the biggest corporate tax cut in US history as the rate of the tax cut was brought down from 35 percent to 21 percent.

With this kind of rate cut, it was estimated that roughly $150 billion of additional funds will be put into the hands of US corporates which can be reinvested.

This dream was successfully sold to the citizens of America with a promise that it will boost the economy, create more jobs and brings in more savings to American households.

In one of his speeches, Trump boasted of himself that it will bring in, on an average, an additional $4,000 to each American household. Once this legislation is cleared a year down the line different studies found that this piece of legislation failed to deliver its objectives.

Centre for Public Integrity, a not-for-profit organization based out of Washington D.C found, after extensively studying 100’s of relevant documents and interacting with scores of corporate leaders, that this legislation hardly brought in savings into the hands of common citizens.

Unfortunately, all the benefits derived out of these tax cuts went out in the form of dividends and buybacks to the shareholders and this category comprises hardly 10 percent of the US population whereas a large number of US citizens didn’t gain any benefit and they were left out.

It was found that, on an average, a large number of American households gained only by a meager $233 p.a whereas corporates remained the biggest beneficiaries. This contributed only to further widen income inequality among US citizens.

The same story may replay even in India also if proper lessons are not learned from the US episode. It is estimated that these tax cuts will place Rs 1,45,000 crore in revenue in the hands of Indian corporates and the expectation is that this money will be used for fresh capex plans, which will kick start the virtuous cycle of investment.

But, if we study the balance sheets of BSE500 companies, it was estimated that these companies are already sitting on cash or cash equivalent of around Rs 8 lakh crore (Source: Indian Express Study) .

Therefore liquidity doesn’t seem to be a problem for corporates to undertake capex plans. It more appears to be the case of the inability of a consumer to create demand as his disposable income at this point in time appears to be very low due to multiple reasons.

Hence, unless surplus money is found in the hands of a consumer he will not able to create demand going forward even if the prices of finished products are reduced.

Hence, FM is required to focus more attention on addressing demand-side issues too after rightly and promptly addressing the supply-side issue.

Can the FM afford to lose more revenues by slashing direct taxes in the near future after foregoing almost Rs 1,45,000 crore of revenues through recent corporate tax cuts needs to be seen over a period of time and unless the disposable income of consumers goes up, the economy may not pick up in the near future?

Long Term Trend check on Nifty:

After the initial euphoria, which mainly appears to be due to massive short covering, in which indices gained by around 10 percent in just two sessions, laws of averages appears to have caught up with the index as it subsequently given up almost 60 percent of the gains it registered from the lows of 10,675 – 11,695 levels.

Hence, in the near future, it is critical for the index to sustain above 11,100 levels as a breach of this on a closing basis shall drag it down towards 10,875.

On the long term charts, critical supports are placed in the zone of 10,878 – 10,616 levels and a decisive breach of this support zone shall open up much bigger downside targets for the index which can also be sub 10,000 levels.

On the upside, fresh rallies shall not be expected unless index registers a close above 11,695 level. If the index doesn't breach the said support then sideways consolidation for a prolonged period in the zone of 10,900 – 11,500 can be witnessed.

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