

Equities

The current Budget from the UPA administration continues to focus on key development areas of infrastructure and social sector spending. Infrastructure accounts for 48% of plan spending at INR 2,14,000 crores while the latter constitutes around 36% at INR 1,60,900 crores. This is in line with the focus areas of the government.

Key highlights are as under:

- ▶ GDP growth targeted at 9% of GDP for FY12. Aim to keep fiscal deficit at 4.6% of GDP in FY12 and to bring it down to 4.1% of GDP in FY13
- ▶ Stress on divestment continues at INR 40,000 crores. Government is likely to remain market friendly
- ▶ DTC and GST pushed to 1 April 2012
- ▶ Direct tax
 - ▶ Increase in exemption limits for individuals to increase disposable income
 - ▶ MAT increase for corporates from 18% to 18.5% largely offset by decrease in surcharge from 7.5% to 5%
- ▶ CENVAT stays at 10%; Customs duties to be aligned with ASEAN; more services under service net

At a sectoral level, we see the impact based on excise/customs duty changes, which are summarised as under:

Financials	Positive
Government net borrowing of INR 3,43,000 crores lower than expectation	Positive
INR 20,200 crores allocated for recapitalisation of PSU banks - to maintain minimum Tier I capital adequacy at 8% and increase GoI equity stake to 58% in some banks	Positive
Interest rate subvention of 1% increased for loans upto INR 15 lakhs (INR 10 lakhs earlier). Ticket size for priority sector classification of home loans increased from INR 20 lakhs to INR 25 lakhs	Positive
Foreign investors allowed to invest in domestic mutual funds	Positive
RBI guideline on banking license expected by March '11	Positive
A microfinance equity fund to be set up with an equity capital of INR 100 crores for furthering financial inclusion	Positive

Real Estate	Negative
Interest rate subvention of 1% increased for loans upto INR 15 lakhs (INR 10 lakhs earlier). Ticket size for priority sector classification of home loans increased from INR 20 lakhs to INR 25 lakhs	Positive
MAT of 18.5% on developers for SEZ development	Negative

Infrastructure	Positive
Excise duty rationalised in line with custom duty for domestic equipment manufacturers supplying equipments for Ultra Mega Power Projects	Positive

Construction	Positive
Allocation for infrastructure sector increased by 23.3% YoY to INR 2,14,000 crores	Positive
FII limit in corporate bonds has been raised by USD 20 bn. The government plans to create Infra debt fund. Government has proposed INR 30,000 crores tax free bonds by government undertakings such as NHAI, IRFC etc.	Positive
Increase in MAT rate from 18% to 18.5%. Negative for Developers. Impact will be negated by cut in surcharge from 7.5% to 5%.	Marginal Negative

FMCG	Positive
Full exemption from basic customs duty to be provided to Crude Palm Stearate for use in laundry soap	Positive
No change in excise duty for cigarettes	Positive
Reduction in excise duty on sanitary napkin, diapers from 10% to 1%	Positive

Auto	Neutral
Excise duty unchanged v/s expectation of increase in rate	Positive
No additional duties on diesel vehicles	Neutral

Technology	Neutral
MAT increased to 18.5%; surcharge removed	Neutral
MAT applicable on SEZ units	Negative
No extension of STPI benefits (under Section 10A/10B)	Neutral

Oil and Gas	Negative
Low provision on subsidy of INR 23,640 crores v/s under-recovery INR 1,00,000 cr at USD 95/bbl	Negative
Increase in MAT rate from 18 to 18.5%	Negative

Metals/Mining	Negative
Iron-ore export tax increased across lumps and fines to 20%	Negative
Import duty increased from 2% to 2.5% on ore and concentrate	Negative
Import duty on Pet Coke reduced from 5% to 2.5%	Positive

Hotels	Negative
Service tax on tariff, with abatement of 50%	Negative
Service tax on A/C restaurants, with abatement of 70%	Negative

Pharmaceuticals	Negative
Private healthcare and diagnostic services brought under the service tax net with some abatement	Negative
MAT imposition on SEZ	Negative

Cement	Negative
Increase in excise duty from 10% ad valorem duty to 10% ad valorem + INR 160 per tonne	Negative
Import duty on pet coke and gypsum (both raw materials) cut from 5% to 2.5%	Positive

Fixed Income

The Union Budget 2011–12 has been presented at a time when the economy has been looking up in the last one year after facing some challenges like inflation. Key highlights are as follows:

- ▶ Tax revenue projected up 18% from 2010–11 (RE) on the back of anticipated buoyancy due to stronger GDP growth at a nominal rate of 14%
- ▶ Disinvestment target of INR 40,000 crores budgeted
- ▶ Visible effort towards controlling expenditure: “Non-plan” expenditure down 0.7%, “Plan” expenditure up 12%
- ▶ Overall fiscal deficit projected at INR 4,12,817 crores (4.6% of GDP) versus a revised figure of INR 4,00,998 crores (5.1% of GDP) for 2010-11
- ▶ Net market borrowing of INR 3,43,000 crores versus INR 3,35,414 crores for 2010-11

Including maturities for the year, the gross market borrowing for 2011-12 is pegged at INR 4,16,581 crores versus 4,39,000 crores in 2010-11. These numbers are lower than the market expectation which is a positive surprise. However, some important points need to be considered:

- ▶ Tax revenue growth is higher at 18% with a slight negative estimate of the “Non-plan” expenditure. This may need aggressive management on part of government
- ▶ Expenditure is expected to be reduced through lower subsidy estimate, which remains dependent on the international crude oil prices for fuel and fertilizer subsidy
- ▶ Government expects to carry about INR 20,000 crores from the current financial year as cash surplus

The supply of government securities may be lower in the second half of the financial year FY12, if the expectations on both revenue and expenditure side are managed.

However, we remain cautious on rates over the medium term due to the following reasons:

- ▶ Inflation has been a long standing concern and will continue to be high on the agenda for monetary policy. Thus, the policy rates remain upward biased
- ▶ Crude oil prices remain strong with concerns in the Middle Eastern and North African countries, apart from easy liquidity globally, fueling the price rise
- ▶ Demand for government bonds is expected to be weaker in the year ahead given rising inflation, expectations of policy rate rise and higher credit growth
- ▶ RBI had bought INR 67,040 crs of government securities under open market operation (OMO) over 2010-11. Given the lower gross borrowing requirement and improved liquidity conditions, RBI may abstain from OMOs in FY12

Overall, we expect some upward bias in bond yields as the market gears up to absorb the fresh auction calendar in April 2011. The shorter end of the corporate bond curve remains positively poised as the short end rates are already higher on back of low liquidity and seasonal tightening. As the liquidity returns in the first quarter of next financial year, the short end rates may ease leading to bullish steepening of the corporate bond curve.

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